Weekly Updates Issue # 628

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1. Weekly Markets Changes

[August 25, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
15,055.99 +103.7 +0.69%	2,443.05 +17.50 +0.72%	21,813.67 +139.6 +0.64%	6,216.53 +49.11 +0.79%	$0.80108 +0.66c +0.83%	$1,283.94 -13.96 -1.09%	$47.87 -0.92 -1.89%

2. How growing household debt levels are putting Canada at risk

[August 25, 2017] In March, Canada Mortgage and Housing Corp. board members received an update on the country's credit and housing trends. And, as it turns out, the steady climb of the domestic household debt-to-GDP level has put Canada's long-term economic growth prospects at risk.

The document pointed to a study that argued household debt accumulation eventually hampers economic growth over the longer term, eclipsing the nearer-term benefits of consumption.

The strong expansion of household spending, encouraged by a prolonged period of historically low borrowing rates, has created concerns over Canadians' record-high debt loads.

It has also been a major driver of economic growth.

The Canadian Press obtained a copy of the CMHC presentation via the Access to Information Act. It was included in a "confidential" memo to deputy finance minister Paul Rochon.

Citing international research, the CMHC presentation points to an estimate that says a one percentage point increase in household debt-to-GDP tends to lower growth in a country's real gross domestic product by 0.1 percentage points at least three years later.

The calculation, published in a January study by the Bank for International Settlements, was based on an average produced from the data of 54 countries from 1990 to 2015.

"Our results suggest that debt boosts consumption and GDP growth in the short run, with the bulk of the impact of increased indebtedness passing through the real economy in the space of one year," said the BIS report.

"However, the long-run negative effects of debt eventually outweigh their short-term positive effects, with household debt accumulation ultimately proving to be a drag on growth."

An accompanying chart in the CMHC presentation showed that between 2010 and 2016 Canada's household debt-to-GDP level rose by more than five percentage points. The household debt-to-GDP ratio increased from almost 93% to just over 101% at the end of 2016, Statistics Canada says.

A reduction of even 0.1 percentage points in the country's GDP can have an impact. For example, Canada saw year-over-year growth in real GDP last year of 1.3%.

The chart listed eight developed countries and ranked Canada second, behind Australia, for having the biggest increase in household debt-to-GDP level over the six-year period.

BMO chief economist Doug Porter says he doesn't dispute the broader conclusion that a rising household debt-to-GDP level poses risks for growth. But he's skeptical one can draw a direct line from the household debt-to-GDP directly to economic growth down the road. For one, he said interest rate levels must be factored in.

"I'd be very cautious about putting pinpoint accuracy on that," Porter said. "I think that's incredibly difficult to do." However, Porter says the record levels of household debt piling up in Canada, like in many industrial-world economies, does suggest it will be tougher for the country to grow as quickly as it has in the past.

"The consumer spending and housing gains that we could reap from lower interest rates have basically been reaped," he said. "And, if anything, interest rates are probably more likely to rise than fall from current levels.

"So, to me that suggests we just really can't count on the consumer to really pull the economy ahead as they have in recent years."

3. Canadian families' tax bills keep rising

[August 25, 2017] Likely due to high housing prices, the mortgage debt of Canadians is rising – in a Moody's report released on August 23, the ratings agency says people’s mortgage obligations are pushing consumer debt to unprecedented levels.

Yet, there’s another financial burden that weighs more on families.

A 2017 study by the Fraser Institute, referred to as the Canadian Consumer Tax Index, 2017 edition, finds the average Canadian family continues to spend more on taxes than housing, food and clothing combined. The index tracked the total tax bill of the average Canadian family from 1961 to 2016 and, it reveals that, including all types of taxes and accounting for inflation, the average tax bills of households have increased 157.6% since 1961, and 2,006% without inflation.

For 2016, the study says, the average Canadian family earned $83,105 and, out of that, paid $35,283 in total taxes. That compares to a combined total of $31,069 on housing (including rent and mortgage payments), food and clothing.

