Weekly Updates Issue # 591

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1. Weekly Markets Changes

[November 18, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,864.03 +308.6 +2.12%	2,189.90 +17.45 +0.81%	18,867.93 +20.27 +0.11%	5,321.51 +84.40 +1.61%	$0.7406 -0.11¢ -0.15%	$1,207.30 -20.10 -1.64%	$45.58 +2.46 +5.71%

2. Home sales strong amid tightening mortgage rules

[November 18, 2016] Canadian existing home sales reached a record level in October, data published Tuesday shows, but the market faces an increasing threat from tighter mortgage rules, which have helped send interest rates higher.

The Ottawa-based Canadian Real Estate Association, which represents about 100 boards across the country, said there were 42,473 sales last month across the country, a two per cent increase from a year earlier and the best-ever showing for the month.

October's sales pace came despite a change in mortgage rules that made it tougher to borrow by requiring, among other things, consumers to qualify based on the posted rate of a five-year fixed rated mortgage. Now set at 4.64 per cent, the rate is significantly higher than what is on consumer contracts and potentially means consumers will only be available to afford smaller loans.

"The expanded stress-test for homebuyers who need mortgage default insurance took effect in the middle of October," noted Cliff Iverson, president of CREA, referring to the changes, which affect all loans backed by the federal government. "More time will need to pass before its effect on housing markets can be gauged. The extent to which they will push first-time homebuyers to the sidelines may vary among housing markets."

The government in the country's most populous province jumped into the fray Monday with a policy change aimed at what is seen as the most vulnerable part of the housing market. Ontario doubled the tax rebate on land property transfers from $2,000 to $4,000 for first-time buyers, while hiking rates on homes that sell for more than $2 million.

Gregory Klump, chief economist for CREA, said the early evidence suggests the impact of tighter mortgage regulations on sales activity has been mixed. The federal government will no doubt want to monitor the effect of new mortgage regulations on the many varied housing markets across Canada and on the economy, particularly given the recent rise in uncertainty about economic growth prospects following the U.S. presidential election," Klump said.

Already there are signs that political uncertainty, along with tighter rules, are sending rates higher. Earlier this month Toronto-Dominion Bank raised its prime rate for variable-rate mortgage customers from 2.7 per cent to 2.85 per cent.

Royal Bank of Canada upped its special discounted rate on Tuesday for fixed-rate products for terms of three, four and five years. The fixed rate for three years rises from 2.69 per cent to 2.79 per cent, four years goes from 2.79 per cent to 2.89 per cent and five years rises from 2.94 per cent to 3.04 per cent.

We consider a number of factors when making changes to mortgage rates, including our funding costs and market conditions. Based on current conditions, our rates reflect the right balance between our clients' expectations and our costs of funding mortgages," said Mary Ellen Brown, senior vice-president of home equity financing for RBC.

Prices continue to remain firm. CREA said its aggregate composite index rose 14.6 per cent in October 2016 from a year ago, which compares with a year-over-year increase of 14.4 per cent in September. The actual (not seasonally adjusted) national average price for homes sold in October 2016 was up 5.9 per cent from a year ago to $481,994 — a number increasingly less affected by a slowing Vancouver market.

The Teranet–National Bank National composite house price index, also out Tuesday, was up 0.3 per cent in October from September but prices were at a record level last month in only four of the 11 metropolitan regions covered: Toronto, Victoria, Hamilton and Winnipeg.

"The pickup in housing demand across most housing markets in Canada (except for Vancouver) is largely consistent with lower interest rates and potentially a near-term boost in demand as homebuyers try to get into the market before being subject to new mortgage regulations," said Diana

Petramala, an economist with TD Bank, who expects prices to fall by two per cent in 2017.

3. Not all mortgage rate hikes are created equal

[November 18, 2016] Shopping for a mortgage, these days, is a lot like shooting those tin ducks at the carnival.

