Weekly Updates Issue # 612

1. Weekly Markets Changes
2. Flat February GDP masking Canada's momentum
3. Ottawa already ahead of spring budget forecast, at $11.5 billion
4. Ontario introduces universal Pharmacare for youth 24 and under
5. Ontario raises limits for disability support
6. Great-West Life Insurance Company to cut 1,500 jobs over 2 years
7. How significant is U.S.-Canada lumber dispute?
8. TransCanada deal won't solve natural gas issues

1. Weekly Markets Changes

[April 28, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,586.13 -28.35 -0.18%	2,384.20 +35.51 +1.51%	20,940.51 +392.8 +1.91%	6,047.61 +137.1 +2.32%	$0.7321 -0.85¢ -1.15%	$1,269.50 -16.50 -1.28%	$49.19 -0.44 -0.89%

2. Flat February GDP masking Canada's momentum

[April 28, 2017] Canadian economic growth took a pause in February after the break-neck pace seen at the start the year.

Statistics Canada said Friday gross domestic product was unchanged in February, matching the expectations of economists, according to Thomson Reuters.

February followed three months of gains including stronger-than-expected growth in January.

"After the exciting growth figures of recent months, it was perhaps inevitable that the Canadian economy would take a slight breather," TD Bank senior economist Brian DePratto wrote in a report. Despite the result, DePratto noted that momentum heading into the year remains consistent with a solid economic expansion.

Paul Ferley, assistant chief economist for RBC Capital Markets, points out there's more to the story. In a release, he says, "February's flat monthly reading belied an acceleration in the annual pace of growth, with real GDP output up 2.49% compared to a year earlier. This was the fastest pace of increase since July 2014, and reflects the recovery in the goods-producing sector."

He also highlights mining production, which was boosted by the recovery in commodity prices, and growth in service-producing industries, which were "steadier over the last two years." Ferley concludes, "This broad-based

strengthening pumped the annual growth in overall GDP higher in February relative to January's 2.29% pace."
Statistics Canada said gains in service-producing industries were offset by declines in goods-producing industries for February.
Service-producing industries were up 0.2% for the month as the finance and insurance sector gained 0.7%. The real estate and rental and leasing sector added 0.5%. Meanwhile, goods-producing industries fell 0.3%, the first move lower since October.
The manufacturing sector fell 0.6% in February after growing in seven of the previous eight months, while the mining, quarrying, and oil and gas extraction group fell 0.2%.
CIBC economist Nick Exarhos said the biggest headwind in February was manufacturing, but noted weakness on the goods producing side was widespread, with only construction posting an increase.
"Despite what's been an anemic pace to business investment, and still muted plans for 2017 on that front, housing starts have had a remarkable recent run," Exarhos wrote in a report. "Residential investment is now poised to be a modest lift to GDP this year, from a drag we had forecast earlier on. That swing explains much of the upgrade to our overall 2017 GDP outlook."
Matthieu Arseneau, senior economist at National Bank, says Canada is outpacing its peers. In a release, he says, "After struggling for some time, it's encouraging to see the Canadian economy being the fastest-growing among G7 countries since the second half of 2016."
He also says, "Even if GDP stagnated in February, it does not mean that economic growth in the quarter is at risk. Indeed, even if we assume a flat number again in March, GDP would have grown above 4.0% annualized thanks to a strong handoff and the surge in January (bottom chart). This is slightly above the 3.8% performance expected by the BoC in the April Monetary policy report."

3. Ottawa already ahead of spring budget forecast, at $11.5 billion

[April 28, 2017] The federal government ran a deficit of $11.5 billion over the first 11 months of its 2016-17 fiscal year, putting it well ahead of its spring budget forecast with one month to go.
The result compared with a surplus of $7.5 billion during the April-to-February period a year earlier.
Not counting a $3-billion contingency cushion, Ottawa's spring budget projected a deficit of $23 billion for 2016-17.

The monthly fiscal monitor report said government revenue for the 11 months fell $400 million to $265.1 billion as personal income tax revenue fell, but corporate income tax revenue grew.
Program spending increased $20 billion to $254.6 billion.
Public debt charges fell $1.5 billion to $22 billion due in large part to lower average effective interest rates.

