Weekly Updates Issue # 655

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1. Weekly Markets Changes

[March 16, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,711.33 +133.5 +0.86%	2,752.01 -34.56 -1.24%	24,946.51 -389.2 -1.54%	7,481.99 -78.82 -1.04%	$0.7641 -1.16c -1.50%	$1,314.24 -9.69 -0.73%	$62.34 +0.30 +0.48%

2. Feds don't know if country's debt-to-income ratio is too high

[March 16, 2018] With a popular measure that shows Canadians' soaring debt remains in record-breaking territory, the federal government has acknowledged internally that there's no way of knowing whether the burden has climbed too high.

A recently released federal analysis, prepared for Finance Minister Bill Morneau, said the country's household-debt-to-disposable-income ratio has been steadily rising since 1990, when it was 90%—that translates to 90 cents in debt for every dollar of household disposable income.

On Thursday, the latest figures showed the ratio hit 170.4% in the final three months of 2017, just below its historical peak of 170.5% the previous quarter. That's just over $1.70 in debt for every dollar of disposable income.

"While the debt ratio is high historically speaking, there is no way of precisely determining whether the current ratio is too high," said the memo, which was written last August.

"There is no estimate of the exact 'optimal' level of household debt."

The Finance Department document, labelled "secret," was obtained by The Canadian Press under the Access to Information Act.

Policy-makers keep an eye on the debt ratio, which is one of several ways experts monitor household debt, in their efforts to gauge the severity—and potential fallout—of the country's years-long borrowing binge.

The Bank of Canada, for one, has carefully assessed the economic risks of consumer debt in order to determine how quickly it can raise interest rates without piling on too many debt-servicing costs for over-stretched households. The central bank has called Canadians' debt burdens an area of top concern.

Still, in response to the stronger national economy, the bank has increased its benchmark rate three times since last summer. When the economy is close to full capacity, the bank hikes its rate to keep inflation from rising above its 2% ideal target.

Even if it is uncertain where the danger zones begin for the household-debt ratio, the briefing note to Morneau said there are "clear negative consequences" for the economy if the number gets too high or too low.

High household debt can lead to "deeper and more protracted recessions," while levels too low among those who can afford it could push home-ownership rates down to sub-optimal levels, the memo said.

But the document notes that static calculations about debt fail to account for many other factors that can affect the entire picture, such as policy changes aimed at slowing debt accumulation.

"Ultimately, what drives the sustainability of debt is whether carrying it is affordable and whether the distribution of that debt poses any systemic financial risk," said the memo, which was partially redacted.

The main theme of the document was to explore likely economic impacts from the Bank of Canada's current rate-hiking path.

The memo presented two primary ways higher rates will affect the economy: they will make existing debt loads costlier to service; and they will make interest-sensitive spending, like expenditures for cars, housing and business investment, more expensive.

Given expectations the central bank will take a gradual approach to raising the rate, the briefing note said the economy is likely to steadily absorb the increases.

Some analysts said the fact this week's debt-ratio reading was slightly lower than the previous number could suggest Canada's debt growth may have turned a corner.

"That should be viewed as a positive development by the (Bank of Canada), though progress on reducing the 'key vulnerability' of elevated household debt will likely be very slow," RBC economist Josh Nye wrote in a research note.

For several years, policy-makers have been introducing new regulations, such as restrictions on mortgage credit, to curb the build-up of household debt.
Earlier this week, Bank of Canada governor Stephen Poloz also said the federal government's steps to add to the public debt in recent years has helped slow the rise in debt accumulated by Canadians.
Poloz, who acknowledged household burdens have still managed to reach historic highs, said Ottawa's spending on programs such as enhanced child benefits and infrastructure have contributed to economic growth. As a consequence, the stimulus has pushed interest rates higher than they would have been without it, he said.
On the household-debt-to-disposable-income ratio, some experts see it as just one number out of many and insist that consideration must be given to the composition of the debt, such as how much of it is high risk.
"It's masking more than it's revealing," Benjamin Tal, CIBC's deputy chief economist, said of the ratio.
"Therefore, the fact that [Finance officials] are saying, 'there's no optimal level, we don't know if it's really very high,' suggests that at least there is some rational thinking when it comes to this ratio, which is very refreshing."