As such, in 2016, the average Canadian family paid nearly twice as much of their income in taxes (42.5%) as they did for housing (22.1%). In 1961 the average Canadian family spent much less on taxes (33.5%).

The index’s findings aren’t new: in 2015, the same annual index found the average Canadian family earned an income of $80,593 and paid total taxes equaling $34,154 (42.4% of their income), versus spending 37.6% of that income on necessities. In 2013 and 2014, families also paid more than $30,000 on taxes and, as a result, also dedicated less to food, clothing and shelter.

The total tax bill as calculated by the Fraser Institute reflects all taxes that families pay to the federal, provincial and local governments including income, payroll, sales, property, carbon, health, fuel and alcohol taxes and more.

“Taxes help fund important public services that Canadians rely on,” it adds, “but the issue is the amount of taxes governments take compared to what Canadians get in return,” says Charles Lammam, director of fiscal studies at the Fraser Institute and co-author of the Canadian Consumer Tax Index. “With more than 42% of their income going to taxes, Canadians might ask whether they’re getting good value for their tax dollars.”

4. Amazon gets green light from Whole Foods shareholders

[August 23, 2017] Whole Foods shareholders are ready for a union with Amazon.

The approval from Whole Foods shareholders came on Wednesday and it’s one of the steps required to close the deal. Seattle-based Amazon.com expects the deal to close before the end of the year, with the go-ahead from government regulators.

Before agreeing to the US$13.7 billion offer, Whole Foods had been under shareholder pressure to improve results and retain customers.

Amazon announced plans to buy Austin, Texas-based Whole Foods Market Inc. in mid-June. The takeover will not only give the e-commerce giant more than 460 Whole Foods stores but also the power to influence the supermarket industry.

5. CPP assets to exceed $15 trillion by 2090: federal analysis

[August 23, 2017] The upcoming enrichment of the Canada Pension Plan will help fuel a 48-fold boost to the public fund's assets over the long haul — to more than $15.8 trillion by 2090, according to federal calculations.

In comparison, the public plan's investment manager reported $326.5 billion in net assets at the end of the first quarter of 2017-18.

Long-term projections on the evolution of the CPP's post-reform assets were included in an internal briefing note prepared for federal Finance Minister Bill Morneau earlier this year. The memo referred to numbers published last October by the Office of the Chief Actuary.

The figures accounted for the impact of a CPP deal reached last year between the federal government and the provinces. They agreed to changes that will increase Canadians' retirement benefits through the public plan by raising contributions as of 2019.

CPP reform was a key goal for Ottawa and provinces like Ontario as a way to provide more financial security for future generations of retirees.

But it has also faced significant criticism. For example, advocates for small businesses have warned it will be devastating for employers and drive up costs in what they have described as a "payroll tax."

The increase also means the Canada Pension Plan Investment Board, which manages the CPP contributions, will be responsible for far more money over the coming decades.

Without the enhancement, the total CPP assets would have totalled $6.7 trillion in 2090, the projections said.

"Additional CPP assets are projected to grow rapidly in the early years as a result of the high level of contributions compared to benefits paid, reaching $70 billion by 2025 and almost $1 trillion by 2045," said the January briefing memo prepared for Morneau ahead of a scheduled meeting with CPPIB president and CEO Mark Machin.

The projections predicted the assets in the enhanced CPP portion to surpass those collected under base CPP program by 2055.

Machin has acknowledged CPPIB will have to adjust to its additional obligation of managing a much-larger envelope. The organization invests CPP assets not currently needed to pay pension, disability and survivor benefits.

“With or without reform, the CPP fund is projected to grow significantly in the future, and we’re well-prepared to manage a larger fund,” Machin told MPs during his appearance at a parliamentary committee last November.

“When we evaluate investment programs, new processes, and supporting technology, we always want to ensure that they can be scaled to take into account increased size. We are very confident that we’ll be ready to manage the additional funds.”

Machin has also stressed the importance of the arms-length CPPIB’s independence from government influence when it comes to its decisions around investments. He’s called that separation from potential political pressure one of the secrets to its success.

