Weekly Updates Issue # 687

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1. Weekly Markets Changes

[October 26, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,888.26 -581.8 -3.76%	2,658.69 -109.1 -3.96%	24,688.31 -756.03 -2.97%	7,167.21 -281.82 -3.78%	$0.7631 -0.99c -1.28%	$1,233.53 +7.04 +0.57%	$67.59 -1.53 -2.21%

2. Consumer spending helps U.S. GDP grow 3.5% in Q3

[October 26, 2018] The U.S. economy grew at a robust annual rate of 3.5% in the July-September quarter as the strongest burst of consumer spending in nearly four years helped offset a sharp drag from trade.

The Commerce Department said Friday that the third quarter's gross domestic product, the country's total output of goods and services, followed an even stronger 4.2% rate of growth in the second quarter. The two quarters marked the strongest consecutive quarters of growth since 2014.

The result was slightly higher than many economists had been projecting. It was certain to be cited by President Donald Trump as evidence his economic policies are working. But some private economists worry that the recent stock market declines could be a warning signal of a coming slowdown.

The GDP report along with next week's unemployment report for October are the last major looks at the economy before voters go to the polls in the mid-term elections.

For this year, economists are projecting the momentum built up should result in growth of 3%, the best annual showing in 13 years. But they believe the impact of Trump's trade war with China and rising interest rates will slow growth in 2019 to around 2.4%, with a further decline to under 2% in 2020.

"I think we will see a significant slowdown, in part because economic growth has been raised to an artificially high level by the tax cuts," said Sung Won Sohn, chief economist at SS Economics in Los Angeles.

Trump in recent weeks has accelerated his attacks on the Federal Reserve for raising interest rates, contending that the higher rates by slowing the economy will work against his efforts to speed up growth through the $1.5 trillion tax cut package Trump got Congress to pass last year.

"Every time we do something great, he raises interest rates," Trump said in an interview this week with the Wall Street Journal in which he again said he viewed the Fed as the "biggest risk" facing the economy "because I think interest rates are being raised too quickly."

The central bank has raised rates three times this year and signalled it will raise rates one more time this year and expect to raise rates three times in 2019. Those moves are being made to ensure that tight labour markets, with unemployment at a 49-year low of 3.7%, and strong growth don't trigger unwanted inflation.

The GDP report Friday was the government's first of three reviews of overall economic activity for the July-September period.

The report showed that consumer spending, which accounts for 70% of economic activity, surged at an annual rate of 4% in the third quarter, even better than the 3.8% gain in the second quarter and the best showing since last 2014.

Trade, which had boosted second quarter growth by 1.2 percentage points, shaved 1.8 percentage points off growth in the third quarter. Exports, which had surged at a 9.3% rate in the second quarter, fell at a 3.5% rate in the third quarter. Analysts had forecast this turn-around, saying it reflected the surge in exports of goods such as soybeans in the spring as producers tried to beat the higher tariffs being imposed by China in retaliation for Trump's tariffs.

Another big swing factor in the third quarter was business restocking of their shelves. Inventories had trimmed 1 percentage point off growth in the second quarter but boosted growth by 2 percentage points in the third quarter.

Housing continued to be a drag, falling for a third straight quarter. Business investment, which had surged at an 8.7% rage in the second quarter, slowed to a small 0.8% gain the third quarter.

3. Can you afford a mortgage as rates rise?

[October 25, 2018] On Wednesday, Canada's big banks raised their prime rates following a rate hike by the Bank of Canada (BoC).

The banks' prime rate is now 3.95%, which will affect mortgages rates.

For clients with variable-rate mortgages, most providers won't increase payments right away, says BMO on its website. "Instead, you'll pay the same

amount as before the rate increase, but less of each payment would go toward the principle," it says.

For such clients to sustain their amortization periods, BMO suggests three choices: increase monthly payments immediately or when the mortgage term ends, make one or more lump-sum payments, or do nothing. With the last option, clients would still have to increase monthly payments or make a lump-sum payment once their mortgage terms end to stay on schedule.

For new homebuyers with down payments of 20% or more (uninsured or low-ratio mortgages), mortgage rules require a stress test that determines whether clients could afford their mortgages if rates increased. The stress test uses the higher of either the five-year benchmark rate published by the Bank of Canada or the lender interest rate plus 2%.

For high-ratio mortgages (down payment of less than 20%), clients must qualify using the higher of the Bank of Canada five-year benchmark rate or the lender's rate.

The stress test applies to mortgages at federally regulated institutions, not credit unions and private lenders.

