Weekly Updates Issue # 639

1. Weekly Markets Changes

[November 10, 2017]

S&P TSX	S&P 500	Dow Jones	NASDAQ	CAD/USD	Gold	WTI Crude
16,039.26 +19.10 +0.12%	2,582.30 -5.54 -0.21%	23,422.21 -117.0 -0.46%	6,701.26 +63.18 +0.94%	$0.7885 +0.51c +0.65%	$1,275.07 +5.87 +0.46%	$56.74 +1.10 +1.98%

2. U.S. versus China on large trade agreements, open economy

[November 10, 2017] Nations need to stay committed to economic openness or risk being left behind, Chinese President Xi Jinping said Friday in comments that contrasted sharply with U.S. President Donald Trump's remarks to the same business conference.

The Chinese president drew loud applause when he urged support for the "multilateral trading regime" and progress toward a free-trade zone in the Asia-Pacific.

"We should continue to foster an open economy that benefits all. Openness brings progress while self-seclusion leaves one behind. We, the Asia-Pacific economies, know this only too well from our own development experience," Xi said.

The leaders were speaking on the sidelines of an annual summit of the 21-member Asia-Pacific Economic Cooperation forum.

Trump told the same group, "We are not going to let the United States be taken advantage of anymore." He reiterated his preference for country-to-country trade deals, saying "I am always going to put America first."

Trump said he would not enter into large trade agreements, alluding to the U.S. involvement in the North American Free Trade Agreement and a Pacific

Rim trade pact, the Trans-Pacific Partnership, that he pulled out of earlier this year.
China is not involved in that deal, called the TPP, but it belongs to other trade initiatives.
“We should support the multilateral trading regime and practice open regionalism to allow developing members to benefit more from international trade and investment,” the Chinese president said.
China’s own recent ascent as the world’s second-largest economy came only after it launched reforms that opened its economy to more trade and foreign investment after decades of isolation following its 1949 communist revolution.
Prospects for a basic agreement on a revised TPP deal appeared in doubt Friday, as a meeting of the leaders of 11 countries still involved in the pact was delayed. There was no word on whether they had given up reaching agreement in Danang or were still working toward an agreement on how to move forward without U.S. involvement.

3. Marijuana tax proposal out for comment

[November 10, 2017] Those who plan to purchase legal marijuana next year will also be paying the taxman — to the tune of at least $1 for every gram, plus GST.
The proposed federal tax scheme, announced Friday, will be available for public comment until Dec. 7, 2017, as Canada prepares to legalize the drug by next summer.
The plan would add an excise tax of $1 per gram or 10% of the final retail price, whichever is higher, with the revenues to be divided equally between Ottawa and the provinces.
“I’m very comfortable that the level of taxation that has been determined as appropriate in this case achieves our goals of keeping the price sufficiently low to be competitive with an illicit market, while at the same time not creating an incentive for the consumption and purchase of this drug,” said Liberal MP Bill Blair, the government’s point man on legalizing marijuana.
“It’s a matter of finding the right level of taxation and price in order to achieve both of those very important public purpose aims. I believe that the work that we have done sets a very appropriate level.”
GST will be also be applied, so if the retail price of a single gram of pot is $8, consumers would pay a $1 excise tax and $1.17 in GST for a total of $10.17.
The taxes would be levied on both on fresh and dried marijuana, pot-infused oils and seeds and seedlings used for home cultivation.

The 50-50 tax revenue split idea has already rankled at least one premier who complained that the provinces won't be getting a fair share, considering they will be doing the bulk of the heavy lifting on legalization, including policing, distributing and regulating the sale of marijuana. That was B.C.'s John Horgan.

The discussions are still ongoing, said Blair, noting that the consultation period will end just before the provincial and territorial finance ministers gather Dec. 10 and 11 in Ottawa to sit down with federal counterpart Bill Morneau.

"It is part of an ongoing discussion that our finance minister is having with his counterparts, provincially and territorially," Blair said. "It would be inappropriate of me to presume the results of the discussions that are currently taking place […] there is still work to be done in the consultations."