The briefing note to Morneau outlined several expected areas of focus for his meeting with Machin, including discussion about the Liberal government’s proposed infrastructure bank.

The government’s $35-billion infrastructure bank will seek to use public funds as leverage to attract billions more in private investment for major projects, such as new bridges, transit systems and rail lines. Ottawa has said it hopes the Canada Infrastructure Bank will entice institutional investors, such as pension plans, to participate.

The partially redacted memo to Morneau noted that Machin has emphasized the importance of CPPIB’s independence when it comes to infrastructure investments.

The document’s suggested speaking notes also featured an overview of the government’s infrastructure bank and a reference to CPPIB’s investment record when it came to infrastructure.

The document, obtained by The Canadian Press under the Access to Information Act, said CPPIB’s infrastructure assets accounted for 7.6% of its global portfolio at the time and that it held only one infrastructure asset in Canada: a stake in the Toronto region’s 407 Express Toll Route.

The memo also noted the CPPIB has looked outside Canada due to a lack of investment opportunities big enough — Machin has said it seeks projects larger than $500 million — and its reluctance to invest in brand-new projects that often carry more risk.

When it comes to the projected size of the CPP's assets in 2090, Jack Mintz, a tax-policy expert from the University of Calgary, said expected population increases and inflation should be taken into consideration.

He added that CPP reform will lift retirement benefits, but it will still be quite small when compared to Canadians' total savings.

"It's an increase, but it's not an overwhelming increase; it's kind of advertised as a bigger change than it really was."

6. Watch banks' credit card portfolios during downturns

[August 23, 2017] Unprecedented household debt levels will give Canadians a rude awakening on their unpaid credit card bills if another economic downturn materializes in the coming years, according to a new report issued Wednesday.

Moody's Investors Service it will be closely watching Alberta and Saskatchewan for signs of increased delinquencies on consumer debt portfolios.

The two provinces already saw a doubling of initial unemployment claims in the latter half of 2016, a result of a prolonged downturn in the oil sector after the global price of crude began to plummet in late 2014.

"We wouldn't be surprised to see that as an area of strain in the country," said Jason Mercer, an assistant vice-president at the ratings agency.

Moody's said card loan performance in these Prairie provinces in coming quarters will be "an illustrative first test" of the ongoing strength of the banks' Canadian credit card portfolios and the broader environment for consumer credit.

"We're all a little vulnerable right now, here in Canada," Mercer said.

"If there's a shock in employment, somehow, that could cause consumers to change their spending and their debt service patterns."

Canadians have seen their dollar-to-debt load nearly double over the past 30 years, as lower interest rates and relatively small economic stresses encouraged more people to spend against things rising house prices, Mercer said.

Moody's says consumers owed $1.69 of debt for each dollar of their disposable income as of March 31.

The meteoric rise of debt has been fuelled partly by attractively low interest rates and a Canadian economy that generally recovered more quickly from the last recession than the United States and Europe. Some analysts have raised concerns that an entire generation was growing comfortable with an unsustainable level of debt.

Moodys says mortgage debt growth, not credit cards, is driving the increase in Canadian household debt.

But consumers typically pay more attention to meeting their mortgage payments over credit card debt, Moodys said, because the flexible payment terms of cards don't lead to losing assets like a home or automobile. However, credit card interest rates tend to be much higher than those associated with mortgages.

7. What OAS at 65 means for younger generations

[August 22, 2017] The previous Conservative government raised the eligibility age for OAS to 67 from 65 to save on costs and prod people to work longer. The Liberals reversed the decision in their first budget, but have stuck by the need to keep older Canadians in the workforce longer.

A spokesman for Social Development Minister Jean-Yves Duclos said the Liberals knew reversing the eligibility age to 65 would have an impact on program cost, but noted that the parliamentary budget watchdog has reported that spending is sustainable in the long term.