3. Manufacturing sales fell more than expected in January

[March 16, 2018] Statistics Canada says manufacturing sales fell 1% in January, with the decline led by the motor vehicle, aerospace and primary metal industries.
Economists had expected a drop of 0.8%, according to Thomson Reuters.
Sales for January totalled $54.9 billion, as 14 of the 21 industries moved lower. The drop came as sales of motor vehicles fell 8% to $4.9 billion, following two consecutive monthly increases.
Meanwhile, production in the aerospace product and parts industry fell 9.5% to $1.6 billion, while the primary metal industry dropped 2.8% to $4.1 billion.
Overall manufacturing sales in volume terms declined 1.1%.
"Canadian factories had a rough start to the year," says Royce Mendes, director and senior economist at CIBC, in commentary.
"The export data we already had in hand suggested a deterioration of this magnitude," he says, so the news wasn't a surprise. However, "The survey suggests that GDP data could look soggy to open the new year," especially

with “already elevated inventory levels and capacity constraints” potentially limiting the gains of U.S. tax reform for factories.

4. Home prices, sales volumes drop in February

[March 15, 2018] Canada’s national average home price was down 5% and sales volume was down 16.9% in February compared with a year ago, evidence that many buyers had already raced to purchase before new mortgage rules came into effect this January.

There was also a 6.5% decline in transactions between January and February, the second month-over-month decline and the lowest reading in nearly five years, the Canadian Real Estate Association reported Thursday.

CREA’s latest monthly statistics show that home sales were down in February in almost three quarters of all local housing markets tracked by the national association.

“The drop off in sales activity following the record-breaking peak late last year confirms that many homebuyers moved purchase decisions forward late last year before tighter mortgage rules took effect in January,” said Gregory Klump, CREA’s chief economist in a statement Thursday.

The number of homes sold nationally in December hit a record high, ahead of a new stress test for uninsured mortgages that requires potential buyers to show they can service their mortgage payments if rates increase.

The federal banking regulator’s tougher rules now require a stress test to be applied even to borrowers with more than 20% down payment.

To qualify for federally regulated mortgages, borrowers must be able to afford interest rates that are two percentage points above the contracted rate or the Bank of Canada’s five-year benchmark rate, whichever is higher.

The stricter residential mortgage lending regulations introduced by the Office of the Superintendent of Financial Institutions (OSFI) were aimed at reducing risk in the market amid high housing prices.

Homebuying activity has also been dampened by the Bank of Canada’s move in January to hike interest rates to 1.25%. The quarter-point increase was the central bank’s third since last summer, after hikes in July and September. In January, Canadian home sales fell by 14.5% from the previous month, according to CREA’s figures.

The national average house price for homes sold in February 2018 was just over $494,000, down 5% from a year earlier. Excluding Toronto and Vancouver, the country’s most active and most expensive markets, the national average price was just under $382,000, up 3.3% from $369,728 a year ago.

The number of newly listed homes in February increased by 8.1%, following a plunge of more than 20% in the month prior. However, new listings across the country in February were still 6.4% below the 10-year monthly average and 14.6% below the peak reached in December 2017. New home listings in February were also below the levels recorded every month last year except January 2017.

5. Near-term outlook for loonie and U.S. dollar

[March 14, 2018] With U.S. growth revised upward due to government spending and tax cuts, markets have priced in three Fed rate hikes for 2018. That's allowed the U.S. dollar to put up a fight against global currencies despite a deficit projected to surpass US$1 trillion in 2019.

"Generous long-end spreads versus still-low overseas yields are providing enough of a siren call to offset what remains a sticky current account deficit," say CIBC economists in a monthly foreign exchange report.

However, the dollar's fight likely won't last long.

In a monthly foreign exchange report, National Bank economists say, "By pushing up Treasury yields near 3%, markets are firing a warning shot about their limited tolerance for fiscal indiscipline. The U.S. dollar is unlikely to flourish in such an environment, even with Fed rate hikes in the cards."

And Trump's trade tariffs won't put much dent in the U.S. trade gap. That's because the tariffs are "narrowly focused, and any improvement in the balance on metals could be offset by the reduced competitiveness of made-in-America products using them as inputs," says CIBC.

Further, "external developments are likely to dominate" to push the currency down, it says. For example, markets aren't pricing in the shortened timeline for the end of quantitative easing in the Eurozone and Japan.

Into 2019, the dollar's decline could accelerate.