The game looks easy enough. Just aim, focus on the duck you want, then squeeze the trigger and…miss. Getting a locked-in, guaranteed, pre-approval rate also looks easy; turns out it may not be. Plus, there appears to be a bit of market jostling going on in the background—the banking sector's equivalent of a carnival barker, the person tasked with luring in the business.

To help, here's what you need to know in the days and weeks ahead, while shopping for a mortgage.

No pre-approvals offered

If you're worried about rates rising before signing your official mortgage documents, get a pre-approval. Just don't be surprised if the best rates in the market—rates that hover between 2% and 2.5%—are off the table. Offered by mono-lenders—finance companies that specialize in the mortgage sector (and many of them are funded by big banks)—these rates don't come with pre-approvals. You can only get these aggressively low mortgage rates by going through an independent mortgage broker and only when you're ready to seal the deal.

"Pre-approvals aren't profitable," explains Robert McLister, an independent mortgage broker and founder of RateSpy.com. Less than 20% of pre-approvals actually turn into a formalized mortgage contract. Those that do typically end up closing when rates start to rise, like now. As a result, pre-approvals end up making the mortgage business more expensive for the lender, who has to hedge this risk, only gets paid one-fifth of the time and yet still pays the administrative costs on the 80% of pre-approvals that fall apart.

Get a pre-approval with a big bank, today

If you're really worried about rates rising in the next 120 days, consider getting a pre-approval with a major bank. "Big banks have economies of scale which means lower pre-approval costs."

Just don't assume that this is the rate you should go with once it's time to sign on the dotted line. Lenders build in a 10 to 15 basis point hedge on all pre-approval rates offered to clients, explains McLister. That means that 120-day guaranteed pre-approval rate of 2.95% that you get today could translate into a 2.80% rate if you signed the mortgage documents today.

But getting a pre-approval with a big bank means you are also hedging against rising rate risks. So, get the best guaranteed rate on offer—and remember to get it in writing, as we learned earlier—then when it comes time to finalize the mortgage, start shopping around aggressively for the absolute best rate (keeping in mind, rates aren't the only factor when choosing a mortgage).

But still shop competitively

This week, TD announced increases to their fixed-rate mortgages (they'd already hiked up variable rates), while RBC had announced increases earlier in the week. There also increases by various mono-lenders, while the remaining banks and specialized mortgage businesses that haven't raised rates yet, will soon follow.

Even though all rates are moving up that doesn't mean all rate hikes are equal. Take RBC and TD, for instance. RBC raised its discounted rate for a five-year fixed rate mortgage to 2.94%—an increase of 30 basis points. TD, on the other hand, only raised it's five-year fixed discounted rate to 2.69%—a 10 basis point increase. RBC increased rates by 40 basis points (to 3.04%) for any mortgage with an amortization over 25 years, TD did not follow suit and, according to a TD spokesperson, "mortgage rates are the same across all amortizations."

The reason for this big gap in rates is that RBC is trying to influence the market, explains McLister. "RBC is Canada's mortgage leader. Other lenders, media and consumers look to it to set the rate trend. RBC clearly wants to influence rate expectations higher."

Still, even after RBC and TD rate hikes took effect (on Nov. 17 and Nov. 15, respectively), McLister could still find discretionary five-year fixed rates at 2.49%. Which makes right now, the perfect time to shop around for a mortgage rate.

4. Transportation, shelter push up CPI to 1.5%

[November 18, 2016] Statistics Canada says the Consumer Price Index in October was up 1.5% compared with a year ago.

That compared with an annual rate 1.3% in September.

The October result matched the expectations of economists, according to Thomson Reuters.

Prices were up in six of the eight major components with the transportation and shelter sectors contributing the most to the year-over-year increase, offset in part by lower food prices.

The Bank of Canada's core index, which excludes some of the most volatile items, increased 1.7% compared with a year ago.