Municipalities, too, have recently indicated they deserve a share of the revenues.

"We have recognized right from the outset that municipalities are an important stakeholder, and that they have a significant role to play in ensuring that the regulatory regime that is put in place is effective in achieving our public purpose aims, of protecting kids and keeping communities safe," Blair said.

"As I've travelled across the country, I've always made a point in virtually every town I've gone into to go and meet with the mayor and the local chief of police to hear that perspective, and we've carried their concerns back, and we've responded to that already in a quite significant way."

The government has already committed resources to municipalities, including $81 million for municipal and Indigenous police services to help offset the cost of additional training and resources, he added.

Early responses

Patient advocate groups and a licensed producer are fuming over the government's proposals.

Canadians for Fair Access to Medical Marijuana and the Arthritis Society say medical pot should be treated the same way as all other prescription medications, meaning it should be exempt from taxation.

The executive vice-president of licensed producer Aurora Cannabis Inc. said Ottawa's proposal unveiled today unfairly penalizes patients, calling it outrageous and wrong.

Cam Battley says sick people do not need the additional cost burden, and patient advocates have long been calling for the removal of existing sales tax on the drug as well.

Liberal MP Bill Blair says the federal government plans to tax both medical and recreational cannabis equally because it does not want to create an incentive for people to misuse the system to seek out cheaper product.

4. U.S. Senate Republicans would delay major corporate tax cut

[November 10, 2017] Sweeping tax legislation from Senate Republicans includes a one-year delay in plans for a major corporate tax cut despite strident opposition from the White House and others in their own party.

Their bill would leave the prized mortgage interest deduction untouched for homeowners in a concession to the powerful real estate lobby but would ignore a House compromise on the hot-button issue of state and local tax deductions.

On the other side of the Capitol on Thursday, the House Ways and Means Committee approved its own version of the legislation on a party-line 24-16 vote, amid intense political pressure on the GOP to push forward on the first major rewrite of the U.S. tax code in three decades. It's President Donald Trump's top priority and a goal many Republicans believe has grown even more urgent in the wake of election losses on Tuesday that displayed an energized Democratic electorate.

Yet as the Senate Finance Committee unveiled its bill, a few stark differences emerged with the version approved by the House tax-writing committee, underscoring the challenges ahead in getting both chambers to agree on the complex and far-reaching legislation that would affect nearly every American.

In a week ahead report, Scotiabank's Derek Holt notes we're likely to see tension in the U.S. in the days to come over the "duelling tax proposals." He expects "a confrontation of sorts that may negatively impact market confidence in tax reform. That will combine with some key data releases that are expected to be on the softer side, Fed-speak and retail-focused earnings to make for elevated market risk over the coming week."

Tax proposal details

The Senate measure fails to repeal the estate tax, though it doubles the size of estates exempted from the tax. It makes couples earning up to $1 million eligible for a $1,650 per-child tax credit. It creates a new 38.5% tax bracket for couples earning more than $1 million and individuals making more than $500,000 per year. And it takes a different approach to cutting taxes for businesses not organized as corporations that is less generous but applies to more businesses.