4. Ontario introduces universal Pharmacare for youth 24 and under

[April 28, 2017] Ontario is introducing a Pharmacare program for all residents aged 24 and under, Finance Minister Charles Sousa announced today at Queen's Park as he tabled the 2017 budget.
OHIP+: Children and Youth Pharmacare will launch on January 1, 2018, and will offer universal drug coverage for all medicines listed in the Ontario Drug Benefit formulary. There will be no co-pay or deductible, and youth will be eligible regardless of family income.
"It will decrease plan sponsors' costs to some extent," says Tiina Liivet, vice-president of benefits and health at Accompass Inc. She notes dependent children and young workers typically aren't the biggest contributors of an employer's drug costs, and the formulary won't cover several high-cost medications. But the Pharmacare program "will still have a mitigating impact on how much [a plan sponsor's] cost is."
Liivet also points out the government will be the first payer, so carriers should ensure coordination of benefits occurs in the correct order. Another issue is how high-cost drugs for orphan diseases, currently available to Ontario Drug Benefit recipients through an exception access program, would fit into OHIP+, or how they would coordinate with the province's Trillium plan.
Earlier this week, the Ontario NDP announced that should they be elected in 2018, they would introduce a universal Pharmacare program for all Ontarians, though it would only include 125 essential medicines to start.
Liivet notes both the Liberal and NDP proposals focus on covering routine drugs while ignoring the high-cost medications that are putting pressure on plan sponsors and insurers. But she isn't sure if the governments will eventually cover those medicines.
"I don't know if they've got the wallet for them, especially if they're going to pick up more of these routine costs," she says. "Where is the money going to come from?"
The budget also includes $73 million to increase publicly funded structured psychotherapy for Ontarians with anxiety, depression and other mental

illnesses. It notes it will publicly fund Mifegymiso, the abortion pill Health Canada just approved in July 2015. Alberta and New Brunswick have also committed to publicly funding Mifegymiso.

5. Ontario raises limits for disability support

[April 27, 2017] People using the Ontario Disability Support Program can soon hold larger amounts in liquid assets without the program clawing back their benefits.

Ontario's 2017 budget, released Thursday, says the government is raising the exempt asset limits for people using the ODSP, helping them to save more and avoid the need to deplete their liquid assets before receiving support.

The government is hiking the exemption limits on cash and liquid assets from $5,000 to $40,000 for single individuals and from $7,500 to $50,000 for couples. The changes will be effective by January 2018, the budget says.

"It will give a lot more latitude to families who have those issues, and to family members to plan in a more effective way," says Doug Carroll, practice lead for tax, estate and financial planning at Meridian.

The exemption limits apply to assets held in cash, RRSPs or TFSAs. Funds held in an RDSP or Henson Trust are entirely exempted and would not count towards the client's exemption limits under the program.

The ODSP has its own provincial qualification criteria but is similar to federal criteria for the disability tax credit.

The government is also increasing the ODSP exemption limits for receiving cash gifts, hiking them from $6,000 to $10,000 per year, noting that some recipients may rely on the support of family and friends.

The Ontario budget will also raise the cash exemption thresholds for people receiving Ontario Works social assistance.

6. Great-West Life Insurance Company to cut 1,500 jobs over 2 years

[April 25, 2017] Great-West Life says it will cut about 1,500 positions over the next two years in response to changing technology and customer expectations. In its release, the Winnipeg-based company says the cuts are equal to 13% of its workforce in Canada.

Today's release says cuts will come from "reducing the temporary workforce" and through "a voluntary retirement program." Great-West also plans to eliminate positions through a severance program, noting, "These reductions are expected to be partly offset by business growth, as well as natural attrition combined with controlled hiring practices."

Great-West says the job cuts are part of a transformation of its business that began in November 2016, when it "made the strategic decision to align its Canadian business around group and individual [insurance] customers." The company also cites "heightened competition" and changing customer needs.
Along with the job cuts, Great-West says it's also aiming to reduce costs through "real estate consolidation, process improvements and updates to information systems."
Great-West says it expects to lower its annual costs by about $200 million, before taxes, by the end of March 2019. For now, the company says restructuring costs will be incurred in Q2 2017, reducing its earnings for the quarter by $127 million after tax, or 13 cents per share.

7. How significant is U.S.-Canada lumber dispute?

[April 25, 2017] Fresh off slapping a duty on Canadian lumber, President Donald Trump is now making threats about dairy as the northern neighbour has suddenly, unexpectedly, become his main target for criticism lately on trade.
The president tweeted Tuesday: "Canada has made business for our dairy farmers in Wisconsin and other border states very difficult. We will not stand for this. Watch!"
That's what he wrote the morning after his government announced initial duties of up to 24% on Canadian lumber, with more expected later this year.
If you're worried about how the move will impact Canada, you can rest easy, according to National Bank. In a research report, the bank says, "While the import duty of as much as 24% imposed by the U.S. will hit the forestry industry on the chin, the overall impact on Canada's economy is likely to be limited. Note that Canada exported less than US$6 billion worth of lumber to the U.S. last year, accounting for just 1.2% of total exports."
As a result, it adds, "even if lumber exports to the U.S. dives to zero ─ which has never occurred in the three decades of lumber-related trade disputes between the U.S. and Canada ─the net impact on Canada's GDP would be less than half a percentage point."
The provinces that stand to lose the most are B.C. and New Brunswick, says National Bank, "although it's worth noting that forestry, logging and sawmill activity account for less than 2% of GDP in both provinces." Plus, when it comes to the labour market, the bank says "there were less than 50,000 jobs left in forestry, logging and support activities, or less than 0.3% of total employment in Canada."