Economists had expected the core rate to be 1.8%. The Bank of Canada expects inflation will be under the target rate of 2% until mid-2018 as the economy continues to underperform, says Dawn Desjardins, deputy chief economist at RBC Economics.

RBC forecasts that the economy will grow at an above-potential pace throughout 2017, absorbing spare capacity, and causing inflation to actually hit the 2% target.

"Against this backdrop there will be little reason for the Bank to ease further and we expect they will maintain the overnight rate at 0.5% through the next year," Desjardins adds in an economic brief.

Starting in December, the Bank of Canada will start reporting core inflation as three indicators of underlying trend inflation, Fotios Raptis, senior economist at TD Economics, points out in a note to analysts. He writes that the new data will help economists understand the Bank's monetary policy decisions.

The transportation index gained 3% compared with a year ago, due to gasoline prices, which posted a 2.5% increase.

"The Canadian inflation backdrop remained a non-story in October, even if comparisons with last year's soft fuel prices allowed headline inflation to gain a bit of momentum," writes Nick Exharos, economist at CIBC Economics in a report.

The oil and gas market's affect on inflation is lessening, as prices slowly record, adds Raptis.

Statistics Canada says the shelter index posted its largest increase since January 2015 as it rose 1.9% compared with a year ago.

Compared with a year ago, food prices posted their first drop since January 2000 as they fell 0.7% in October.

Prices for food purchased from stores recorded their largest decline since July 1992 as they fell 2.1%. The prices for food purchased from restaurants gained 2.6%.

This month's inflation data has little impact on Canadian monetary policy, notes TD's Raptis.

5. Sudden rise in rates could drop home prices by 30%: CMHC

[November 17, 2016] A sudden rise in interest rates could cause house prices to plummet on average 30% nationally, according to stress tests performed by Canada's federal housing agency released Thursday.

Canada Mortgage and Housing Corp. (CMHC) said it studied the impact of two interest rate hikes — a one percentage point increase over one quarter this year, followed by a 1.4 percentage point rise during one quarter next year.
CMHC said its mortgage insurance business would incur $1.13 billion in losses in such an event but that it could withstand the hit. A spokesman for the agency stressed that the scenario is an "extreme case" and would be unprecedented.
Interest rates have started to go up this week as a sell-off in the U.S. bond market has driven bond yields higher, making it more expensive for banks to access capital.
Two of Canada's biggest banks — TD Bank and Royal Bank — have hiked their fixed mortgage rates, anywhere from 0.05 percentage points to 0.4 percentage points.
There are concerns that as interest rates rise, some Canadian homeowners could encounter difficulty making their mortgage payments and face the risk of default.
"Households are so leveraged right now, and house prices are at such incredibly high levels relative to household incomes," said David Madani, senior Canada economist at Capital Economics.
"Even a moderate doubling in interest rates — which sounds like a lot but we're talking about maybe 200 basis points (two percentage points) — could potentially pop the housing bubble."
The stress test conducted by CMHC was one of several extreme scenarios it examined over a time period from 2017-2021. They included a U.S.-style housing correction, a high-magnitude earthquake that destroys critical infrastructure in a major Canadian city and a drop in oil prices where they fall to US$20 per barrel next year and remain between US$20-30 for another four years.
Another scenario that the agency tested involved a "severe and prolonged" economic depression, which CMHC said would see house prices drop 25% and unemployment rise to 13.5%. The insurer said it would incur $3.12 billion in losses in that case.
CMHC said its capital holdings were sufficient to withstand all scenarios it tested. None of the scenarios should be considered a prediction or forecast, the agency added.
"Stress testing involves searching out extreme scenarios that have a very remote chance of happening and planning for them," Romy Bowers, CMHC's chief risk officer, said in a statement.
"Rigorous stress testing is an essential part of our risk management program and allows CMHC to evaluate its capital levels against these scenarios."