The Bank of Canada's benchmark rate is 5.34%, and the best bank rate on ratehub.ca Thursday for a five-year fixed mortgage is 3.49%. Assuming a client were to receive this rate, they'd have to qualify for their mortgage at 5.49%.

Even in the best of circumstances, a large increase in mortgage rates could prove a lot to handle for some clients, says BMO on its website. For example, depending on income and mortgage size, a 2% increase, represented in the stress test, could leave a client with a significant proportion of their income spent on housing. See BMO's website for an example.

BMO is calling for three more BoC rate hikes through 2019. With a more hawkish tone from the central bank Wednesday, "expect rates to continue to push higher at least through early 2019," says a BMO report.

A BMO survey earlier this year found that most new homebuyers were influenced by rising mortgage rates, with 51% saying the type of mortgage they'd choose would be based on rates. Nearly one-third (30%) said they'd likely go for a fixed-rate mortgage, and 5% said variable rate. Only 13% said interest rates would have no influence on mortgage type.

Mortgage rules and the economy

In its latest monetary policy report (MPR), the Bank of Canada says mortgage rules enacted over the last two years, along with higher interest rates, have reduced household debt vulnerability.

Household credit growth has declined, and the quality of new mortgage lending has improved since the rules took effect. For example, new low-ratio

mortgages declined by about 15% in the second quarter of 2018 relative to the same quarter in 2017.
In fact, loan activity fell among all borrowers, with the largest drop exhibited among new borrowers with a loan-to-income ratio above 450%.
The drop means there are fewer new, highly indebted households, says the BoC. Still, vulnerability associated with household indebtedness will persist because of the sheer size of that debt, it says.

4. BoC raises key rate to 1.75%, citing strong economy

[October 24, 2018] The Bank of Canada raised its key rate Wednesday, citing "solid" economic growth in Canada and "healthy" growth globally.
The central bank raised its overnight target rate to 1.75%, up a quarter-point from 1.5%. It was the bank's first rate hike since July and fifth since summer 2017.
The interest rate hasn't been above 1.5% since December 2008. At that time, during the financial crisis, the bank made a 0.75% cut to the benchmark, bringing it to 1.5% from 2.25%.
Last month, the bank left the rate unchanged, and senior deputy governor Carolyn Wilkins later said the unknown consequences of trade talks—as well as the tit-for-tat tariff dispute—were front-and-centre in the decision.
Today, the bank's tone was more hawkish. It noted in a press release that the new U.S.-Mexico-Canada Agreement had reduced trade policy uncertainty, which had been an "important curb" on business confidence and investment. Reflecting in part the trade deal, the bank revised projections for business investment and exports upward.
Referring to a relatively steep yield curve, the October Monetary Policy Report says long-term bond yields are well above short-term yields—a positive for the economic outlook. It added that inverted yield curves are less indicative of a recession in Canada relative to the U.S., likely due to the strong influence of global factors on Canadian long-term yields.
Still, ongoing economic challenges remain, the central bank said, including Canada's competitiveness relative to the U.S.
For global growth, the central bank cited U.S.-China trade conflicts as a key risk, though global growth projections are little changed from the previous MPR published in July. Global growth projections for 2018 and 2019 are 3.8% and 3.4%, respectively, compared to 3.8% and 3.5%.
Though the economic outlook is solid overall, the latest report from the central bank recognizes the return of financial market volatility and stress in emerging

markets. That's because global financial conditions are becoming less accommodative as advanced economies remove monetary policy stimulus.

As a result, more balancing across asset classes could occur, says the MPR. It also notes that emerging market economies are vulnerable to tighter global liquidity given they have elevated debt levels denominated in U.S. dollars.

Growth and rate outlook

The Canadian economy continues to operate close to potential, and growth composition is more balanced, says the MPR. For example, a positive sign is demand is shifting toward business investment and exports and away from consumption and housing.

Even so, consumption is expected to grow at a healthy pace, supported by rising wages.

Real GDP is projected to grow 2.1% this year and next, before slowing to 1.9% in 2020. Previous projections from July were similar at 2%, 2.2% and 1.9% for 2018, 2019 and 2020, respectively.

The BoC expects core inflation measures to remain at about 2%, in line with an economy operating at capacity. Recent increases in inflation are attributable to temporary factors, such as airline fairs, it says.

The MPR also says the effects of cannabis legalization on monetary policy (i.e., the economy) are likely to be small.