Democrats are strongly opposed to the GOP rewrite, so the Republicans must find agreement among themselves to have any hope of passage.
The Senate bill would fully repeal the state and local deduction claimed by many taxpayers, an idea that has drawn vigorous opposition from House Republicans in New York and New Jersey and resulted in a compromise in the House version of the bill that would allow property taxes to be deducted up to $10,000.
House Majority Leader Kevin McCarthy told The Associated Press that the Senate's total-repeal approach would face tough sledding in his chamber. As for the hard-fought compromise, he said, "I think it'd be difficult not to have it in the final bill."
On the other hand, the House bill would lower the cap on the mortgage interest deduction, an idea that caused intense blowback from the real estate lobby, but the Senate tax measure would leave it unchanged. That means homebuyers would continue to be able to deduct interest payments on loans of up to $1 million as permitted under current law; the House bill would reduce the limit to $500,000 for new home purchases.
The feverish efforts by Republicans in both chambers are aimed at fulfilling a self-imposed deadline to get legislation out of the House and Senate before Thanksgiving so the period between then and Christmas can be devoted to reconciling the two versions. But the Senate already seems unlikely to meet that deadline because of complex rules governing how it must consider the tax bill.
In one provision sure to cause a major dispute, the Senate measure includes a one-year delay in lowering the corporate tax rate, which is to be cut from 35% to 20%. Delaying that reduction would lower the cost of the bill to the Treasury, but the delay is opposed by the White House and some Senate Republicans.
"The president would like this to go into effect right away," Treasury Secretary Steven Mnuchin said Thursday on Fox Business Network.
Other obstacles remain, among them a band of deficit hawks in the Senate who are unhappy about the $1.5 trillion the legislation would add to the national debt over the coming decade.
"I remain concerned over how the current tax reform proposals will grow the already staggering national debt by opting for short-term fixes while ignoring long-term problems," said Sen. Jeff Flake, R-Ala. "We must achieve real tax reform crafted in a fiscally responsible manner."
The House and Senate bills are broadly similar in their outlines. Both would drastically reduce the corporate tax rate and also lower rates for individuals, while eliminating deductions claimed by many people.

The House version would collapse the current seven tax brackets into four, while the Senate would retain seven. The House bill would entirely eliminate the estate tax, while the Senate version would retain it while doubling the exemption level. Both versions would retain an adoption tax credit that had initially been eliminated in the House bill, but that adoption advocates fought to restore.

Both would increase a child tax credit, though not to levels sought by Sens. Marco Rubio and others, an indication of how individual provisions will need to be negotiated with one lawmaker after another in the weeks to come. House Republicans appear on track to pass their version of the bill next week, but in the Senate Majority Leader Mitch McConnell has a slim 52-48 majority that has proven difficult to corral.

Democrats are angrily opposed to the GOP rewrite, arguing it's a giveaway to the rich and corporate America. Republicans contend that the tax reductions will help the middle class, even though some independent analyses have found that the wealthy and corporations benefit disproportionately.

The tax bill must deepen federal deficits by no more than $1.5 trillion over the coming decade. If Republicans don't meet that, the measure would be vulnerable to a bill-killing Senate filibuster by Democrats that GOP senators lack the votes to block. It also cannot add to red ink beyond the first 10 years without facing the same fate.

Breakdown of House, Senate GOP plans

Here's a comparison of a Republican-written tax bill — approved Thursday by the House Ways and Means Committee — and another being proposed by GOP members of the Senate Finance Committee.

Personal income tax rates: House condenses current seven brackets to four: 12%, 25%, 35% and 39.6%. Senate retains seven brackets but changes them to 10%, 12%, 22.5%, 25%, 32.5%, 35% and 38.5%. Under current law, top bracket is 39.6%.

Standard deduction: Is currently $6,350 for individuals and $12,700 for married couples. House, Senate would both raise those levels to $12,000 for individuals and $24,000 for couples.

Tax credits: House raises per-child tax credit from $1,000 to $1,600, extends it to families earning up to $230,000. Creates a $300 tax credit for each adult in a family, which expires in 2023. Senate raises per child tax credit to $1,650 and raises income limit of families who qualify to $1 million. Both bills preserve adoption tax credit, which House bill initially eliminated.

Home mortgage interest deduction: House would limit the deduction to the first $500,000 of the loan. Senate would retain the current $1 million ceiling.