6. JPMorgan fined for hiring kids of China's elite to win business

[November 17, 2016] JPMorgan Chase improperly hired the "unqualified" children of China's ruling elite to win lucrative business from the country's key decision makers, authorities alleged on Thursday.

Regulators slapped JPMorgan with $264 million in fines and said the bank "corruptly influenced government officials" with its hiring and internship tactics in China.

The settlement follows a three-year investigation into JPMorgan and marks one of the first major crackdowns on a big U.S. bank for running afoul of the Foreign Corrupt Practices Act. Known as the FCPA, the law prohibits companies from making payments or giving "anything of value" to win business from foreign officials.

"JPMorgan engaged in a systemic bribery scheme by hiring children of government officials ... who were typically unqualified for the position on their own merit," Andrew Ceresney, director of the SEC's enforcement division, said in a statement.

The practice of giving the children of China's ruling class plum jobs and internships was so common at JPMorgan that the bank even had a formal program known as "Sons and Daughters." The program included spreadsheets that tracked how often the hires turned into business deals.

"The so-called Sons and Daughters program was nothing more than bribery by another name," said Assistant U.S. Attorney General Leslie Caldwell. She called it "corruption, plain and simple."

Over the course of seven years, JPMorgan hired about 100 interns and full-time employees at the request of foreign government officials, according to authorities. These jobs scored JPMorgan more than $100 million in business.

JPMorgan admitted to authorities that individuals hired during the scheme were given the same titles and paid the same amount as entry-level investment bankers. That's despite the fact that, according to the DOJ, they mostly focused on routine work such as "proofreading" and generated little actual business.

JPMorgan's $264 million in fines is being divided up among multiple government agencies. The bank has agreed to pay more than $130 million to the SEC, $72 million to the Justice Department and $62 million to the Federal Reserve.

Despite the "blatant" conduct alleged by authorities, the U.S. did not announce any criminal charges against JPMorgan itself nor any individual employees of the bank.

In a statement, JPMorgan said the hiring practices were "unacceptable" and the program was stopped in 2013. The bank said it took "action" against the individuals involved and has since improved its hiring procedures.

JPMorgan also said in a filing that it continues to cooperate on other related investigations that are "ongoing." The SEC said it continues to investigate the issue.

Authorities say the hirings were quid pro quo arrangements expressly made with the intent to win business.

For instance, the DOJ said that in late 2009 a Chinese official told a senior JPMorgan banker in Asia that hiring a referred candidate would significantly influence the role JPMorgan would play in an upcoming IPO of a Chinese state-owned company. JPMorgan then spent months trying to place the candidate in a New York investment banking position -- despite realizing he was not qualified.

The SEC said JPMorgan's internal controls were "so weak" that not one of these hiring requests was denied.

The settlement comes as JPMorgan's CEO, Jamie Dimon, has been floated as a potential treasury secretary in the Trump administration.

It's also the latest black eye for Wall Street and big banks. Earlier this year, Wells Fargo outraged Americans by saying it fired 5,300 employees for creating as many as 2 million fake accounts. The scandal dealt a blow to Wells Fargo's reputation and resulted in the sudden retirement of long-time CEO John Stumpf.

JPMorgan itself has also been in trouble in recent years. In 2013, JPMorgan paid $5.1 billion to Fannie Mae and Freddie Mac linked to misdeeds in the run up to the housing bubble. JPMorgan was also hit with a $1 billion fine for improper oversight that led to the London Whale trading debacle.

Regulators worry the misbehavior among bankers is causing a credibility problem for the industry.

"Deep-seated cultural and ethical problems," New York Federal Reserve President William Dudley recently warned," have "eroded the industry's trustworthiness."

7. How Ontario’s new financial regulator will affect pensions

[November 15, 2016] The Ontario government announced plans yesterday to establish a new pension regulator.

The Financial Services Regulatory Authority will be an independent and flexible regulatory body aimed at improving protections for consumers, investors and pension plan beneficiaries, according to the Ministry of Finance's 2016 fiscal update.

