Weekly Updates Issue # 608

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1. Weekly Markets Changes

[March 31, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,547.75 +105.1 +0.68%	2,362.72 +18.74 +0.80%	20,663.22 +66.50 +0.32%	5,911.74 +83.00 +1.42%	$0.7505 +0.33¢ +0.44%	$1,247.40 +4.10 +0.33%	$50.85 +2.71 +5.63%

2. January GDP growth of 0.6% tops expectations

[March 31, 2017] The Canadian economy kicked off the year with a bang as it grew faster than expected in January with the manufacturing sector leading widespread growth.

Statistics Canada said Friday gross domestic product grew 0.6% in the first month of the year on strength across both goods- and service-producing industries.

Economists had expected a gain of 0.3%, according to Thomson Reuters.

"Another day, another robust reading on the Canadian economy," CIBC economist Nick Exarhos wrote in a brief note to clients.

The strong figures for January cap a recent string of better-than-expected economic data.

Still, Bank of Canada governor Stephen Poloz said earlier this week that he remains cautious and that risks for the economy remain.

Statistics Canada said Friday that goods-producing industries grew by 1.1% in January, while service-producing industries rose 0.4%. The manufacturing sector was the largest contributor to the increase as it advanced 1.9%.

A partial rebound in the oil and gas industry helped the mining, quarrying, and oil and gas extraction sector, bumping it up 1.9% after contracting 0.5% in December.

Oil and gas extraction was up 2.0%, offsetting some of its decline in December. Mining and quarrying excluding oil and gas extraction gained 1.1% in January.

3. Why the greenback is falling despite rate hike

[March 30, 2017] The U.S. dollar has been depreciating since the Fed hiked its key rate midmonth.

The decline's "not in line with our scenario of monetary policy divergence," says a Desjardins forecast report on foreign exchange. But, because the Fed was unclear on how its future monetary firming would play out, the markets interpreted the move as dovish, says the report.

Indeed, instead of assuming the Fed's in a tightening cycle, it's more useful for investors to think of forthcoming Fed rate hikes as a process to remove "a substantial amount of monetary policy accommodation sloshing through the global financial system," says Richard Clarida, managing director at PIMCO, in a report.

He calls the cycle a removal of accommodation, or ROA, and says the real effective Fed funds rate remains accordingly negative and accommodative.

"Initial market reaction to the policy rate hikes — with stocks higher, credit spreads tighter and the dollar weaker — was consistent with this interpretation that the Fed intends a gradual path toward normalization," he says. "Call it a dovish ROA."

Though the Fed's policy rate isn't expected to effectively reach the nominal rate of 2% until the end of 2018, investors shouldn't rest easy while markets buy into the plan, because three potential complications could dampen the rosy ROA scenario, says Clarida.

First, there's the issue of how to shrink the $4.5-trillion U.S. balance sheet, resulting from years of quantitative easing (QE). Currently, there's no plan in place for starting that process or giving it a timeline.

Second is the threat of geopolitics. Says Clarida: "As we saw in the summer of 2015 with the June sell-off in China equities and the August devaluation of the Chinese yuan, such global developments can interrupt the game plan and complicate Fed guidance."

Last, the Fed's board will see changes next year, as the chair's term expires and other vacancies come up.

Desjardins notes the pause in monetary firming could limit the greenback's gains while boosting the loonie. However, announcements by the Trump administration to support the U.S. economy with tax cuts, infrastructure spending and deregulation could reverse the trend — not to mention U.S. protectionism.

Desjardins forecasts the Canadian dollar at US$0.72 for year-end.

4. Feds, Ontario government investing in Ford’s Canadian operations

[March 30, 2017] The federal and Ontario governments are each investing more than $100 million to support a $1-billion partnership with Ford Canada. Prime Minister Justin Trudeau and Ontario Premier Kathleen Wynne announced the conditional grants of up to $102.4 million each at a Ford engine plant in Windsor, Ont., on Thursday.

Trudeau said the funding would allow Ford to stay “innovative and cutting-edge. Our government is committed to helping our most competitive industries get ahead.”

Meanwhile, the Ontario government said the investment will create 300 new jobs at Ford in the province and protect hundreds more.

The funding is also aimed at helping Ford establish an advanced manufacturing program that will transform the company’s power-train facility in Windsor, and it will also support Ford’s plan to create a research and engineering centre in Ottawa to develop new automotive technologies.

In recent months, the federal and Ontario governments have actively discussed major investments in the big automakers. Last December, one auto union leader estimated the combined public investments could reach hundreds of millions of dollars.