At that time, "investors could be looking past the bulk of U.S. monetary tightening, and a potential fiscal tightening in 2020 as a post-election Congress faces the reality of a budget deficit in excess of $1 trillion," says CIBC.

Losses for the loonie

For its part, the loonie has the ignominious distinction of being the only reserve currency losing ground against the U.S. dollar this year.

Since the end of January, the loonie has depreciated 5%, because of trade uncertainties and softer economic data—and the Canuck buck could have further to fall.

For example, though Canada is excepted from U.S. steel and aluminum tariffs, trade threats have made the markets more aware of protectionist risks.

"NAFTA uncertainties are unlikely to be resolved this year, with the Mexican general elections and the U.S. mid-terms causing negotiators to hit the pause button in the next few months," says CIBC.

Relative to the Fed, CIBC expects one further quarter-point rate hike by the Bank of Canada this year and two in 2019. "That would lean toward a bit more C$ weakness," says the bank.

Add in moderating crude oil prices, and pessimism for the loonie grows. For example, diminished flows through an impaired Keystone pipeline have contributed to a large differential between Western Canada Select and West Texas crude, says National Bank.

CIBC forecasts USDCAD at 1.32 by mid-year, "with a general trend toward U.S. weakness against other majors, keeping the Canadian dollar range-bound thereafter."

National Bank is more optimistic for the loonie, with USDCAD at 1.23 mid-year. That's because, despite various concerns including NAFTA, "the Canadian dollar has room to appreciate amidst USD weakness, which is likely to be reinforced by a sharply deteriorating U.S. budget deficit." Further, global synchronized growth bodes well for commodity prices.

"We have adjusted our targets to show a more resilient loonie over the forecast horizon, albeit with USDCAD remaining in the 1.20-1.30 range for the next 12 months," says National Bank, adding that those projections assume a favourable outcome for NAFTA.

Euro to benefit

Other major currencies stand to benefit from U.S. dollar weakness. And improved GDP forecasted for the U.S., thanks to fiscal stimulus, has spillover effects for U.S. trade partners.

"IMF research shows that [an] exporting economy's output would rise about 0.1% on average in response to a 1% GDP overall fiscal shock in the U.S.," says National Bank.

The eurozone, in particular, will benefit from such spillover effects, because the region has economic slack, which "helps keep inflation under wraps and prevents significant interest rate hikes that would crowd out private investment in the exporting economy," says National Bank.

The bank has accordingly raised its EURUSD targets. "But the path of the common currency over the coming months won't be linear, with events such as Italy's March elections expected to periodically fuel volatility."

6. GTA luxury home sales down: report

[March 13, 2018] While luxury homes sales in the Greater Toronto Area (GTA), Oakville and Hamilton–Burlington have fallen short of last year's record-breaking pace, this segment of the market will still see plenty of activity in 2018, finds a report by RE/MAX INTEGRA Ontario-Atlantic Region.

The report notes 76 freehold and condominium properties sold over the $3-million price point in the GTA between Jan. 1 and Feb. 28, down from 180 sales during the same period in 2017. In the $5-million-plus category, luxury sales fell 46% to 15 transactions in the GTA, compared with 28 one year ago. Oakville reports slower sales in the first two months of the year as well, with six homes selling over $3 million, compared to 15 one year ago. Meanwhile, 59 homes sold for over $1 million in Hamilton–Burlington, down from 133 in 2017. Only condominium apartments and townhouses located in Toronto proper bucked the trend, with eight sales over $3 million so far this year, up from five during the same period in 2017.

"Sales of upper-end homes year to date are more in line with 2016 volumes rather than 2017, which should be distinguished as an outlier year for luxury real estate," says Christopher Alexander, executive vice-president and regional director, RE/MAX INTEGRA Ontario-Atlantic Region, in a release. "Any comparison will fall short of 2017 levels throughout much of the spring, but demand for luxury product is likely to improve by early summer and carry through to the remainder of the year."

What will drive demand?

The Capgemini World Wealth Report for 2017 notes the population of high-net-worth individuals in Canada—the vast majority of whom live in Ontario—rose 11.3% in 2016, while net worth increased 11.7% to US$1.1 trillion.

