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1. Weekly Markets Changes

[February 22, 2019]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,013.01 +174.77 +1.1%	2,792.67 +17.07 +0.62%	26,031.81 +148.56+0.57%	7,527.55 +55.14 +0.74%	$0.7591 +0.53c +0.70%	$1,329.40 +6.91 +0.52%	$57.26 +1.67 +3.00%

2. Increase in HELOCs poses potential vulnerability, DBRS warns

[February 22, 2019] Policymakers have long been concerned about Canada’s household debt levels, largely thanks to overheated housing markets, but the growth in home equity lines of credit (HELOCs) is also worrying, says DBRS Limited.

In a new report, the rating agency highlights the risk that may be lurking for the Canadian banks in the growth of HELOC borrowing, which now represents about 11.3% of total household credit, up from 10.7% in January 2017.

DBRS says that HELOCs have been growing faster than residential mortgages over the past year, “as financial institutions have increasingly promoted products that combine a HELOC with a traditional mortgage.”

In these products, available credit under the HELOC increases as the mortgage is paid down, DBRS explains, making it easy for households to increase their borrowing. As such, HELOCs could “induce already highly leveraged Canadian consumers to increase their leverage,” it says.

Increased leverage in combination with rising rates would result in an “amplified shock” to consumers, it says.

The rating agency also points out that, because HELOCs allow borrowers to consolidate high debt loads, lenders may have difficulty identifying emerging credit problems, which could contribute to systemic vulnerabilities.
Further, HELOC borrowers are susceptible to a housing market correction, since the line of credit is secured by the residential property. “Borrowers could find themselves with a debt load that exceeds the value of their home,” the report says.
DBRS estimates that the large Canadian banks had a total of about $120 billion in undrawn HELOC commitments as of Oct. 31, 2018, in addition to $243 billion in outstanding HELOC balances.
Despite the concerns raised in the report, the agency views the big banks as “well positioned to absorb higher levels of credit losses.”

3. Feds post $300M surplus in first 9 months of fiscal year

[February 22, 2019] A preliminary analysis of the federal books says the government ran a budgetary surplus of $300 million through the first nine months of the fiscal year.
The surplus is an improvement compared with the April-to-December period in 2017-18, when Ottawa posted a deficit of $8.9 billion.
The Finance Department’s latest fiscal monitor says overall revenues were up $19.3 billion, or 8.7%, compared with the same period last year, due in large part to higher revenues from taxes and incoming employment insurance premiums.
The report says program expenses were up $8.4 billion, or 3.9%, compared with the same nine-month stretch last year, because of increases in major transfers to individuals and other levels of government, and due to an increase in direct program spending.
The fiscal monitor also said public debt charges rose $1.7 billion, or 10.3%, mostly due to the higher effective interest rate on government debt and the higher inflation adjustments on real return bonds.
Last November, the Liberals’ fall fiscal update predicted the government was on track to run annual shortfalls of $18.1 billion in 2018-19, $19.6 billion in 2019-20 and $18.1 billion in 2020-21.

4. Retail sales edge down 0.1% in December

[February 22, 2019] Retail sales edged down 0.1% to $50.4 billion in December, StatsCan reported today. Lower sales at gas stations were partly offset by higher sales at motor vehicle and parts dealers, it says.

Economists had expected a contraction of 0.3% for the month, according to Thomson Reuters Eikon. In a report, Royce Mendes, senior economist at CIBC Capital Markets, said the modest surprise was "somewhat supportive" of the loonie today.

Excluding gasoline stations, retail sales increased 0.4%.

Sales at gas stations fell 3.6% in December, and sales at motor vehicle and parts dealers rose 1.0%, led by a 1.2% increase at new car dealers.

Sales at electronics and appliance stores decreased 4.0%.

In volume terms, retail sales increased 0.2%. That modest increase is enough to move monthly GDP tracking forecasts out of negative territory, Mendes said. CIBC will be looking for a flat reading for December's GDP (to be released next Friday) and just below 1% growth for the fourth quarter of 2018.

StatsCan says retail sales declined 0.5% for the fourth quarter. The drop follows a 0.7% increase in the third.

Despite the stance by the governor of the Bank of Canada that interest rates will be headed higher at some point, a hike likely isn't imminent (the next rate announcement is March 6). Soft readings for interest-rate-sensitive sectors such as consumer spending and housing will leave the central bank standing pat on rates "for some time," Mendes says in the report. CIBC forecasts one rate hike from the central bank in 2019, in the third quarter.

5. Upward path for interest rates 'highly uncertain': Bank of Canada governor

[February 21, 2019] The country's road to higher interest rates is "highly uncertain" as the Bank of Canada monitors evolving unknowns related to indebted Canadians, stricter mortgage rules, business investment and global trade, governor Stephen Poloz said Thursday.