Other deductions: House reduces allowable charitable deductions and eliminates medical expense deductions. Senate does neither.
State and local taxes: House ends deductions for state and local income and sales taxes, allows it for up to $10,000 in property taxes. Senate eliminates entire deduction.
Alternative minimum tax: House, Senate both repeal the tax aimed at ensuring that higher-earning people pay at least some tax.
Inheritance tax: When someone dies, the person inheriting the estate currently must pay taxes on its value above $5.5 million for individuals, $11 million for couples. House bill initially doubles those limits and repeals the entire tax after 2023. Senate doubles the exemptions but does not repeal the tax.
Individual mandate: Neither chamber repeals the requirement in President Barack Obama's health care law that people pay a tax penalty if they don't purchase health insurance.
Corporate taxes: House, Senate both reduce current 35% rate to 20%, but Senate has one-year delay in dropping that rate.
Pass-through businesses: Millions of U.S. businesses "pass through" their income to individuals, who then pay personal income tax on those earnings, not corporate tax. House bill would tax many of them at 25%, plus creates 9% rate for the first $75,000 in earnings by some smaller pass-throughs. Senate bill would let people deduct some of the earnings and then pay at their personal income tax rate on the remainder.
Businesses: House, Senate both expand write-offs allowed companies that buy equipment.
Multinational corporations: House levies 10% tax on profits for overseas subsidiaries of U.S. corporations, and seeks to eliminate tax incentives that encourage some U.S. companies to move overseas. Senate ends tax advantages for firms moving overseas.

5. Drop remaining tax proposals: Manitoba finance minister

[November 9, 2017] Manitoba's finance minister says the federal government should abandon its tax-reform proposals and set up an independent commission to examine ways to improve the tax system.
Cameron Friesen made the point to a Senate committee that is holding hearings across the country on the proposed tax changes.
He says the changes would hurt the middle class and force small businesses to cut investment and jobs.

Friesen says any changes should be part of a broad review of the tax system, similar to the Royal Commission on Taxation of the 1960s under then-prime minister John Diefenbaker.
The federal government is proposing changes that would limit tax breaks such as income sprinkling among family members for private corporations and business owners.
The proposals have been criticized by business groups, political opponents and people such as physicians and farmers who incorporate their operations.
The committee launched its hearings in Ottawa on Nov. 1 with testimony from Finance Minister Bill Morneau. It has since travelled to Vancouver, Calgary, Saskatoon and Winnipeg to hear from local medical organizations, chambers of commerce and other business groups.
Senators will head to St. John’s, Nfld. on Nov. 20 to start a series of hearings on the East Coast.

6. Construction of multi-unit homes on the climb

[November 8, 2017] Canada Mortgage and Housing Corp. says the annual pace of housing starts ticked higher in October, boosted by construction of multi-unit homes.
The housing agency says housing starts for the month came in at a seasonally adjusted annual rate of 222,771 units in October, up from 219,293 units in September.
The annualized pace of urban starts increased by 2.5% in October to 205,935 units, boosted by a 12.5% jump in multiple urban starts to 149,593.
“New home construction activity exceeded expectations for the fifth month in a row,” says Derek Holt, vice-president and head of capital markets economics at Scotiabank, in a report.
Single-detached urban starts fell 17.1% to 56,342 units.
“In Vancouver, singles fell 15% [month-over-month], while multis were up 136%. Yes 136%,” says Holt.
Rural starts were estimated at a seasonally adjusted annual rate of 16,836 units.
For the quarter as a whole, “starts were up by 34% [quarter-over-quarter] at a seasonally adjusted and annualized rate,” says Holt. “That reverses a 26% [quarter-over-quarter] slide in Q2.”
He adds: “Q3 urban singles were up 3.5% [quarter-over-quarter] while urban multiples were up 56.5%. That’s a positive for residential construction in the GDP accounts.”

The six-month moving average of the monthly seasonally adjusted annual rates of housing starts was 216,770 units in October, up from 215,153 units in September.
By province, gains in B.C. and Quebec offset a large decline in Ontario, while Alberta was flat, says Holt. The biggest monthly gain was in Saskatchewan, followed by B.C. and Quebec. Nova Scotia posted the weakest monthly gain.
"All told, the run up in starts through 2017 is a positive omen for residential investment, although already elevated levels of activity mean that there isn't much room for housing to become more of a positive for the growth outlook," says Nick Exarhos, director at CIBC World Markets, in a note.

