Weekly Updates Issue # 547

1. Weekly Markets Changes

[January 15, 2016]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
12,073.46 -372.0 -2.99%	1,880.33 -41.70 -2.17%	15,988.08 -358.4 -2.19%	4,488.42 -155.2 -3.34%	$0.7057 -1.82¢ -2.58%	$1,088.60 -15.50 -1.40%	$29.70 -3.18 -9.67%

2. Why another rate cut will fail

[January 15, 2016] Investors should brace for another rate cut from the Bank of Canada.

BoC Governor Poloz has hinted he’s ready to make a move. In a December policy update, he dropped the Bank’s effective lower bound for its policy rate from +0.25% to -0.5%. So, in the event of “another major negative shock,” the Bank can “move [the] policy rate below zero to encourage spending.”

Since then, oil prices have weakened further while manufacturing is still in the doldrums. Plus, the Bank’s latest Business Outlook Survey was bleak. Not only are surveyed businesses as pessimistic as they were in 2009, but ripples from the oil shock have now spread to non-oil producing regions and sectors that are tied to the energy supply chain.

Investors should be concerned. Last year’s oil weakness began in the summer, which gave the Bank ample time to decide to cut rates—and it made the right call. This time, the BoC’s only had a few weeks to consider the impact of $30 oil, so a third rate cut would be even more reactive and would only serve to bring us closer to 0% rates.

There'd be little payoff to such a move. Prab Sagoo, associate director at Nasdaq Advisory Service, notes, "Rates are already so low, while consumer debt is high. When Poloz cut from 0.75% to 0.5%, the movement wasn't very effective because few changes were made to banks' lending. Banks were already under pressure, and a further cut could weigh on profit margins" if banks felt compelled to pass those rates through to consumers.

Still, Poloz's early January speech about U.S. monetary policy repeatedly stressed the BoC will run an independent policy "anchored by [its] inflation target." Since then, inflation and growth expectations have both fallen. Also, he hammered home that the Bank isn't afraid to do what it takes to stabilize the economy.

Most economists are predicting the BoC will ease rates. And, in a recent research note, CIBC World Markets economist Avery Shenfeld notes markets have also priced in more than one cut before mid-2016. Such predictions will mitigate the shock.

If Poloz stands pat, we can be sure of one thing: The Bank will remain dovish, and depress the loonie in hopes the so far elusive pick-up in exports and manufacturing will materialize. It also wants to keep credit cheap and hold off a bond sell-off.

When the Bank releases its January MPR, look for further explanation of the funding-for-credit program that was mentioned in a December BoC report. That program would allow the BoC to provide credit to significant markets, such as the energy sector. But, Sagoo says, it "would be used sparingly to stop further weakness and stabilize business sentiment. It would be a short-term measure that could be used from six months to a year."

Poloz is in a tough spot, but has two choices: he can reactively lower rates with little effect, or can start 2016 by properly weighing how best to leverage policy tools to support the economy.

3. December home sales down in four markets

[January 15, 2016] The Canadian Real Estate Association says sales through its MLS system in December were down 0.6% from November.

The association says sales were down from the previous month in slightly more than half of all local markets.

Sales were down in Calgary, Edmonton, York Region and Hamilton-Burlington.

Compared with December 2014, sales for the final month of 2015 were up 10%.

The national average price for a home sold in December was $454,342, up 12% from a year ago, boosted by gains in the Vancouver and Toronto regions.

Excluding Greater Vancouver and Greater Toronto, the average price was $336,994, up 5.4% from a year ago.

4. Poloz will cut: BMO

[January 14, 2016] The odds that the Bank of Canada will lower its key interest rate next week are rising, with some of the country's big banks now predicting a rate cut.

Economists at the Bank of Montreal joined what is a growing chorus of analysts Thursday in predicting the central bank will cut its key interest rate next Wednesday when it releases its updated forecast for the economy.

The Bank of Montreal cited low oil prices, a weak business outlook survey and recent comments by governor Stephen Poloz as reasons for its new forecast.

"The Business Outlook Survey showed the lowest investment and hiring intentions since the Great Recession," the Bank of Montreal said in a research note Thursday.

"The commodity sector's pain is spreading to the domestically-focused, non-resource parts of the economy, trumping the gains in non-commodity exports to the U.S."

The key overnight rate sits at 0.5%, and expectations that the Bank of Canada will cut its rate target have been gaining momentum with the low price of oil.