From the standpoint of foreign investors, the combination of a strong U.S. dollar and undervaluation from a global perspective, Ontario is ripe for investment. In fact, the GTA and the surrounding areas have stepped into the spotlight in recent years, often dominating the top positions in world rankings, including the best city in the world by The Economist and one of top 10 most innovative cities in the world by the Melbourne-based "Innovation Cities Index."

According to Numbeo, a crowd-sourced property price comparison site, the price per sq. ft. for an apartment in Toronto's city centre hovers at approximately $791.17—making the city look like a bargain by international standards.

As a result, foreign investors will continue to be a major driver of sales at the top end of the GTA housing market. “The accumulation of real estate is an integral component of their overall investment strategy, and as such, the foreign buyer tax is not a deterrent. It is just the cost of doing business in Ontario,” Alexander said.
Given solid economic fundamentals throughout the Golden Horseshoe, the current pause in luxury home-buying activity is enigmatic, he said.
“As market conditions stabilize, and uncertainty regarding rising mortgage rates and more stringent lending practices diminishes, home-buying activity in the top-end of the market will resume at a more sustainable pace,” he said.

7. Big banks’ forecasts for growth, rate hikes

[March 12, 2018] Canada isn’t expected to maintain its hot 2017 growth—but it will continue to grow at a more sustainable pace.
“We expect Canada’s economy to slow to 1.9%—a pace that is closer to potential, which we estimate at 1.6%,” says an RBC outlook report.
Relative to last year, more growth is expected to come from business investment and government spending, and less from consumers.
Along with regulatory changes, “rising interest rates will take a toll on the highly indebted household sector in 2018, but the softening should be limited by support from a healthy labour market and rising wages,” says RBC.
In contrast, the economy will get a lift as the federal and provincial governments ramp up spending on infrastructure projects. “Investment outside of the public sector will shift away from residential construction toward spending on machinery and equipment as businesses expand,” says RBC.
The bank’s outlook is for the Bank of Canada (BoC) to raise the overnight rate in each of the next three quarters against solid growth and “more robust global trade flows,” as the global economy expands.
The BoC’s pace is likely to be measured, though, says RBC. “That’s due to the impact that NAFTA uncertainty could have on exports and investment, as well as concerns about the ability of Canadian households to finance their elevated debt at higher rates.”
RBC further forecasts inflation in Canada to hit the central bank’s target of 2% this year, which, combined with rising short-term rates, will pressure 10-year yields higher.
BMO expects the BoC to sit on the sidelines a little longer.

For example, in a weekly financial digest, BMO deputy chief economist Michael Gregory notes that the annual change in household credit is 5.5% annualized—" well above any longer-run path for personal income growth." With the BoC concerned about interest rate sensitivity generally as well as in the housing market, Gregory says: "On balance, we judge the [central] bank has signalled that it will likely be on hold in April as well."

What the Fed will do

With the U.S. economy on a firm footing, thanks in part to government spending and tax cuts, RBC expects the Fed to announce rate hikes each quarter this year.

"The strength of the underlying economy will outweigh concerns about the [recent] stock market correction, which some recent Fed speakers have referred to as a 'healthy correction,'" says the RBC report.

For example, job creation is robust, unemployment remains low and wages growth is accelerating.

Yet, that in turn could cause inflation to pick up.

"Rising wages and increasingly stressed capacity tees up for inflation to rise sustainably at the Fed's 2% target," says RBC. "Looking ahead we expect rates to continue to move higher, albeit at a somewhat slower pace, and forecast the 10-year yield to end the year at 3.3%."

In a weekly global equity report, BMO senior economist Robert Kavcic notes that the recent increase in U.S. labour force participation could dampen wage growth.

"For equity investors, this is a bullish outcome suggesting strong growth but no excessive inflation pressure. For the Fed, we believe this supports a March rate hike, and keeps us comfortable with a one-per-quarter pace through 2018," he says.

A risk is a potential U.S. trade war.

The introduction of U.S. tariffs on steel and aluminum (for now, Canada and Mexico are excepted) could result in retaliation by affected countries—such as China—in the form of tariffs on U.S. exports.

Though such a trade battle could negatively affect the U.S., "the overall growth impacts to the large U.S. economy would be fairly modest," says TD senior economist Leslie Preston in a weekly economics report. That would raise inflation only "a couple of tenths of a percentage point."