In a speech in Montreal, Poloz said he expected the benchmark rate to eventually rise above its current level of 1.75%, but how long it takes to get to its likely destination of between 2.5% and 3.5% is the part that remains to be seen. The destination is also referred to as the bank's neutral range.

"As we said at the bank's most recent interest rate announcement, we judge that we will need to move our policy rate up into a neutral range over time, to a point where it is not stimulating or constraining economic growth," Poloz told the Chamber of Commerce of Metropolitan Montreal.

"However, the path back to that neutral range is highly uncertain. We will watch the data as they come in, and use judgment to deal with the uncertainties and manage the associated risks."

The bank's neutral range is an estimate of the preferred level for the interest rate when the economy is operating at full capacity and when inflation is within its target zone of 1% to 3%.

For now, Poloz noted that the rate is low enough, at its below-inflation level of 1.75%, that it's continuing to deliver stimulative effects to the economy. Statistics Canada's December inflation reading was 2%.

Poloz said the central bank will scrutinize incoming data to watch how several important uncertainties unfold.

They include, he added, the evolution of the impact of higher interest rates on indebted Canadians, how housing markets adjust to higher borrowing costs and stricter mortgage guidelines, whether business investment picks up its pace and the "highly uncertain" global trade environment.

The improved economy has encouraged the bank to raise its key interest rate five times since mid-2017 to keep inflation from creeping up too high—but it hasn't introduced an increase since last October.

"We've been at the same interest rate since last October precisely because the data have been giving us some mixed messages," he told reporters following his speech.

"As we've said over and over, we're data-dependent. So, it depends on how the economy delivers."

Poloz has said the central bank will likely continue hiking rates once the economy builds new momentum following a soft patch largely caused by unexpectedly weak oil prices in late 2018.

He made a point Thursday of saying that Canada's labour market remains "extremely strong" and wages are showing improvement outside of oil-producing provinces. Business sentiment indicators have also been encouraging, he said.

The bank's next interest-rate announcement is March 6—and many market watchers expect Poloz to leave the benchmark untouched until late this year.

The governor's speech also walked the audience through the power and the limitations of the bank's main policy tool: the key interest rate target.

He shared an example on what would have likely happened if the bank hadn't introduced five quarter-point increases to bring the rate up to 1.75%.

"If we had kept our interest rate at 0.5% from mid-2015 until now, our models tell us that we would have seen stronger economic growth—no surprise there," Poloz said.

"By now, the level of [the growth domestic product] would be about 2% higher than it is today."

However, he added that while such an increase may sound good, it would have pushed inflation to the top of the bank's inflation range, and likely even higher.
The bank would have then been compelled to raise rates "forcefully" to guide inflation back to its target over the next year or two, Poloz said.
With lower rates over a longer period, he added every Canadian would have likely amassed about $2,000 more in additional debt.

6. US tariffs could cost German automakers $7 billion a year

[February 21, 2019] US tariffs could cost German automakers $7 billion a year, but they will hurt more than just car factories.
President Donald Trump has less than 90 days to decide whether to impose tariffs of up to 25% on vehicle imports, a threat that has unnerved automakers in the industrial powerhouse of Germany.
The tariffs would cost Volkswagen €2.5 billion ($2.8 billion) a year in profit, according to Evercore ISI. BMW earnings would be reduced by €1.7 billion ($1.9 billion) and Daimler would take a €2 billion ($2.3 billion) hit.
Volkswagen CEO Herbert Dies told the Financial Times the estimate is about right.
"In the worst-case situation, that would probably be close to the real figure," he told the newspaper in an interview. BMW and Daimler, the owner of Mercedes-Benz, declined to comment on the figures.
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With cars making up roughly 30% of all German exports to the United States, the broader economic impact promises to be severe.
Germany's Ifo Institute for Economic Research said last week that 25% tariffs would send annual German car exports to the United States plummeting by about 50% within a decade, from €34 billion ($38 billion) to €17 billion ($19 billion). Last year, the institute calculated that the tariffs would knock 0.16% of Germany's GDP.

Global pain

Other countries would also be hurt. Almost half of all cars sold in the United States are made outside the country, mostly in Mexico, Canada and Japan.
Ifo estimated that Mexico would see its GDP decline by 0.39% as a result of the US tariffs. Canada's GDP would drop 0.23% while Japan's would fall 0.1%.

Auto tariffs would probably spark a much bigger conflict between Europe and the United States, because of the importance of the sector to the European economy.

Vehicles currently accounts for 10% of total trade between the two regions, according to ACEA, the European Automobile Manufacturers Association. The jobs of more than 13 million people, or 6% of all employees in the European Union, depend on the industry.