TD Bank said Wednesday it was an "exceptionally close call" but predicted a rate cut.

Meanwhile, CIBC chief economist Avery Shenfeld said Thursday the odds have tilted in recent days and "are now ever so slightly on the side of seeing a rate cut in January, or April at the latest."

"That's not based on a recommendation to do so," Shenfeld said.

"At this point, we're concerned about risks of a runaway C$, believe the currency to be weak enough to do the job on the trade side, and see little if any benefit in terms of generating more debt financed private sector activity."

Desjardins senior economist Jimmy Jean noted the federal government may be speeding up infrastructure spending plans in an effort to boost the ailing economy.

“What is shaping up is a scenario where the government picks up the baton from the central bank,” Jean wrote in a note to clients.
“This adds to the current stimulation offered by the currency, making a sufficiently strong case for the Bank of Canada to remain on the sidelines next week.”
The Bank of Canada cut its key interest rate twice last year in an effort to cushion the impact of falling oil prices on the economy.
By cutting its target for the overnight rate, the central bank is trying to push down the interest rates charged by Canada’s big banks, making it cheaper for companies to borrow money to grow their businesses.
A cut also likely means lower interest rates for variable rate mortgages, lines of credit and other loans based on the prime rate, likely to boost consumer spending.
But the banks have not passed on the full savings of the Bank of Canada’s most recent rate cuts to consumers.

5. Russia says cuts are needed to avoid a crash

[January 13, 2016] Russia’s leaders are warning the government will need to make more cutbacks if the nation is to avoid a repeat of the 1998 financial crash, the country’s biggest post-Soviet economic trauma.
The economy, which is heavily reliant on its massive oil and gas industry, is getting hammered by the plunge in global energy prices. State revenues are running dry and the cost of living is soaring for Russians as the currency drops.
Faced with the prospect of the economy languishing in recession in an election year, the government sought Wednesday to manage expectations.
“Our task is to bring the budget in line with new realities. If we don’t do that, then the same thing will happen as in 1998 and 1999, when the people pay through inflation for what we haven’t done,” finance minister Anton Siluanov was quoted as saying by state news agency Tass.
At the time, Russia devalued its currency and defaulted on its debts, events that caused inflation to jump to around 85%. Analysts say Russia’s situation is not as dire now, as it has very little debt. But its economic prospects grow darker as energy prices drop.
The IMF forecast in November that the Russian economy would shrink by 0.6% in 2016. Since that estimate was made, oil has dropped almost another 40%, to about US$30 per barrel. The Russian budget drawn up in October is based on oil at US$50 a barrel.

That leaves few opportunities for the government's traditional largesse to voters ahead of September's parliamentary elections, a key test for the ruling United Russia party, which has much lower levels of popularity than President Vladimir Putin's soaring personal ratings. The last legislative elections in 2011 saw United Russia win a majority but were dogged by allegations of electoral fraud that led to street protests.

In a warning against "populism" at a conference in Moscow, Prime Minister Dmitry Medvedev tried to temper hopes for the future.

Quoting former British Prime Minister Margaret Thatcher, he said "there can be no liberty without economic liberty," before adding: "However, liberty does not come without responsibility … It's always nice to make promises about a bright future, but promises must be kept."

As Russia burns through once-ample cash reserves, the budget adopted in October increasingly seems a relic.

"If the oil price continues to fall, the parameters of the budget will require correction," Medvedev said. "That needs to be understood. We need to prepare for the worst-case scenario, as other countries are doing."

Following 10% cuts in most budget areas in 2015, with a few exceptions such as military spending, further reductions will be a test of public support for the government. Alexander Zhukov, a senior United Russia figure who is also deputy speaker, said Wednesday the axe would likely fall first on investment projects, something he said was "deeply unpleasant" but necessary to avoid painful cuts to social spending.

Consumer price inflation was over 12% last year, accompanied by increasing cases of unpaid wages and particular concern over rising food prices pushed up by Russia's ban on food imports from the European Union and other countries.

On the opening day of the Gaidar Forum in Moscow, traditionally a start-of-year showcase for Russian government policy following the 10-day New Year break, there was a mood of grim endurance.

Leading figures did not echo the assurance that Putin regularly made in the fall that "the peak of the crisis is behind us," instead focusing on the challenges yet to come. Low energy prices are the "new normal," Economic Development Minister Alexei Ulyukayev said.

