This is the last issue for 2018. I wish to all of you

The next issue will be on January 5th 2019.

Weekly Updates Issue # 694

1. Weekly Markets Changes
2. Strong U.S. consumer supports Fed rate hikes
3. Canadian debt-to-income ratio inches higher in Q3
4. Toronto and Vancouver most vulnerable to interest rate hikes: CMHC
5. Business investment, other factors to weigh on Canadian economy in 2019
6. Progress stalls on gender equality: report
7. Big banks need to set aside more capital to prepare for turmoil: OSFI
8. Modest home price growth forecasted for 2019: Re/Max and Royal LePage
9. Ontario's deficit to reach $12.3B this year, financial watchdog says

1. Weekly Markets Changes

[December 15, 2018]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
14,595.07 -200.06 -1.35%	2,599.95 -33.13 -1.26%	24,100.51 -288.44 -1.18%	6,910.66 -58.59 -0.84%	$0.7474 -0.45c -0.60%	$1,239.02 -10.29 -0.82%	$51.20 -1.41 -2.68%

2. Strong U.S. consumer supports Fed rate hikes

[December 14, 2018] U.S. retail sales increased 0.2% in November, as strong sales tied to holiday shopping were offset by lower gasoline prices.
Excluding gas, the Commerce Department said Friday that last month's retail sales rose a healthy 0.5%—a positive sign for economic growth and future Federal Reserve rate hikes.

When the volatile auto component is also removed, retail sales in the control group that feeds more directly into GDP were up 0.9% for the month. That figure leaves fourth-quarter consumption tracking higher than previously thought, "and gives the Fed another reason to raise interest rates at its meeting next week," said CIBC economist Katherine Judge in a report.

Judge added that today's data is supportive for the U.S. dollar and negative for fixed income.

Derek Holt, vice-president and head of capital markets economics at Scotiabank, likewise said in a report that today's strong data should result in a hike on Wednesday, as well as "guide that further gradual hikes are to come in 2019."

He also said his long-run economic view remains unchanged: "I don't subscribe to the simplistic notion that the U.S. economy must go into recession simply because the expansion will be of record duration in about six months. […] There is plenty left in the tank for the U.S. consumer."

Retail sales details

Retail sales have climbed a solid 5.3% so far this year. In November, non-store retail sales—a category that includes internet brands such as Amazon—jumped 2.3%. Furniture stores, electronics stores and health stores also enjoyed a solid bump as the holiday shopping season went into full swing.

Americans have responded to an improvement in economic growth this year by spending more, especially online and at restaurants. Retail sales are an indicator that Americans have faith that the economy, with a half-century low unemployment rate of 3.7%, will continue to grow.

Yet the economic gains of the past year—buoyed by President Donald Trump's deficit-financed tax cuts—have not insulated retailers from broader long-term pressures. Sales at department stores have slipped compared with last year, while sales gains for automakers have been weak. General Motors recently announced layoffs for thousands of workers.

In November, gas stations trimmed retail sales. Service stations had a 2.3% drop in purchases last month. This was a reversal from October when higher gas prices, along with a short-lived bump in auto-buying, had helped propel broader retail sales gains of 1.1%.

The average U.S. price of regular-grade gasoline has plummeted 22 cents a gallon over the past three weeks, to US$2.51.

Those lower gas prices may have led Americans to spend more on themselves, or friends and family.

"The kick from the tax cuts is gone, but the huge and rapid drop in retail gas prices is freeing a great deal of cash at just the right time for retailers," said Ian Shepherdson, chief economist at Pantheon Macroeconomics.

Besides non-store retailers, the gains were fuelled by a 1.2% increase in purchases at furniture stores and a 1.4% growth in sales at electronics and appliance stores.

Core sales, which exclude autos, gas and building materials, have increased over the past two months at the fastest pace in two years, a reassuring sign for economic growth coming into the end of 2018.

3. Canadian debt-to-income ratio inches higher in Q3

[December 14, 2018] The amount Canadians owe relative to their incomes ticked higher in the third quarter even as the pace of borrowing continued to slow.

Statistics Canada said Friday that **household** credit market **debt** as a proportion of disposable income was **177.5%** in the third quarter on a seasonally adjusted basis. That compared with 177.4% in the second quarter.

In other words, Canadians owed nearly $1.78 in credit market debt, which includes consumer credit and mortgage and non-mortgage loans, for every dollar of household disposable income in the third quarter.

Priscilla Thiagamoorthy, economic analyst at BMO Capital Markets, said the health of Canadian balance sheets unexpectedly deteriorated in the quarter.

"But unlike in past quarters, the culprit is a weaker income backdrop rather than higher debt loads," Thiagamoorthy wrote in research note.