The real fear for investors and businesses is a global trade war, says the BMO financial digest, with tariffs ultimately undermining U.S. competitiveness and productivity. "Look for forthcoming surveys on business confidence to take a step back from multi-decade highs," says BMO senior economist Sal Guatieri.

But overall, U.S. economic data are positive. “A variety of forces are expected to push inflation higher this year; the only question is how quickly,” says Preston. “The risks that inflation will accelerate faster than the Fed currently expects are mounting.”
The Fed’s next announcement is on Mar. 21.
Says Preston: “A hike at the meeting is essentially a lock. We currently expect three 25-basis point moves in 2018, but the risks are skewed to more hikes rather than fewer.”

Cautious market outlook

In February rising interest rates and firming inflation expectations introduced volatility into the markets. Early last month, the S&P was down 10% from its Jan. 26 peak, and the MSCI world index lost 8.8%.
RBC puts the markets in perspective: “While the sell-off clipped 2018 gains, index levels remain well above year-ago levels. As a result, our forecast does not incorporate any negative hit to the global economy from this short sharp interruption in stock market performance.”
However, U.S. tariffs are a risk.
“For now, you can add the tariff row, if it escalates, to the list of things that might derail a nine-year old expansion,” says Guatieri.
Despite capacity supporting the bias to tighten over time, Canada exhibits some less-than-stellar economic indicators, notes Kavcic, such as weak trade and a still-correcting Toronto housing market.
“For equity investors, the TSX faces the reality of softer growth, less-than-friendly relative [to the U.S.] policy dynamics (be it on the fiscal or trade fronts), and an increasingly challenged domestic oil market,” he says. “So far this year, the [TSX] hasn’t shown any sign of reversing its underperforming path.”

8. Canadian household debt hits $1.8T, as report warns of domestic risk

[March 12, 2018] Canadians’ collective household debt has climbed to $1.8 trillion as an international financial group sounds an early warning that the country’s banking system is at risk from rising debt levels.
Equifax Canada says consumers now owe $1.821 trillion including mortgages as of the fourth quarter of 2017, marking a 6% increase from a year earlier.
Although nearly half of Canadians reduced their personal liabilities, roughly 37% added to their debt to push the average amount up 3.3% to $22,837 per person, not including mortgages.

The fresh numbers come as an international financial group owned by the world's central banks says Canada's credit-to-gross-domestic-product and debt-service ratios show early warning signs of potential risk to the banking system in the coming years.
The latest report by the Bank of International Settlements says Canada's credit-to-GDP gap and debt-service ratios have surpassed critical thresholds and are signalling red, pointing to vulnerabilities.
The group, however, cautions that these indicators should not be treated as a formal stress test, but as a first step in a broader analysis.

9. Job vacancies show growing labour shortage: CFIB

[March 12, 2018] Job vacancies reached a new high in Q4 2017, totalling 399,000 jobs left unfilled in Canada's private sector, according to a CFIB report.
The job vacancy rate—the proportion of unfilled jobs relative to all available jobs in the private sector—reached 3%, compared to 2.4% for Q4 2016.
"Labour shortages are a growing problem. This is the second consecutive quarter in which the job vacancy rate has surpassed the high recorded at the beginning of 2008, before the recession," said Ted Mallett, vice-president and chief economist at CFIB, in a release.

Results by province

British Columbia, which already had the tightest labour market, experienced the largest jump (+ 0.3 points) of all the provinces, with a vacancy rate of 3.9% in Q4 2017. Quebec, Ontario, New Brunswick, Alberta and Manitoba saw a more modest 0.1-point increase.

Provinces	Vacancy rate	Unfilled jobs
British Columbia	3.9%	69,500
Quebec	3.4%	94,700
Ontario	3.2%	164,000
New Brunswick	2.7%	6,300
Alberta	2.4%	37,600
Manitoba	2.3%	9,900
Saskatchewan	2.3%	7,700

Nova Scotia	2.0%	6,000
Newfoundland and Labrador	1.8%	2,800
Prince Edward Island	1.6%	700

Job vacancies by industry

The job vacancy rate rose in eight out of 14 industry sectors in Q4 2017, with the most significant increases occurring in the personal services, information, arts/recreation and retail sectors.

Labour shortages continue to put upward pressure on wages, with companies having unfilled jobs expecting to offer an average wage increase that is 0.5% higher than those businesses without such vacancies, finds the report.

Have a nice and fruitful week!

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