Ulyukayev said that the budget deficit could hit 7.5% of GDP in 2016 because of the low oil price, compared to a planned deficit for 3% outlined in the budget, in comments reported by RIA Novosti.

To raise funds, privatization of state-owned banks and oil company Rosneft has been discussed, though similar ideas have been raised in the past to no avail.

6. No real estate crash, but slowdown coming

[January 13, 2016] Canada's residential real estate market showed strong growth in the fourth quarter of 2015, led by hot Vancouver and Toronto markets, finds Royal LePage.

In 2016, the real estate company expects continued price increases in most markets, but not at the pace that has been the recent norm. Instead, the national real estate market is expected to slow later this year, principally due to the effects of a dampened economy in Western Canada and eroding affordability in Toronto and Vancouver.

The Royal LePage National House Price Composite, compiled from property value data in 53 of the nation's largest markets, finds the price of a home increased 6.5% year-over-year to $500,688 in the fourth quarter. The price of a two-storey home rose 7.7% year-over-year to $610,134, and the price of a bungalow increased 5.4% to $420,082.

During the same period, the price of a condo increased 3.1% to $341,448.

Royal LePage forecasts that the aggregate price of a home in Canada will increase 4.1% for 2016 compared to 2015.

"The frenetic pace of our country's largest housing markets should moderate throughout the year ahead," says Phil Soper, president and chief executive officer, Royal LePage, who adds Greater Vancouver- and Toronto-area prices will settle down thanks to real estate appreciation that has significantly outpaced job and wage growth.

"Through the recent period of depressed oil prices, property prices in Canada's energy-centric regions, particularly Alberta and Newfoundland and Labrador, were more resilient than most onlookers had expected," says Soper. "Consumers, reluctant to sell their homes at what they perceived to be a discount to their true value, simply withdrew from the market, resulting in steady house prices and a drop in unit sales volume. In the coming year we expect to see the delayed impacts of the slowing economy and rising unemployment on the regions' housing stock, with moderate declines in home values."

In Quebec, home prices were relatively flat during 2015. A lower Canadian dollar and robust U.S. economic growth should fuel the service and manufacturing sectors in 2016, improving employment levels and consumer confidence, and lifting home prices.

"Montreal's slow-growing real estate market is expected to be much more vigorous in 2016," said Soper. "A recent economic opportunity study

pointed to Montreal as Canada’s third ‘city to watch’ in 2016, just behind Vancouver and Toronto in growth potential.”
Macroeconomic factors
The price of residential real estate in Canada will be more influenced by macroeconomic factors than by housing-specific variables, such as tighter regulation in the mortgage industry.
“The new federal government moved quickly with a policy change in the minimum down payment required to secure mortgage insurance,” says Soper. “The change will produce an added benefit akin to a slight tap on the brake for our two costliest cities. On a nationwide basis, we expect the number of transactions that this will impact to be minimal – significantly less than the initial industry reaction would lead consumers to believe.”
Further, the Bank of Canada is expected to keep its overnight rate steady through the spring market, extending low borrowing rates.

7. Alberta asks National Energy Board to OK Trans Mountain pipeline

[January 13, 2016] Premier Rachel Notley says the proposed expansion of a pipeline to the B.C. coast is not just in Alberta’s best interests, but is the best thing for Canada as well.
“Our government believes that this project is good for Albertans and good for all Canadians,” Notley told reporters Tuesday.
“It will create jobs, it will spur economic growth, and it will help ultimately fund many of the programs that support our province’s transition to a greener, less carbon-intensive economy.”
Her remarks echoed a written submission she delivered to the National Energy Board on behalf of the province earlier Tuesday.
A three-member board panel is hearing submissions on its assessment of the 1,150-kilometre Kinder Morgan Trans Mountain pipeline, which carries crude oil and refined products from Edmonton to terminals in the Vancouver area.
Kinder Morgan is looking to twin the line to almost triple capacity to 890,000 barrels a day.
The company says there is enough demand on the line to make the expansion worthwhile, and Notley agrees.
In her letter, she said Alberta has abundant oil resources for an expanded line. The province currently isn’t getting a fair return on its oil because lack of pipeline capacity is restricting sales to just one buyer — the United States, she said.

“Because of limited market access, Western Canada’s oil price has persistently been undervalued relative to world prices,” wrote Notley.

“The loss from price discounting is of such size and persistence that it cannot be in the Canadian public interest, and should be weighted heavily by the National Energy Board in its considerations.”