"While the decades-long consumer debt mania is finally easing, income growth now remains a concern, keeping household credit burdens a key headwind to the Canadian economy."

On an unadjusted basis, household credit market debt as a proportion of disposable income, excluding pension entitlements, increased to 173.8% in the third quarter from a revised 173.2% in the second quarter.

The household debt service ratio, measured as total obligated payments of principal and interest as a proportion of disposable income, was 14.5% in the third quarter, relatively unchanged from the previous quarter.

Household debt has been a key concern for the Canadian economy.

The Bank of Canada has been watching to see how well households have been adapting to higher borrowing costs as it has been raising its key interest rate target.

The central bank has hiked its trend-setting rate five times since the summer of 2017, moves that have pushed the prime lending rates at Canada's big banks higher.

Total credit market borrowing slowed for the third consecutive quarter as households borrowed $18.3 billion, down from $20.0 billion in the previous quarter.
Demand for mortgages posted a third consecutive quarterly decline as they decreased by $1.2 billion. Demand for consumer credit also fell by $500 million, while non-mortgage loans decreased by $100 million.
Credit market debt totalled nearly $2.19 trillion in the third quarter.
Mortgage debt stood at $1.42 trillion, consumer credit totalled $648.6 billion, while other loans amounted to $112.7 billion.

4. Toronto and Vancouver most vulnerable to interest rate hikes: CMHC

[December 13, 2018] Canadians living in two of the country's largest cities may find themselves more "vulnerable" to interest rate increases as personal debt levels in Toronto and Vancouver continue to hit record levels, warns a report by Canada Mortgage Housing Corp.
The housing agency says the debt-to-income (DTI) ratio for those living in **Vancouver** climbed to **242%** in the second quarter, which ended June 30.
That means that for every $1 of disposable income, $2.42 is owed. It was similarly high in **Toronto**, where the DTI is at **208%**.
This is the highest ratio recorded for both cities for any second quarter since 2015. Nationally, the DTI ratio is 171%.
A major contributor to increasing levels of indebtedness is mortgage debt, which accounts for two-thirds of all outstanding household debt in Canada.
CMHC says those with elevated debt levels could see their budgets stretched if interest rates continue to rise.
"While households may be able to service their debt during periods of low interest rates, some may face challenges when rates rise," it said in the report. "Highly indebted households have usually few debt consolidation options to respond to increasing debt service costs."
The report noted that higher interest rates means that households could see an increase in the amount required for debt repayment, which could exceed their original budgets.
"The increased debt payment burden may come at the cost of reduced consumption, decreased savings or opting to make lower repayments on the principal," it warned. "Some households might even default on their loans if their incomes are not sufficient to cover higher expenses and credit charges."
CMHC says this could lead to a ripple effect if households begin defaulting on their loans, and banks begin scaling back on the loans they give out.

"These negative effects could then impact other areas of the economy," it said. "Research has shown that recessions in highly indebted countries tend to exhibit a greater loss in output, higher unemployment, and last longer compared to countries with lower debt levels."

The report, which was based on an analysis with data from credit monitoring firm Equifax, Statistics Canada and the Conference Board of Canada, also noted that household debt levels vary widely, and have in fact, gone down in some of Canada's largest cities.

The DTI ratio has decreased in the Ottawa-Gatineau region, Halifax and Sherbrooke, Que. It is the lowest in Saint John, N.B., where it declined to 106% in the second quarter.

Household debt has been identified as a key vulnerability for the financial system by the Bank of Canada, which has raised its key interest rate five times since July 2017. The rate currently sits at 1.75%, with expectations that there will be another hike next year.

Since the Great Recession, the central bank has kept interest rates low to help stimulate the economy but that has also helped fuel hot housing markets in undersupplied regions such as Toronto and Vancouver.

5. Business investment, other factors to weigh on Canadian economy in 2019

[December 12, 2018] In 2018's latter half, slumping oil prices and higher interest rates weighed on Canada's economy, and will likely continue to do so in 2019, a series of economic reports say.

Globally and in the U.S., growth is also expected to moderate in the new year.

In an economic outlook report, RBC forecasts Canada's GDP growth to decrease to 1.7% in 2019, from 2% this year. Along with the headwinds of oil and interest rates, that outlook is based on a consumer slowdown, and modest increases in business investment and exports.

A National Bank report suggests business investment might be more disappointing in 2019 than expected, and highlights an economic measure released today by StatsCan: industrial capacity utilization rate. That's the ratio of the economy's actual output to potential output, which fell to less than 83% in Q3—the lowest in a year—due to declines in manufacturing, construction, and oil and gas.

