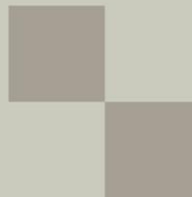


Monthly Market Snapshot – November 2016

CETA: What's in it for Canada?

November 15, 2016

Joseph Zawawi / (416) 840-8170
joseph.zawawi@scotiabank.com

Throughout the month of October, a topic that was widely covered by local media outlets was Canada's signing of the historic Comprehensive Economic and Trade Agreement (CETA) with the European Union (EU). And a good story it was. From a small French-speaking region of Belgium nearly toppling the entire deal, to an airport delay and plane troubles keeping the Prime Minister grounded in the final crucial hours before the deal could be signed, it had all the makings of a soap opera. In the end, Canada and the EU finally signed the free trade agreement that was seven years in the making.

Setting the inner workings of the deal aside, you're probably wondering what the signing of CETA means for you, and for the nation as a whole. For this month's piece, we are not going to go over the story of how the deal came to be. Instead, we thought we'd go through the details of the intended benefits and discuss how it could impact us.

What is CETA?

The aim of CETA is to strengthen economic relations and increase trade to benefit the economies of both Canada and the EU. Although CETA does not come as close to invoking the degree of openness that countries within the EU share amongst themselves, it is the most comprehensive free trade agreement that the EU has ever negotiated with another country outside of the trading bloc.

Once CETA is enforced, 98% of tariff lines that the EU enforces on Canadian goods will become duty-free, and that figure will become 99% within seven years. Prior to the agreement, just 25% of goods exported to the EU were duty-free. The agreement essentially covers all sectors involved in Canada-EU trade.

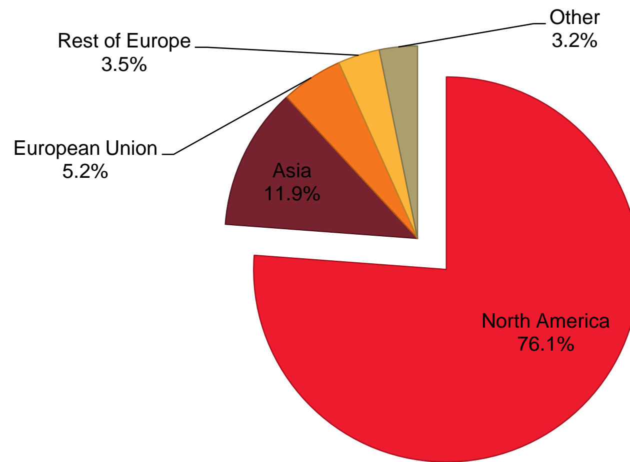
For those wondering, it is also worth mentioning that CETA does not require Canada to pay into the EU budget or be subject to the free movement of people policy; two of the main factors that proponents of the recent Brexit referendum cited as main reasons they wanted to leave the trading bloc.

Canada's Perspective

From Canada's perspective, there is much the nation stands to gain from entering a free trade agreement with the EU. With CETA in place, Canada will now have preferential access to two of the world's largest economies. Currently, about three-quarters of Canadian exports go to the United States, and just over 5% to the EU. Diluting the concentration of export destinations by providing Canadian companies with a competitive advantage in the EU – an $18 trillion dollar economy with 500 million people – will not only act as a tailwind to growth, but also assist in insulating the economy if the U.S. were to experience a downturn.

Please be advised that this material is not to be distributed to residents of the European Union

Chart I: Canada's Export Destinations (2014)



Source: Bloomberg

A joint Canada-EU study which was conducted in 2011 found that the agreement could boost the volume of bilateral trade by 20% and increase Canada's income by as much as $12 billion a year. That, the study found, would translate into about 80,000 new jobs or $1,000 in additional income on average to Canadian households.[1]

Boosting the Bottom Line of Canadian Companies

The key benefit of CETA is the strong competitive advantage Canadian companies stand to gain.