Getting more oil to west coast ports would allow for access to Asian markets such as China.

She cited reports that estimate an expansion could increase western Canadian crude oil revenues by $73.5 billion in the first two decades of operation.

Kinder Morgan is working to clear the final hurdles in the evaluation process.

The energy board panel is set to inform the federal cabinet on May 20 whether it approves the project. Ottawa then has three months to make its decision.

On Monday, the British Columbia government said it can’t support the line as it stands because Kinder Morgan has failed to meet the province’s five conditions for approval.

In particular, Kinder Morgan has not spelled out plans on how it would deal with oil spills on land and on water, the province said.

B.C. also wants any aboriginal concerns addressed and is demanding a fair share of revenue for having the line go through its territory.

The pipeline debate is set against the grim backdrop of free-falling world oil prices that have gutted the Alberta government’s bank account and sent out recessionary ripples across the country.

West Texas Intermediate, the benchmark price for Alberta’s oil, has fallen by more than two-thirds since the middle of 2014 and is dipping below US$30 a barrel.

Earlier Tuesday, Finance Minister Joe Ceci said the continued decline in prices is forcing a spending re-evaluation as Alberta prepares to present its new budget this spring.

“Everything is going to be reassessed … with these commodity prices being as low as they are,” said Ceci.

In this budget year alone, low oil prices have reduced the expected revenue from non-renewable resources by $6 billion.

Chris Bloomer, president and CEO of the Canadian Energy Pipeline Association, said safety, environmental protection and effective emergency response are top priorities for pipeline companies.

“We have collaborated with the B.C. Ministry of Environment around improved land and marine-based spill response legislation, worked with

Natural Resources Canada to develop the Pipeline Safety Act and formalized a mutual agreement with members to help each other during emergencies," Bloomer said in a statement Tuesday afternoon.
"We also strongly support robust regulatory processes that ensure no pipeline is operated without regulatory conditions being met.
"We need to continue to build public confidence and trust in our industry and engage in sensible policy discussions. By working with provincial and federal governments and our many stakeholders, we will get to the point where existing and new pipelines are understood to be safe, environmentally sound and an instrument of economic growth."

8. Carbon tax may not be forever: Alberta environment minister

[January 12, 2016] Alberta's environment minister told an oil and gas conference that she hopes the government's broad-based carbon tax won't have to be collected forever.
Shannon Phillips reassured industry officials that the Alberta NDP government is aware of the challenges being faced by the energy sector as a result of nosediving oil prices.
"We acknowledge as a government the pain of low oil prices and the effects it has had on Calgary and all communities that are dependent on resource extraction in this province," says Phillips. "As a government we have a choice in how we respond. We don't control the price of oil. What we do control is how we treat one another. We also choose a different, more hopeful path than might be offered by others."
Phillips outlined for the crowd the Alberta government's climate change plan announced last fall, saying the move was necessary due to a worldwide desire to deal with global warming.
The carbon tax is one of the pillars of Alberta's new climate change strategy. The plan will cap oilsands emissions, phase out coal-fired electricity plants, and move to more enviro-friendly fuel sources over the next 15 years.
The tax on emissions, to begin in 2017, will affect everything from the price of gas at the pump to home heating and power bills. It's expected to bring in $3 billion a year when fully implemented in 2018.
The government will also move to phase out the province's coal-fired power generation by 2030 and introduce a hard cap on greenhouse gas emissions for the oilsands.
But Phillips says there's no guarantee how long the government will need to collect the carbon tax. "Our goal is not to collect the carbon price forever,"

she says. “A successful outcome of this particular policy would be that revenue would begin to decline as we find ways to reduce our emissions in our day to day lives and in each industrial sector.”
Ric McIver, interim leader of the Alberta Progressive Conservatives, says there was only one thing that stood out in the speech. “The only thing I did pick out that was new is that the carbon tax is going to be temporary, although there was no particular details on when it would cease and desist.”
With the price of oil continuing to drop toward the US$30 mark, Phillips says it is making planning for the 2016 provincial budget more difficult.