7. RRSP, pension limits are outdated, report says

[November 7, 2017] The federal government should raise the contribution limits for RRSPs and defined-contribution pension plans to reflect lower yields on investments and longer life spans, a report from Toronto-based think tank C.D. Howe Institute says.
"People are living longer and — even more importantly — yields on investments suitable for retirement saving are very low. These changes have raised the cost of obtaining a given level of retirement income," said William Robson, the report's author, in a release.
The report, called "Rethinking limits on tax-deferred retirement savings in Canada," says those with defined-contribution pensions and RRSPs face a number of challenges that make saving for retirement much more difficult than for those with defined-benefit plans. It points to the factor of nine, an equivalency test for savings in various retirement saving plans. First adopted in 1990, the test uses a hypothetical defined-benefit pension plan in which saving 9% of annual earnings will let a person buy a retirement annuity equal to 1% of pre-retirement income.
But the factor of nine hasn't kept up with life expectancy and lower yields on retirement assets, the report says, and people now have to save more than twice as much as it presumes. Those saving in defined-contribution pensions and RRSPs also typically face higher risks and costs than those with defined-benefit plans, and can't contribute extra funds to cover past capital losses.
The report recommends three reforms to fix the factor of nine:

- allow a higher tax-deferred saving limit, raising the threshold from 18% to 30% or more;
- level the playing field for savers catching up on contributions later in life, or for savers with differences in pension plan design;

- replace the current annual saving limits with flexible tax-deferral regimes: either index unused contribution room for inflation or establish an inflation-indexed lifetime tax-deferred savings limit.

8. Poloz explains temporary drag on inflation

[November 7, 2017] Inflation has repeatedly fallen short of the BoC‘s 2% target in recent years, but governor Stephen Poloz says Tuesday fundamental factors are continuing to drive price growth.

In a luncheon speech to CFA Montreal and the Montreal Council on Foreign Relations, Poloz says the fundamental drivers of supply and demand, as well as short-term factors, can explain the movement in prices and that the popular perception that inflation has become inexplicable is exaggerated.

“In part this perception reflects a misunderstanding of the accuracy with which economists can predict inflation and a misunderstanding of the precision with which central banks can control it,” he says, according to a prepared text of his speech released in Ottawa.

Inflation in Canada slowed over the first half of this year and remained in the lower half of the Bank of Canada’s target range even as the economy grew quickly.

However, Poloz says that there have been a number of one-time factors including below-average food inflation and the Ontario government’s reduction in electricity prices that helped keep inflation in check.

“The bottom line is that fundamental drivers of inflation, along with some special factors we can identify, can explain the recent behaviour of inflation reasonably well,” Poloz says. “Certainly the remaining shortfall is well within a reasonable margin of error.”

Poloz also says there may also be some drag on inflation from globalization and digitalization, which the bank is studying. “Over time, as we accumulate data, we may be abler to identify and statistically quantify these effects.”

The BoC aims to keep inflation at 2%, the midpoint of a range of 1% to 3%, by making changes to its key interest rate target.

In keeping the rate on hold last month, the BoC said less monetary policy stimulus will likely be required over time, but that it will be cautious in making future adjustments to the policy rate and be guided by the incoming economic data.

“A lot of pieces need to fall into place before we can be certain that the economy has made it all the way home,” Poloz says Tuesday.

Reaction

The BoC is in no rush to pre-judge achieving 2% inflation and to act accordingly through pre-emptive tightening, says Derek Holt, vice-president and head of capital markets economics at Scotiabank, in a report. “That remains the most important message the BoC is delivering these days.”

He notes that the loonie and rates markets “largely shook off the speech because, while it put a different spin on uncertainty, the broad messages of caution and uncertainty were not new.”

He characterizes the speech as dovish or neutral in the near term and hawkish in the longer run.

“That’s in keeping with our forecast for a pause until April, two hikes in 2018 (April, September) and three in 2019,” he says.

9. Commercial real estate in Toronto to heat up

[November 7, 2017] The population of the Greater Toronto Area (GTA) is projected to increase by 42.3% to reach 9.6 million by 2041, finds an Avison Young report, creating opportunities for commercial property owners.

With the provincial Ministry of Infrastructure planning to invest more than $160 billion over 12 years, starting in 2014, developers are making significant investments in all types of residential and commercial real estate in locations connected with the expansion of public infrastructure.