The main reason to look at why Trump imposed the duty is to search for clues about his plans for NAFTA, as well as keep in mind the broader implications of trade changes between the U.S. and Canada.

Speaking in Kitchener, Ont. today, Prime Minister Justin Trudeau stressed that "we are tremendously interconnected in our economy with that of the United States, [and] it's not just a one-way relationship."

He added, "There are millions of good U.S. jobs that depend on smooth flow of goods, services and people back and forth across our border," noting, "You cannot thicken this border without hurting people on both sides of it."

Trudeau says "any two countries are going to have issues that will be irritants to the relationship, [but] having a good constructive working relationship allows us to work through those irritants. There's always going to be political pressures to raise this issue or that issue […] but the core of this relationship is bigger than any two individuals sitting in the top of their respective governments."

Trade irritants and NAFTA

Lumber and dairy are longstanding irritants, and were also a problem file under previous presidents. In softwood lumber, the countries have a once-a-decade cycle of tariffs, trade litigation, and ultimately settlements.

What's new is how Trump is playing up the issue.

While Barack Obama referred to lumber as a minor irritant, the self-styled America First president is playing up these irritants as examples of his desire to get tough on trade.

His sudden flurry of complaints about Canada are a dramatic departure from the early days of his presidency–suddenly, he's complaining less about China and Mexico, and more about the northern neighbour.

In an exchange late Monday with conservative media gathered at the White House, the president said, according to Breitbart News: "We love Canada, wonderful people, wonderful country, but they have been very good about taking advantage of us through NAFTA."

Then his commerce secretary went out of his way to link this dispute to broader complaints, about dairy and about NAFTA: "It has been a bad week for U.S.-Canada trade relations," Wilbur Ross said. "This is not our idea of a properly functioning free trade agreement."

The softwood spat is unfolding amid a much bigger trade issue: the renegotiation of the North American Free Trade Agreement.

It's worth noting that, despite remarks from the president and his cabinet secretary, neither lumber nor dairy are actually part of the current NAFTA. However, different actors would be pleased to add provisions on one or the other.

CIBC's Avery Shenfeld says in a research note that "it's likely the reaction today is on fear that the lumber duties are the tip of the iceberg, showing that despite cozy talk between Trudeau and Trump, the U.S. is willing to flex its muscles to show a protectionist's" win". […] [But] more telling will be how the broader NAFTA talks go."

8. TransCanada deal won't solve natural gas issues

[April 25, 2017] In the natural gas space, "one of the big things that market participants have been watching is the TransCanada Mainline negotiation," says Scott Vali, vice-president of equity for CIBC Global Asset Management. The TransCanada pipeline deal was signed in March, but it may not affect the price of gas in Canada the way investors hope.

The 10-year deal, between TransCanada Corp. and natural gas producers in Western Canada, calls for an additional 1.5 billion cubic feet (Bcf) of natural gas to be shipped daily from Alberta to Ontario. The deal was made to compete with pipelines being built in the U.S. and to save the industry from potentially losing billions in revenue.

Vali, who manages the Renaissance Global Resources Fund, explains that the price differential between gas in Alberta and in the rest of North America, and at the Union Gas Dawn Hub in Ontario, is wide — it was about $1.00 to $1.20 per thousand cubic feet (Mcf), as of mid-March 2017.

So, "the [market] expectation was, with [the TransCanada] deal, that spread would start to narrow as more gas flowed out of Western Canada into the Ontario market," says Vali (according to news reports, the deal introduces a simplified toll, versus a varied toll structure that was considered pricey by shippers).

But, he says, "we believe the market is wrong."

That's because 1.5 Bcf "is only half the capacity of the pipeline," says Vali. "The way the other half is still contracted today requires a one-year commitment by a producer to buy capacity on the line, and the rate that capacity can be bought is at about $1.20 per Gigajoule." As a result, "at least a Bcf of gas will continue to be priced at the higher toll, and that […] will price the market in Alberta."

This basis differential, and the reasons for it, are significant for Canadian equities in terms of the gas producers in Western Canada, says Vali. "[In March], gas [was] trading at just under $3 Mcf in the U.S., and if Canadian gas is trading at a dollar discount, it means that Canadians are receiving just under US$2 in Mcf, which is a very big discount to what other producers in North America are receiving."

Vali adds, “That, in turn, will hurt their cash flows and growth prospects as we move forward. So, again, we believe that the Western Canadian producer is generally going to be disadvantaged relative to their U.S. counterparts, unless something else changes with respect to the TransCanada Mainline.”

Have a nice and fruitful week!

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