"Most sectors now have lower utilization rates than before the Great recession of 2008-2009," says the National Bank report, adding that the Q3 measure doesn't bode well for investment spending.

Further, “Oil and gas, one of the rare sectors where utilization is higher than pre-recession levels, is unlikely to see much investment given depressed energy prices,” the report says.

On a more granular level, two of Canada’s western provinces are expected to diverge in growth next year, as Alberta is affected by oil production cuts in an attempt to address energy prices. RBC projects Alberta’s growth to decline to 1.5% from 2.4% this year.

Meanwhile, B.C.’s economy is expected to thrive as LNG Canada’s $40-billion natural gas project provides a significant boost to the province’s economy. RBC forecasts 2.6% growth for B.C. in 2019, jumping from 1.9% in its previous quarterly outlook. The higher pace of growth is likely to continue into 2020, says the RBC report.

A Conference Board of Canada report has a brighter outlook for Alberta. It forecasts GDP growth of 2.2% in 2019, but uncertainty in the province’s oil sector around prices, transportation and mandated production cuts could result in lower-than-projected growth.

Newfoundland is expected to lead the country in economic growth thanks to offshore oil royalties, the report says. Just a year after having the weakest economic outlook in 2018, the province’s real gross domestic product is expected to grow by 5.2% in 2019.

Prince Edward Island and British Columbia are also expected to see strong growth of 2.7% next year, according to the report, with P.E.I. benefiting from steady immigration and a booming tourism industry.

The think tank forecasts Canada’s growth at 2% in 2019.

For a closer look at provincial growth, see the Conference Board report, as well as this separate RBC report.

Global and U.S. outlook

The global economy also faces headwinds as accommodative monetary policy ends, and global trade tensions and political uncertainty continue. “The political backdrop is the most unsettled since the Cold War,” says the RBC report, which refers to populism and Brexit.

RBC forecasts the global economy to expand by 3.7% in 2019, matching the pace of the previous two years as past momentum tops out.

The bank expects the U.S. economy to continue to expand at an above-potential pace in 2019, at 2.5%, though tighter financial conditions will weigh on consumers and business investment.

Also, growth of global exports and imports will likely slow as a result of tariffs, says the report, and the strong U.S. dollar will weigh heavily on demand for U.S. exports. While costs associated with tariffs will initially be

absorbed by businesses, they will likely filter into consumer prices the longer they remain in place, it adds.

6. Progress stalls on gender equality: report

[December 12, 2018] Despite securities regulators' efforts to promote women's representation in the boardrooms and executive offices of Canadian public companies, a survey by PricewaterhouseCoopers LLP (PwC) published Tuesday finds that progress has stalled.

For the fifth year in a row, Canada continues to rank 10th out of 33 countries in terms of progress on gender equity, according to PwC's Women in Work report.

According to the global survey of over 3,500 professional women between the ages of 28 and 48 across all sectors—including close to 250 Canadian participants—Canada continues to face a larger-than-average gender pay gap, says the report, with women earning an average $0.87 for every dollar earned by men.

The survey suggests there is room for progress:

- 35% of Canadian respondents believe demographic factors such as gender, ethnicity, age and sexual orientation can be barriers to career progression;
- 36% believe participating in programs designed to facilitate work-life balance can negatively affect their careers; and
- fewer than half believe that their companies are doing enough to improve diversity (48%) or treat men and women equally when it comes to promotions (46%).

These latest findings follow research earlier this year from the Canadian Securities Administrators (CSA), which found incremental progress toward greater female representation on corporate boards and executive suites, and that gender parity remains a long way off. Specifically, the CSA research found that just 4% of CEOs are female at the 648 issuers it reviewed, and just 15% of board seats are held by women.

"There's mounting evidence to suggest a diverse workforce leads to more innovation and stronger financial results," says Jean McClellan, national leader, people and organization practice at PwC Canada, in a statement. "Creating an environment where women thrive makes good business sense. However, the survey's results show that there's still work to do in Canada."

McClellan adds, "The takeaway for employers from the report is that every step toward achieving greater gender equality will pay off. Through initiatives such as increased transparency and communication related to promotion and

pay criteria, sharing data on the current state of diversity and inclusion (D&I), measuring results and making the necessary adjustments to their D&I strategy, employers will reap the benefits of more trusting and satisfying relationships with their employees."

7. Big banks need to set aside more capital to prepare for turmoil: OSFI

[December 12, 2018] Canada's big banks should be setting aside additional capital in preparation for future economic turmoil, the Office of the Superintendent of Financial Institutions (OSFI) announced Wednesday.

OSFI has raised the level for the domestic stability buffer for domestic systemically important banks' (D-SIBs) to 1.75% of total risk-weighted assets (RWA), effective April 30, 2019. The buffer was previously set at 1.5% of RWA.