“With so much planned development on the drawing board and funding in place, this is a time of opportunity for forward-looking commercial property owners and occupiers,” said Bill Argeropoulos, principal and practice leader for research (Canada) at Avison Young, in a release.

Key commercial growth areas in the GTA will emerge at a number of transit-oriented development hubs, notes the report. This will create significant opportunities for development and investment.

Specifically, the report highlights the areas of East Harbour, Vaughan Metropolitan Centre, the Pearson Transit Centre and the Hurontario Light-Rail Transit corridor as the ones to watch.

Rapid population growth and demand for commercial space will challenge government and private developers’ ability to deliver necessary infrastructure, adds the report. However, strategic investment from both investor groups will provide significant opportunities for commercial property owners and occupiers to capitalize on the GTA’s growth.

“The recent news that Toronto is vying for selection as the location of Amazon’s proposed $5-billion second headquarters in North America, and Google sister company Sidewalk Labs’ plan to build a high-tech neighbourhood called Sidewalk Toronto on the city’s waterfront, only serve

to emphasize the importance of making investments in the city's future to further increase its appeal to major global corporations," said Argeropoulos.
He added, "We are hopeful that the commitments made by private stakeholders and all levels of government will ensure the success of these plans, helping to future-proof the GTA and setting an example for achieving its long-term growth and prosperity."

10. Economic indicators point to further BoC rate hikes

[November 6, 2017] Canada's GDP lost steam in August, shrinking 0.1%. But economists aren't concerned.
Benjamin Reitzes, strategist at BMO, says in a weekly economics report that two one-time factors hurt the recent GDP print:
maintenance at a chemicals plant, which hit manufacturing hard and
maintenance on an east coast oil platform, which put oil production lower.
"Absent those two factors, GDP would have come in at +0.1% (a low 0.1 but still positive)," he says. "While August was weak, the reversal of those factors suggests we'll get a solid rebound in September."
Reitzes's takeaway: "Growth of around 2% isn't bad, even though it will keep the BoC patient with further tightening as long as inflation pressures remain subdued."
While BoC Governor Stephen Poloz has said several temporary factors exert downward pressure on inflation, those factors should lift in coming months, says Jean-François Perrault, senior vice-president and chief economist at Scotiabank, in an economics report.
Upside pressure for inflation, excess capacity
"Inflation […] has clearly bottomed and is rising," Perrault says. "From its year-on-year low point of 1.3% in May, [the BoC's] measure of inflation has accelerated at its most rapid pace in over six years."
Along with upward momentum in inflation measures, he sees upward pressure on wages. He's not the only one.
In a weekly economics report, James Marple, TD senior economist, assesses the BoC's take on Canada's excess capacity.
The BoC's latest monetary policy report says that slack remains in the labour market, related to elevated long-term unemployment, low average hours worked and modest wage growth.
These three factors have shown improvement, says Marple.
First, for long-term unemployment, "Statistics Canada's supplementary data show a rate of 2.2% for people unemployed for more than three months. This is the lowest level since prior to the recession," he says.

Second, “on a year-over-year basis, average hours worked were up 1% in October,” he says. “Even more impressive, average hours are up 1.8% relative to the trough in January of this year.”
He further explains that there’s a long-term downward trend in average hours worked, which probably won’t reverse.
“Major steps down appear to occur around recessions, and then remain relatively steady,” he says. “This suggests that even as average hours continue to move higher, they may not go back to previously-observed levels.”
Third, year-on-year wage growth accelerated to 2.4% in October, from a trough of 0.5%.
“The indicator appears to be a lagging one,” he says. “Its recent acceleration is confirmation of strong economic growth and a good sign that inflation is likely to turn higher in the months ahead.”
His outlook: “As with the overall output gap, the labour market is increasingly giving an all-clear-ahead signal to the Bank of Canada to continue tightening monetary policy.”
Perrault agrees that the data point to tightening, and enumerates economic conditions that support a December hike, including an output gap that will “move further into excess demand during 2018,” on the back of sustained growth in GDP.
However, his outlook calls for the next hike to come in April 2018, because of “Governor Poloz’s recent focus on downside risks.”

Have a nice and fruitful week!