"Such tariffs, to which the European Union would respond in kind, would be a massive escalation of the trade tensions between the two biggest economic powers of the world," said Holger Schmieding, chief economist at Berenberg. "They could severely damage economic growth on both sides of the Atlantic."

US consequences

Trump has threatened tariffs on not just foreign-made vehicles, but auto parts made abroad, too. American automakers, who use imported parts in almost every model, say the cost of production would go up.

Research from the Center for Automotive Research based on figures from the National Highway Traffic Safety Administration shows that a typical car made in the United States has 40% to 50% of its parts imported.

The tariffs would increase the price of an American-made vehicle by an average by $2,750, according to the Center for Automotive Research.

American consumers could also face higher prices on other goods as the result of EU retaliation. Trade between the European Union and the United States is bigger than between the United States and China.

"In commercial terms, the European Union could hit back at the United States much harder than China could," Schmieding said.

7. Fed’s minutes note rising threats to economy

[February 20, 2019] Federal Reserve policymakers last month noted greater threats to the U.S. economy, ranging from adverse effects of the government shutdown to rising trade tensions, and opted to emphasize that they would be “patient” in raising interest rates.

Minutes of the Fed’s discussions in January showed that Fed officials also felt that further rate hikes might be needed only if inflation were to accelerate.

The minutes showed that Fed officials believe a “patient approach” to rate hikes would give them more time to assess the economic impact of President Donald Trump’s trade battles with China and other countries, as well as the severity of a developing slowdown in global growth.

In emailed commentary, Royce Mendes, senior economist at CIBC Capital Markets, noted that some Fed officials still believe the most likely path for rates is higher—if the economy evolves as expected.
“While that’s not exactly a resounding consensus, it is slightly more hawkish than market discussions recently,” Mendes said.
As a result of that slight hawkishness, investors are “bidding up the greenback and pushing yields at the short end a little bit higher,” Mendes said.

8. CRA opens 2018 tax filing season

[February 19, 2019] The Canada Revenue Agency (CRA) says it has no plans to eliminate paper income tax returns, even as it reports that close to 90% of all returns submitted last year were received in digital format.
“It’s really about not leaving anyone behind and making sure everyone has access to interact with us in as easy or straightforward manner as possible,” said Gillian Pranke, deputy assistant commissioner in the assessment, benefit, and service branch of the CRA, in a media briefing on Tuesday.
This week marks the official opening of the 2018 tax season, where the CRA begins the process of processing income tax returns.
This year, the CRA says it mailed paper-format income tax packages to 1.7 million individuals who had filed their returns in paper format last year. A limited quantity of 2018 tax packages are also made available at Canada Post and Service Canada outlets, as well as Caisse Populaire Desjardins locations in Quebec. Canadians can also find information on how to order packages by phone or online from these locations, should they not be available, the CRA says.
New for this year, the CRA has merged the paper tax forms and guides into a single “all in one” tax package, featuring simplified language, enhanced information on forms, and a more “user-friendly” design.
The CRA says it encourages Canadians to file their returns in the manner that suits them best, including online, by paper or by phone, for those who are eligible. “What’s important to us is to make sure that the tax filing is as simple as straightforward as possible,” Pranke says.
Among the reasons that individuals might still choose to file by paper is longstanding habit, perceived concerns around privacy, or a lack of access to technology, says Evelyn Jacks, a tax specialist and founder and president of Winnipeg-based The Knowledge Bureau. “We assume that all people in Canada have access to a computer, but they don’t,” says Jacks.
The CRA says it provides tax service to more than 27 million filers, and that the trend toward digital services continues to rise each year.

For the 2017-18 fiscal year, 96% of tax returns were processed within two weeks of receiving of the CRA receiving a digital return or eight weeks of receiving a paper individual income return, the agency says.
The CRA also says it is improving services at its call centres after receiving complaints from Canadians about wait times and quality of service. The agency will now provide estimated wait times if an agent is not immediately available, and it has improved training for call centre agents.
The CRA is also expanding its new dedicated telephone service (DTS) for tax preparers to provide answers to complex questions about the Income Tax Act as they prepare returns and give tax advice to their clients. The DTS was started as a pilot project in July 2017 for chartered professional accountants in Ontario and Quebec. It has now been expanded nationally and is available to CPAs, as well as non-CPA employees, including accounting clerks, lawyers, and notaries. The DTS is available to small and medium-sized income tax service provider who register with the CRA for the service.