Two key factors monitored by the central bank, household indebtedness and housing activity, are "moderate" and "stabilizing," respectively, said the central bank in a release. "As a result, household vulnerabilities are edging lower in a number of respects, although they remain elevated."

Notably, the central bank removed the word "gradual" from its outlook for further hikes—a way to clarify that the pace of hikes isn't pre-ordained, senior deputy governor Wilkins said during a press conference.

That removal and today's more hawkish tone will likely be interpreted by markets, which the economic data don't warrant, said CIBC chief economist Avery Shenfeld in a report. He's less optimistic for consumer spending, which he expects will decelerate. He also expects residential investment to be negative for growth in 2019, relative to a slightly positive growth impetus from the central bank.

"The central bankers see the need to slow growth by a single decimal place to 1.9% by 2020 to contain inflation. So where's the case for a lot more rate hikes ahead?" he said in the report.

In emailed commentary, he added, "The tone today will push yields higher and be bullish for the [Canadian dollar]." He isn't changing his call for one more hike this year, in December.

5. Watchdog says Ottawa will run deeper deficits next few years

[October 23, 2018] The federal government is on track to run deeper deficits than it's been predicting for each of the next few years, says a new analysis released Tuesday by the parliamentary budget officer.

The watchdog also estimates Ottawa has just a 10% chance of balancing the federal books in 2021-22 and a 30% chance of seeing black ink in 2023-24.

The fresh projections come as Canada's fiscal trajectory comes under closer scrutiny with only a year to go before the next federal election. The fate of the budgetary balance is positioned to emerge as a major campaign issue.

The Conservatives have frequently criticized the governing Liberals for abandoning their 2015 vow to run only modest shortfalls of no more than $10 billion and to eliminate the deficit by 2019.

The federal bottom line has received a multibillion-dollar revenue boost over the last year thanks to the stronger economy and the Liberal government has channelled large amounts of the extra cash into new spending it argues will lift Canada's long-term growth.

The Liberals have no timetable to eliminate the deficits even though the economy is running close to full strength, which has raised concerns among some economists.

The report published Tuesday by Yves Giroux's office predicts Ottawa is on pace to post a $19.4-billion deficit in 2018-19, which is $1.3 billion higher than the Liberal government's projection in its budget last February.

Beyond this year, the watchdog says the annual shortfalls will be between $500 million and $2.8 billion bigger than the government's predictions. It anticipates deficits of $21.3 billion in 2019-20, $17.4 billion in 2020-21 and $14.8 billion in 2021-22.

The larger forecasted deficits are tied to recent changes in how the government calculates its pension liabilities—which have immediately raised Ottawa's direct program expenses—and to higher-than-anticipated increases in provisions for claims and litigation, the report said.

Last week, the government's latest annual financial documents showed Ottawa posted a $19-billion deficit last year—slightly smaller than the shortfall it predicted in the budget.

Giroux's report also examined the outlook for the economy.

It predicted major tax reform in the United States will not have a material impact on Canada's investment climate. The business community and senators have urged Ottawa to immediately cut corporate taxes north of the border to prevent Canada from falling behind on competitiveness.

The budget officer said that in the first half of 2018 global foreign direct investment flows into Canada totalled $26.8 billion, which are broadly in line with figures over the past five years.
Finance Minister Bill Morneau intends to announce plans in his fall economic update in the coming weeks to bolster Canada's competitiveness, but sources have said he's looking at targeted measures rather than broad-based corporate tax cuts.
On trade, the report warned negative changes will shave 0.25% from Canada's gross domestic product by 2022. Real GDP, it predicted, would contract by 0.5% if U.S. tariffs on steel, aluminum and other products—and Canada's retaliatory levies—were made permanent.
If they remain in place, the watchdog said Canada's duties on these imports are expected to generate additional revenue of $1.3 billion in 2018-19, $1.8 billion in 2019-20 and $1 billion per year, on average, thereafter.
Giroux doesn't expect the recent agreement-in-principle on an updated North American trade deal—also known as the USMCA—to have a big impact on the Canadian economy. But he noted the uncertainty over its future have dissipated.
"We continue to believe the most important downside risk is weaker export performance due to rising protectionism in global trade policies, which would dampen global trade and economic growth," his report said.