The announcement follows recommendations by an expert panel appointed to review the mandates of the Financial Services Commission of Ontario, the Financial Services Tribunal and the Deposit Insurance Corp. of Ontario.

According to Larry Ritchie, one of the panel members and a partner at Osler Hoskin & Harcourt LLP, the new authority would replace FSCO once it's fully operational as of an expected 2018 target date.

In its fiscal update on Nov. 14, the government said that once it passes enabling legislation, it would take steps to support the transition process by appointing the new regulator's initial board of directors and developing a detailed implementation plan.

In its March 2016 report, the panel said that after consulting regulators, financial services and pension sector stakeholders and investor advocates, it concluded there was a need to modernize the mandates of the agencies and change their governance, structure and accountability mechanisms.

"We do not believe a thorough transformation could be accomplished within the current regime," the panel said in its report. "So we have recommended a new, independent and integrated regulator called the Financial Services Regulatory Authority […]."

In regards to FSCO, one of the big concerns was its limited resources, says Ritchie. "The structure of the current regulatory model didn't allow it to be as nimble and flexible to cope with a rapidly changing environment in a way that was responsive to the needs of market participants and consumers," he says.

According to Ritchie, the panel recommended the new regulator should:

Have an expert board of directors;

Recover its operating costs by imposing proportional fees and levies on the financial sectors it regulates;

Be operationally independent from the government;

Have authority to make and enforce rules, as limited by its enabling statute;

Have an obligation to act in a transparent and principled way, guided by a clearly articulated mandate set out by its enabling statute.

Currently, the superintendent of financial services has the power to make regulatory policies that are in line with the Pension Benefits Act, with no discretion to go beyond what the legislation permits, said Andrea Boctor, head of the national pensions and benefits group at Stikeman Elliott LLP.

By giving the authority more rule-making powers, employers will have "more direction and certainty that when they do something in accordance with one of the rules that the FSRA has put forward, that that is the correct way to do it," Boctor told Benefits Canada previously.

Included in its vision for the new regulatory body, the panel described three divisions — each with its own superintendent of either market conduct, prudential oversight or pensions — that will work separately but liaise through upper management.

"Our recommendation is that within FSRA, there would be a distinct person and staff responsible for overseeing pensions," says Ritchie. "Right now, the same superintendent is responsible over all of the areas […] but within [FSRA], our recommendation is that there be a group with specialized expertise in the areas of pensions […]."

8. Ontario doubles land transfer tax rebate for first-time homebuyers

[November 14, 2016] Ontario is doubling the rebate on the land-transfer tax for first-time homebuyers to $4,000, but is increasing the same tax on homes that sell for more than $2 million.

The government says half of first-time buyers won't pay any land-transfer tax to the province, while the half-percentage point increase on homes over $2 million will affect less than 1% of the population.

The province takes in over $2.1 billion a year in the land-transfer tax, and the government says any increase in revenues from the increase on luxury homes will help pay for the doubled rebates for first-time buyers.

Premier Kathleen Wynne had said the government was worried about the difficulty faced by first-time buyers trying to get into the housing market, especially in the Greater Toronto Area where the average price is $762,975.

The government also announced it's freezing the property tax on apartment buildings while it reviews how it affects rental market affordability.

The changes to the land-transfer tax are outlined in the Ontario government's fall economic statement, which says that home ownership has become a key factor in many people's long-term financial security.

The Ontario Real Estate Association had asked the government to expand the land-transfer tax rebate program for first-time buyers as one way to help more of them get into the housing market.

The city of Toronto has its own land-transfer tax, which offers rebates of up to $3,725 for first-time buyers.

Ontario's land-transfer tax rises from 0.5% on the first $55,000 of a purchase price to 2% for everything above $400,000. Toronto's land-transfer tax is 1% on the first $55,000 and 2% on the rest.

Have a nice and fruitful week!