9. How US sanctions on Venezuela are rippling through oil markets

[February 19, 2019] US sanctions on Venezuela's national oil company have accelerated the unprecedented collapse of its oil output and set off a domino effect in the global energy market.
The sanctions, which were announced on January 28 in a bid to speed up Nicolas Maduro's exit, have sent US Gulf Coast refineries scrambling to find alternate sources for the heavy crude they once relied on from Venezuela.
And Venezuela, which as of last fall was the No. 4 crude importer to the United States behind only Canada, Saudi Arabia and Mexico, has been forced to find new customers and new ways to dilute its very heavy crude to ready it for export.
"Sanctions are already having a crippling effect on oil supplies," Ryan Fitzmaurice, energy strategist at Rabobank, wrote to clients in a report last week.
Heavy crude is typically cheaper than light crude, but demand for it has become so intense that it's suddenly trading at a premium to lighter barrels. US Gulf Coast refiners, led by Citgo, Chevron and Valero, blend heavy crude with lighter barrels found in US shale oilfields to churn out gasoline, diesel and jet fuel.
Meanwhile, Venezuela's government, which relies on oil exports for 90% of its revenue, is searching for other customers for its crude. Venezuela's oil

minister Manuel Quevedo traveled to India last week in an apparent bid to drum up support.
"They're scrambling to find buyers for their crude," said Matt Smith, director of commodity research at ClipperData.
Double-whammy for Venezuela
Venezuela is in the throes of a massive humanitarian crisis. Millions of people are unable to get basic supplies, which has lead to starvation and illness.
The country's oil industry, its main source of income, is in sharp decline. Venezuela's oil production plummeted from 2.4 million barrels per day in 2015 to just 1.34 million at the end of 2018, according to research firm Rystad Energy.
"This freefall is poised to carry over into 2019," Rystad analysts wrote in a recent report.
US sanctions are a double-whammy for Venezuela.
Not only was the United States Venezuela's No. 1 customer, but it was the country's main source of naphtha, the liquid hydrocarbon mixture used to dilute crude. Without it, Venezuela's heavy crude can't be readily transported.
Rystad Energy forecasts that some operators in Venezuela will run out of diluent by March.
US oil prices are up almost 5% since the sanctions were announced. Brent, the global benchmark, is up 8%. But analysts don't believe Venezuela is the main reason for the run-up in crude. Instead, they point to OPEC's deeper-than-expected production cuts, turmoil in Libya and the bullish tone in global financial markets as recession fears fade.
"The rally has mostly been driven by the OPEC-plus cuts," said Artyom Tchen, Venezuela expert at Rystad Energy. "Most of the Venezuelan risk had already been priced in a long time ago."
Saudi Arabia, another major source of heavy crude, has been especially aggressive in slashing shipments to the United States. Analysts say that's because America's transparent and timely data make those cuts immediately clear to oil traders.
"That's where they get the most bang for the buck," said Smith.

'Contingency planning'

US Gulf Coast refiners are trying to find ways to replace Venezuela's barrels.
Earlier this month, Chevron CEO Mike Wirth said the company activated "contingency planning" to maintain supply at its Pascagoula, Mississippi, refinery, which ran on an average of 70,000 barrels per day of crude from Venezuela.

"We are actively working to ensure we continue to supply top quality fuels and lubricants to our customers in the United States," Chevron said in a statement to CNN Business.

Valero has stopped bringing in crude from Venezuela altogether, and has been substituting it with oil from other North American locations. Prior to the sanctions, Valero received one-fifth of its heavy crude from Venezuela.

"We're certainly hopeful that we'll see prompt resolution to the crisis, not only for the benefit of the crude markets, but for the welfare of the people of Venezuela," Gary Simmons, senior vice president of supply and international operations, told analysts January 31.

Western oil companies that partnered with PDVA have gotten caught in the middle.

France's Total recently said its bank accounts were blocked. The company also evacuated its foreign workers from Venezuela, Reuters reported. Total did not respond to a request for comment.

Chevron said that its operations in Venezuela continue and the company is "committed to the country's energy development in compliance with all applicable laws and regulations."

Citgo Petroleum, the Houston-based refiner owned by PDVSA, has put on hold a $685 million refurbishment to a refinery in Aruba because of the US sanctions, Reuters reported Monday.

Venezuela's freefall to continue

The oil world is bracing for the historic collapse of Venezuela's oil output to deepen because of the crisis and US sanctions.

"Maduro is looking unlikely to go without a fight — setting the stage for a prolonged power struggle that will likely lead to sustained production declines if history is any guide," Fitzmaurice said. "We remain highly convicted that prices are undervalued given the current supply uncertainty,"

Rystad Energy expects Venezuela's oil production will decline from 1.34 million barrels per day in 2018 to just 1 million barrels this year and 890,000 barrels in 2020. If Venezuela is unable to offset the impact of US sanctions and secure new financing, production there could slide to 680,000 barrels per day in 2020, Rystad said.

It's a stunning decline given that Venezuela has more proven oil reserves than any other nation on the planet.

Have a nice and fruitful week!

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