However, a February presentation to a group of deputy ministers said that if the retirement age stays fixed at 65, and life expectancy increases, there will be relatively more people claiming pension benefits for longer, and fewer people working and paying income taxes.

"Younger generations may be required to pay higher taxes to compensate for higher spending commitments and lower tax revenue," one slide reads.

"This could create disincentives to work and for firms to invest, and in turn lead to a fall in growth and productivity."

CPP changes help control costs

A mandatory review of CPP predicts all-time highs in spending over the coming years with waves of baby boomer retirements — spending levels that could have been even higher if not for changes to the public pension program.

The report is the first glimpse into how the CPP expansion, phased in over the next 40 years, will affect seniors' benefits.

The country's chief actuary writes in his report that program spending is projected to hit about $247 billion by 2060, an almost five-fold increase from planned spending this year, as more Canadians hit retirement and live longer, meaning more beneficiaries drawing payments for longer periods of time.

The projected increase is expected to be cushioned by ongoing economic growth.

Over the same projection period, CPP benefits will increase.

The extra money to be doled out through CPP, funded by an increase in employee and employer premiums, is expected to reduce the number of low-income seniors — meaning $3 billion less in spending on the guaranteed income supplement in 2060 — and reduce overall spending on OAS benefits, which are scaled back as incomes rise.

Paul Kershaw, an associate professor in the school of population and public health at the University of British Columbia, said the report shows that the country is expecting younger adults to rely less on OAS down the road by paying more into CPP, while simultaneously asking them to pay for increases in spending for today's aging population, noting they are often parents and grandparents.

"Younger generations will (hopefully) gladly do this," says Kershaw, the founder of the group Generation Squeeze, which seeks to engage young people in politics, in an email. "They will be much happier doing so if their aging parents and grandparents contribute to an honest conversation about the fact that today's aging population didn't prepay for OAS like they did for their CPP, and that this is having substantial implications for the public resources that are available to spend on all age groups — including their kids and grandchildren."

The most recent census figures show the ranks of seniors grew by the fastest rate in 70 years, with Statistics Canada projecting there could be 12 million seniors by 2061. Declining birth rates mean that without increases in immigration levels, there will be fewer younger workers to replace coming waves of retirees.

Could these demographic trends result once again in changes to the age of eligibility for CPP and OAS? That awaits to be seen.

8. Wholesale sales dip for first time in nine months

[August 21, 2017] Canada's wholesale sales declined slightly in June, with the food and auto industries showing the biggest impact. The dip ends a run of eight consecutive increases for the sector.

Wholesale sales fell by 0.5% to $61.4 billion.

The food industry's wholesale sales were down 1.1% from May, falling to $10.78 billion.

Motor vehicle wholesale sales were down 1.7% at $9.13 billion in June.

Statistics Canada says the value of wholesale sales fell in five of the seven subsectors it follows and in six provinces, with the biggest decline in Alberta and the biggest gain in Ontario.

CIBC economist Andrew Grantham writes in a note to clients that June's decline from May was modest and still up by 8.8% compared with June of last year.

"In volume terms, sales were 0.7% lower on the month, suggesting that the wholesale sector will be a slight drag on monthly GDP — a print that already isn't shaping up to be particularly good following the earlier manufacturing data," says Grantham.

"Overall, it's a decline but not a surprising one, and not one that changes what is still a very healthy underlying trend," he concludes.

A closer look at wholesalers

StatsCan explains that wholesalers connect farmers or manufacturers that produce goods with the companies or public institutions that need them, such as factories buying inputs for their industrial processes or retailers buying finished goods to sell to Canadian households.

They also import goods from other countries and redistribute them within Canada, and export goods produced in Canada to other markets.

Wholesalers are also often experts in logistics, and can provide marketing and support services such as labelling and packaging.

The wholesale trade sector accounts for about 5% to 6% of GDP, comparable with the retail trade sector. In 2014, wholesalers employed about 5.0% of all employees in Canada, says StatsCan. That's a similar number to those employed by the finance and insurance sector (4.5% in 2014).

Have a nice and fruitful week!