6. Sales of luxury homes fall 35% in Toronto and Vancouver

[October 23, 2018] Luxury home sales in two of Canada's most expensive markets are down from a year ago, as the high-end real estate market feels the effect of foreign buyers' taxes.
In an annual report, realty brokerage Re/Max says sales of single-detached homes priced from $1 million to $2 million fell 35% from a year ago in both Toronto and Vancouver.
Single-detached homes in the $2-million-to-$3-million range were down 50% in Toronto and 22% in Vancouver.
Homes that were sold for more than $3 million dropped 44% in Toronto and 45% in Vancouver.
Ontario and B.C. have introduced foreign buyers' taxes, while B.C. has also increased property transfer taxes and school taxes on homes over $3 million.
Although luxury home sales are weakening, sales in the low-end of the luxury condo market in the cities saw increases driven mainly by millennials who are

using their inheritances and baby boomers looking to downsize, the report said.

Condo sales in the $1-million-to-$2-million range were up 2% year over year in Toronto and 6% in Vancouver. Calgary saw condo sales in this price range jump by 3%, while Victoria sales climbed 19%.

The most expensive condominium sold in Toronto in 2018 so far was priced at $11.5 million, topping the $8 million that was paid for the most expensive condo sold in 2017. The priciest condo sold in Vancouver so far this year was $11.7 million, up 34% from the top price of $8.7 million paid last year.

Elton Ash, executive vice-president of Re/Max of Western Canada, said the tax on foreign buyers has impacted overseas activity, opening more opportunities for local buyers to enter the luxury market.

"As a result, local buyers are driving demand for luxury condos going into 2019, which is welcome news for developers in major city centres looking to build more properties," Ash said.

7. Freeland, Mexican minister noncommittal on U.S. lifting of tariffs

[October 22, 2018] Chrystia Freeland and Mexico's future foreign minister are noncommittal when it comes to when they expect the United States to lift its stinging tariffs on steel and aluminum products from their countries.

Canada and Mexico have responded to the American tariffs by imposing their own retaliatory levies on U.S. imports—and the dispute has failed to disappear even after the three countries reached an agreement-in-principle this month on an updated North American free trade pact.

Freeland, Canada's foreign affairs minister, offered no timeline Monday on when the U.S. will remove the duties as she fielded questions during a joint news conference in Ottawa alongside Marcelo Ebrard, Mexico's incoming foreign affairs minister.

"I'd love them to be lifted today—there is nothing at all stopping any of us from lifting these tariffs," Freeland said.

"We think that would be great further evidence of the importance of the North American partnership and that is what we're communicating very directly to our U.S. partners."

Ebrard, who will assume the foreign minister's portfolios Dec. 1 when Mexico's incoming government takes power, said through an interpreter that he thought the removal of the tariffs "might occur" once the new trade agreement is signed.

The meeting between Freeland and Ebrard was one of several meetings in Ottawa on Monday between the Trudeau government and Lopez Obrador's future cabinet ministers. They also sat down with International Trade Minister Jim Carr and Mexico's incoming economy minister, Graciela Marquez.

Prime Minister Justin Trudeau was scheduled to meet the Mexican officials later in the day.

Earlier this month, Canada, Mexico and the U.S. struck an agreement-in-principle on a new trade deal that narrowly beat a deadline imposed by the U.S. Congress. The aim was to get the deal fast-tracked and voted on by Dec. 1, ahead of Lopez Obrador's incoming government.

Asked how committed the new Mexican government is to approving the trade deal, Ebrard said, "We believe that it's not the very best agreement, but we do need to support the advances that have been made."

He added that the Mexican congress is examining the details under consideration.

"We believe that it's worth supporting the agreement, looking to the future of all three countries," said Ebrard, who offered no timetable as to when the deal could be ratified.

8. Wholesale sales edge down in August

[October 22, 2018] Canadian wholesale sales dropped slightly in August—a marginal pullback that shouldn't affect GDP forecasts, an economist said.

Wholesale sales were down 0.1% to $63.6 billion for the month, StatsCan reported. Sales dropped in four of seven subsections, representing 65% of total wholesale sales.

In volume terms, wholesale sales were down 0.1%.

August's biggest declines came from the building material and supplies (–2.3%) and motor vehicle and parts (–1.4%) subsectors. For the latter—and for the motor vehicle industry as a whole—the decline was the largest since November 2016, StatsCan said.

In contrast, the biggest gain came from the machinery, equipment and supplies subsector, up 2.2% to $13.3 billion. StatsCan said the monthly gain was the highest on record, led by higher sales in the computer and communications equipment and supplies industry.

The personal and household goods subsector declined 0.5% following two consecutive monthly gains.

In emailed commentary, CIBC economist Katherine Judge says Monday's economic data matched the bank's forecast, and is in line with its forecasted GDP for August. Market reaction should be limited, she added.

Have a nice and fruitful week!

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