After the conclusion of labour negotiations last year, the auto companies launched talks with Ontario and Ottawa about investing in an industry critical to the both economies. The automotive sector employs about 125,000 people in assembly and parts production.

Last week’s federal budget proposed to consolidate several “business innovation” programs, including the Automotive Innovation Fund and the Automotive Supplier Innovation program. Both offer “non-repayable contributions” for the auto sector.

Earlier this year, Ottawa made changes to its Automotive Innovation Fund that enabled the government to provide grants to car companies. Before the changes, the program offered loans.

In its 2017 budget, the feds proposed to roll the two auto programs under a new, broader umbrella called the Strategic Innovation Fund, which will allocate $1.26 billion over five years.

The budget also announced $125 million for the launch of an artificial-intelligence strategy. It aims to leverage Canada’s already-significant expertise in AI, so the country can become a world leader in a field packed with economic potential.

The AI strategy will seek to strengthen collaboration between what Ottawa identified as Canada's main centres of expertise: Edmonton, Montreal and the Toronto-Waterloo region.
Federal Economic Development Minister Navdeep Bains, who also attended the Windsor announcement, has said the feds are open to helping the automakers expand their footprints in Canada.
He's indicated a particular interest in investments that would support the more technologically advanced and research-focused areas of the auto industry.
Bains, in charge of overseeing Ottawa's "innovation agenda," has also said the government wants to make sure Canada is on the "cutting edge of the car of the future."
Last year, the three largest North American automakers committed to pump more than $1 billion combined into their Canadian operations following contract talks with their unionized workers.
Ford has said it would invest about $700 million at its Ontario facilities.

5. People may risk steep penalties if they don't file U.S. tax forms

[March 29, 2017] Haven't filed all your required U.S. tax paperwork? If you're really unlucky, you might get sued.
Last May, the U.S. Department of Justice (DOJ) sued Jeffrey P. Pomerantz — a U.S.-Canadian dual citizen resident in Canada — for more than US$860,300 in penalties and interest for failing to file his FBAR bank disclosure forms, even though he filed his tax returns.
This case is one of the first known instances of the enforcement of FBAR penalties against a U.S. citizen living in Canada. U.S. citizens who have bank accounts abroad must file an FBAR each year if they have more than US$10,000 in aggregate in bank and other financial accounts outside the United States. Further, accounts over which the U.S. taxpayer has signing authority also have to be reported.
The penalties for failing to file an FBAR are harsh, ranging from US$10,000 per account to the greater of US$100,000 or 50% of the balance of the account if the violation was wilful. It is up to the IRS to establish wilfulness, the legal test for which is a voluntary, intentional violation of a known legal duty.
Court documents indicate that on March 3, the DOJ "sought an order to serve the summons and complaint on Pomerantz and his lawyer via international mail and courier." This motion was granted on March 17.

Facts of the case

According to court documents, Pomerantz is a dual Canadian-U.S. citizen living in North Vancouver, B.C. Aside from a period between late 2008 and mid 2009 during which he lived in California, he has been a Vancouver resident since 2001. The complaint alleges he personally owns two CIBC chequing accounts, as well as several companies that in turn own foreign bank accounts in Switzerland. The U.S. government wants to collect more than US$860,300 in FBAR penalties and interest arising from Pomerantz's alleged wilful failure to report the above accounts in 2007, 2008 and 2009.

Although Pomerantz has not formally been served with the documents, the DOJ has expended significant effort to track him down, including:

- extensive searching on the internet for his contact information;
- sending multiple notices by Fed-Ex to different addresses he has used;
- calling his phone number;
- calling his lawyer.

From the court documents, it's not clear how the DOJ discovered Pomerantz's failure to report his bank accounts. The IRS previously audited Pomerantz's U.S. tax returns that he prepared himself. According to court documents, the audit resulted in more tax owing and penalties. Amongst the additional taxes identified in the audit, Pomerantz had allegedly not reported income from the sale of home furnishings and from the sale of a Toyota.

A U.S. Tax Court case concerning the assessed additional tax is still ongoing. While the IRS audit began in 2010, the FBAR penalties in question were not assessed until May 2014 for tax year 2007, and March 2015 for tax years 2008 and 2009. Potentially, the unreported accounts were discovered during the audit, but this cannot be determined from the court documents.