OSFI's decision to increase the D-SIBs buffer is based on its assessment that systemic vulnerabilities "remain elevated," even as economic conditions remain accommodative, the banking regulator says in a news release.

"While Canada is currently in the midst of a favourable credit environment with a stable domestic economy, household debt levels continue to be high relative to incomes and uncertainty persists in some housing markets. Corporate indebtedness is also growing, representing a potential future risk," says OSFI.

Banks should be setting aside capital so that they can weather a deterioration in economic conditions without being forced into asset sales or a drastic reduction in their lending activity, the regulator says. The D-SIB buffer is to range between 0 and 2.5% of a bank's total RWAs and must be met with tier 1 common equity.

"In light of positive credit performance and generally stable economic conditions, now is a prudent time for banks to build resilience against future risks to the Canadian financial system," says Jamey Hubbs, assistant superintendent, deposit-taking supervision sector, OSFI, in a statement.

8. Modest home price growth forecasted for 2019: Re/Max and Royal LePage

[December 11, 2018] Home prices across the country are expected to rise in 2019, but only at a moderate pace compared with recent years, according to two of Canada's largest residential real estate brokerages.

Royal LePage is anticipating the national median home price will increase by 1.2% in 2019, with prices in Toronto and the surrounding areas expected to rise 1.3% to $854,552.
Home prices in Greater Vancouver are forecast to go up by just 0.6% to $1.29 million, while home prices in Montreal and the nearby region are expected to see the largest rise out of Canada’s biggest cities, with home prices anticipated to jump 3% to $421,306 in 2019.
Royal LePage CEO Phil Soper said the national housing market is expected to remain in a “correctional cycle” that began this year, with home prices appreciating at a “snail’s pace.”
“Markets aren’t perfect. They overshoot and then they must correct,” he said in a statement.
The Royal LePage report blamed the “tepid pace” of price growth on a number of factors including rising interest rates, global trade risks and the low price of Canadian crude.
It noted that would-be buyers who had for years been shut out of hot markets in Toronto and Vancouver may have a bigger opportunity to purchase in 2019. It says it expects a jump in sales activity come spring.
Meanwhile, in a separate report Tuesday, Re/Max said it expects average home sale prices to go up by 1.7% in the new year.
It also anticipates housing markets across the country will stabilize as Canadians feel a bigger impact from higher interest rates.
“Demand isn’t as strong as it was in the past but it is still very, very strong,” said Christopher Alexander, executive vice-president and regional director of Re/Max of Ontario-Atlantic Canada.
“The government has said it may not be as conservative with raising rates as they have been in the past. That’s why there’s uncertainty. People don’t really know what to expect.”
Re/Max expects average home sale prices in Vancouver to fall 3% next year, after increasing 2% this year.
The report forecasts that some smaller cities outside of the big urban areas will see large price growth, with London, Ont., leading with a projected increase of 17%, followed by Chilliwack, B.C., and Windsor, Ont., at 13%.
Alexander said a more stable real estate market is positive for both buyers and sellers.
“The threat of a bubble bursting isn’t around the corner, and at the same time, there is going to be a little bit of an appreciation so people will get a return on their investment,” he said.
“We’re in healthy territory right now and homebuyers and sellers can feel confident that the market shouldn’t go too drastically in either direction.”

9. Ontario's deficit to reach $12.3B this year, financial watchdog says

[December 11, 2018] Ontario's financial watchdog says the province's deficit will rise to $12.3 billion this fiscal year, half a billion more than he predicted before the spring election.

Financial Accountability Officer Peter Weltman says policy decisions such as cancelling the cap-and-trade program and reversing several tax increases, combined with a weaker economic forecast, contributed to the change.

In his fall economic and budget outlook, Weltman says that without further policy changes, the deficit is expected to exceed $16 billion by 2022-23.

He says that while the government's fall economic statement did not include a budget forecast beyond this year, balancing the books in one mandate would require "significant changes" to policy that could have wide-ranging impacts on Ontario households and businesses.

The FAO's spring report, issued just weeks before the provincial election, said the province's deficit would jump to $11.8 billion in 2018 as a result of higher spending in the budget presented by the then-governing Liberals, as well as weak revenue gains.

The Liberals had projected a deficit of $6.7 billion, a figure that was also called into question by Ontario's auditor general.

The Tories have since accepted the auditor general's accounting but said a commission of inquiry and financial review convened to examine government spending found the province's deficit will grow to $15 billion this year.

They said this fall that various savings measures had brought that number down to $14.5 billion.

The FAO says its projections do not include any election promises that the government has yet to act on or announce.

Have a nice and fruitful week!

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