9. Despite poor growth, Liberals to push ahead with tax breaks

[January 12, 2016] The federal finance minister painted a bleak picture of economic growth hampered by plunging commodities prices, as he kicked off his national budget consultation tour in Halifax. But his government still plans to keep its campaign promises of lower taxes for the middle class.
Bill Morneau repeated prior statements that the Canadian economy is suffering from slower growth than originally projected by the former Conservative government, due partly to oil prices that are less than half those of 2014.
“We knew when we were campaigning we were facing a slow-growth environment,” he says. “The challenge is greater than we expected.”
The minister adds there’s hope that oil prices will improve, but as it stands a declining tax base means his department is expecting a $15 billion per year reduction of GDP beginning this year, compared with what was projected in the last budget.
“It’s important to have a frank view of where we’re starting from,” he says.
Morneau is travelling across the country this week to seek input as he draws up his first federal budget.
The finance minister spoke on the same day as the Bank of Canada’s latest business outlook survey was released indicating companies’ investment in equipment and hiring intentions for the next year are tumbling to their lowest levels since the 2009 recession.
The former executive chairman of a human resources firm told reporters the survey indicates his party’s infrastructure spending will assist in retaining business confidence.
He also repeated the party will keep its campaign promises to bring in middle class tax breaks and spend billions on infrastructure.

But during a news conference, Morneau offered few details when local reporters asked about how Ottawa will stimulate the Nova Scotia economy and help with the upkeep of aging infrastructure. He says he couldn't comment on whether the number of federal ships being built in Halifax yards will remain.

He also says he had little information about the Victoria General, an aging Halifax hospital beset by routine floods and leaks, and couldn't say whether helping fix the problem falls within the planned infrastructure spending.

Randy Delorey, Nova Scotia's Liberal minister of finance, says in an interview he's content to wait for more details about how his federal counterpart's infrastructure program will work — and whether he can ask for help with the decrepit facility.

During a news conference, the federal minister was also asked whether Ottawa will continue efforts by the former Conservative government to create a national securities regulator.

He says his government will work with provinces who want to create the regulator, but respected that Alberta and Quebec weren't interested in proceeding with the plan.

"We do favour a collaborative national securities regulator," he says. "We recognize we'll do this together with those provinces willing to be part of this initiative. We think it's important for Canada find a way to be efficient in all things we do."

10. Pace of housing starts slows

[January 11, 2016] Housing starts in December came in at a seasonally adjusted annual rate of 172,965 homes, down from 212,028 in November, says the Canada Mortgage and Housing Corporation. That's mainly because of fewer multiple-unit projects.

The data also came in short of what economists had expected, which was an annual pace of 200,000, according to Thomson Reuters.

The slowdown in the annual pace of new home starts came as the rate of urban starts fell 19.1% in December to 159,007 units.

Multiple urban starts dropped 27% to 10,264, while single-detached urban starts held steady at 57,743. The pace of urban starts fell in the Prairies, Ontario, and Atlantic Canada, but increased in British Columbia and Quebec. Meanwhile, rural starts were estimated at a seasonally adjusted annual rate of 13,958.

The six-month moving average of housing starts was 203,502 units in December compared with 208,204 in November.

11. Business sentiment deteriorating across Canada: BoC

[January 11, 2016] Business sentiment has deteriorated across Canada, with firms reporting little change in credit conditions, says the Bank of Canada's latest Business Outlook Survey.

The survey notes that "while firms continue to anticipate an acceleration in their sales over the next 12 months, the diverging outlook evident in recent surveys persists. The low-commodity-price environment poses significant challenges for many businesses, [given] the adverse effects of the shock are increasingly being felt across most regions and sectors. [But], expectations for future sales are more robust among exporters in light of strengthening foreign demand."

Still, says the survey, "Investment and hiring intentions have fallen to their lowest levels since 2009, as domestically oriented firms and those exposed to the resource sector adjust their plans to slower activity."

Further, "Capacity pressures are still subdued, largely owing to weak demand conditions, especially for firms in the prairies […] Businesses expect input and output prices to rise at a slower pace," in part due to dip of the Canadian dollar and weak market conditions. Inflation expectations fell, with a greater share of firms expecting inflation to be in the lower half of the BoC's inflation-control range."

The Bank's report highlights how far the oil shock has spread, says Nick Exarhos, director at CIBC World Markets. "[Even] though much of the weakness is concentrated in the oil-producing provinces, weakness is 'now also evident in other regions.' That's a result of firms being more concerned on the domestic economic outlook, a result of the spillover effects from the crude shock."

As a result, "[Any] optimism on top line-growth isn't being reflected in firms' intentions for investment and employment." Plans to cut stuff are "more widespread," according to the Bank's report and not exclusive to commodity-producing sectors and regions.

Have a nice and fruitful week!