Although CRA does not assist in the collection of FBAR penalties against assets in Canada, the consequences of non-compliance can be severe. In fact, there are several implications of the Pomerantz case for U.S. citizens living in Canada:

1. It shows that the IRS scrutinizes U.S. taxpayers who live in Canada.
2. It illustrates the risks associated with not properly filing a U.S. tax return and/or FBAR forms.
3. Considering these risks, U.S. citizens who have never filed a U.S. tax return should get caught up on their U.S. returns. Failing to file U.S. returns could lead to expensive penalties, but also difficulty accessing the U.S. Under U.S. immigration law, a U.S. citizen is required to use a U.S. passport to enter the U.S. But a new law allows the U.S. government to confiscate a U.S. passport if a taxpayer owes more than US$50,000 in back taxes.

4. FATCA increases the risk to U.S. citizens even further. Under FATCA, the IRS receives information on bank accounts held by U.S. citizens in Canada from Canadian financial institutions. This makes it easy for them to determine whether or not a U.S. citizen living in Canada has reported all bank accounts on an FBAR form and instigate penalties as appropriate.
5. A U.S. citizen in Canada who has not filed their U.S. taxes should take the necessary steps to catch up on their taxes using the streamlined procedure if only to renounce their U.S. citizenship.

6. 38% of insolvent millennials use payday loans

[March 27, 2017] It's no secret Canadians are cash-strapped, with previous research suggesting many aren't contributing enough to RRSPs and TFSAs.

But, for those who face the extreme of insolvency, daily expenses can be insurmountable, let alone contributing to savings plans.

The average insolvent Ontarian uses most of his income to pay for necessities such as housing and regular living expenses, reveals new research from insolvency firm Hoyes, Michalos & Associates. Further, debt is used to fill any gap in daily expenses, resulting in a vicious cycle.

Millennials (aged 18 to 29) make up 14% of Ontario insolvencies, up from 12% in 2015, finds the report. As expected, one third (31%) of insolvent millennials have student debt. But, more concerning, 38% have payday loans. That compares to 25% for insolvent people overall.

And less than 1% of millennials have cash on hand, indicating they're living paycheque to paycheque.

Another potential problem: millennials tend to be more loyal to their banks than other generations, reveals a survey by LowestRates.ca. For instance, they trust their banks to provide them with the best credit cards, thus they don't shop around for the best rates and features.

Other details on insolvency from the Hoyes Michalos report:

- Seniors aged 60 and older are the fastest-growing risk group for insolvency, making up 12% of all insolvent debtors.
- Insolvent seniors have the highest credit card debt, and only 44% have RRSPs.
- Single-parent households are twice as likely to become insolvent than two-parent households, and 33% of insolvent single parents use payday loans.

Ipsos conducted the survey for Lowest Rates, polling 1,001 Canadians February 14-15. Hoyes, Michalos & Associates reviewed the details of more than 6,700 personal insolvencies in Ontario from January 1, 2015, to December 31, 2016, and compared the results with previous insolvency reports.

7. Federal budget, CPI support neutral rate outlook

[March 27, 2017] Last week, the federal budget projected medium-term deficit increases, including a deficit of $28.5 billion for 2017-18, and a deficit of $18 billion still remaining by 2021.

The small measures of raising taxes on alcohol and cigarettes, removing the public transit tax credit and applying GST to Uber rides won't "substantially move the needle on revenues," says TD economist Diana Petramala, in a weekly economics report. However, the government's wait-and-see budget may be appropriate, she says.

Though TD forecasts nominal GDP growth of 4.7% in 2017 (the government projects 4.1%), "the timing might not be right for restrictive fiscal policy given the extensive risks facing Canada and the global economy," says Petramala.

The report "fits with the [BoC's] narrative on slack in the economy," says RBC economist Josh Nye in an economics update. "And, given heightened uncertainty regarding U.S. policy, we doubt [the bank's] neutral tone will change much at April's meeting despite the solid run of data we've seen in recent months."

Soft core inflation "is just one additional reason for a fairly dovish BoC outlook and for betting against rate hike pricing," says Derek Holt, vice-president and head of capital markets economics at Scotiabank, in an economics update on CPI. To the list of economic indicators, he adds things like the collapse in business investment in the last two quarters, lack of export growth, uncertainty on the commodities outlook and the imported bond shock.

Petramala says ongoing Fed hikes could pull up the 10-year government of Canada bond yield by 30 to 40 basis points in 2017 and 2018 above the federal budget assumptions.

Still, despite looming deficits, the debt-to-GDP ratio is not expected to breach 30% over the forecast plan, she says. "This is quite low from a historical perspective, at half the peak reached in the late 1990s, leaving some fiscal room to work down the deficit only gradually," concludes Petramala.

Have a nice and fruitful week!