By removing nearly all tariffs, Canadian goods would become more affordable to consumers in the EU, relative to goods from other countries. In addition, Canadian producers may also achieve cost savings through CETA commitments to reduce processing times at the border and making the delivery of goods cheaper and faster. The combination of these two factors will assist in boosting the bottom lines of Canadian producers. Both the success of Canadian companies and growth of the economy have for years benefited from trade that has increased substantially over time. According to data from the World Bank, exports of goods and services as a percentage of GDP equated to over 31% in 2015. That compares with just 17% in 1960.[2]

The agreement also allows for improved access for trade in services. Canadian services exporters will enjoy improved transparency and predictability when doing business with the EU. Aside from a few exceptions, Canadian firms will be treated equally as those from the EU. The EU is the largest importer of services worldwide and imported $16.5B from Canada alone in 2015 ($936B in total worldwide)[3]. Some of the EU's top service imports include Financial, Management and ICT services, which are also some of Canada's top exports. The preferential access that Canadian firms will enjoy can assist in carving out a larger chunk of the market share of the EU services import market.

Another bright element that arises from increased trade openness with the EU is government procurement opportunities. Similar to services imports, the EU is the largest government procurement market in the world, worth an estimated $2.7 trillion annually. This means that there will be increased potential for Canadian goods and services providers to bid on contracts from public utilities, local contracting authorities, transit and railway entities and other bodies governed by public law in the EU.

[1] "Canada-European Union - Global Affairs Canada." Government of Canada, n.d. Web. 11 Nov. 2016.

[2] "Exports of Goods and Services (% of GDP)." The World Bank. World Bank, n.d. Web. 11 Nov. 2016.

[3] "Boost Your Bottom Line." Government of Canada, 2016. Web. 11 Nov. 2016.

Key Benefits by Sector[4]

Drilling it down a bit further, certain sectors are expected to reap particularly strong benefits. Although there are positive ramifications for almost all sectors spanning from Aerospace to Pharmaceuticals and everything in-between, here are some of the details on the most impacted:

Automotive

With annual automotive and auto part imports of over $107B (2015), the EU is the third largest automotive importer in the world after the US and China. Currently Canadian exports make up just 0.5% of that, with about 13,000 vehicles per year. Once CETA is enforced, tariffs on nearly all vehicles and parts will be eliminated, with the remaining tariffs removed within three to seven years. Furthermore, the agreement allows for up to 100,000 vehicles per year to be exported to the EU.

Metals, Mining and Minerals

Tariffs on all metals and minerals shipped to the EU will be eliminated. To put the impact of this into perspective, aluminum currently is hit with a 10% tariff, lead and zinc at 5% and copper at 5.2%. As with other exports, increased affordability for EU consumers and the preferential treatment of Canadian firms will result in exporters enjoying a strong competitive advantage over other countries. Currently Canada is the fourth largest supplier of metals and minerals to the EU, but this could improve if some of the market share from the U.S., Russia and Switzerland can be captured.

Infrastructure

With annual infrastructure outlays of approximately $400 billion, the EU is only second to China. It has also set aside hundreds of billions of euros for several planned infrastructure projects over the next four years. Tariffs on all products used in building will be completely eliminated once CETA enters into force. Canadian producers of construction materials, machinery and equipment and other infrastructure related products stand to gain. In addition, Canadian infrastructure companies also benefit from the increased government procurement opportunities.

Oil & Gas

Not only is the EU the world's largest importer of oil and gas (worth about $403B in 2015), but given the recent strain in relations between Russia and the rest of Europe, the EU currently has a strong focus on diversifying its energy supplier base. Canadian energy products currently make up less than 1% of the EU's energy imports and thus there is much growth potential.

What about Canadian Consumers?

In addition to the potential of increasing average household incomes and creating jobs here at home, Canadian consumers also stand to benefit from lower prices on goods and services imported from the EU. The deal is, after all, is bilateral, meaning it is a two way street. Tariffs on European goods will almost be completely eliminated. For example, car imports from Europe will see the current 6.1% tariff removed – meaning that new Mercedes could be in the cards as it becomes more affordable. Aside from cars, some of the other top products that Canada imports from the EU include machinery and equipment, pharmaceuticals, electronics and food products and alcohol.

Looking Forward

For Canada, a free trade agreement with another economy, especially one as large as the EU, provides ample opportunities. Previously, Canada was a small player in bilateral trade with the EU but now has been equipped with a strong competitive advantage that may be leveraged in order to capture market share. By making imports cheaper for consumers, providing preferential access to goods and services providers, shorterning process times and border delays and by filling other voids such as assisting the EU in its aim of diversifying its energy providers, the positive ramifications of CETA for both Canadians and Europeans alike are far reaching and affect all sectors.

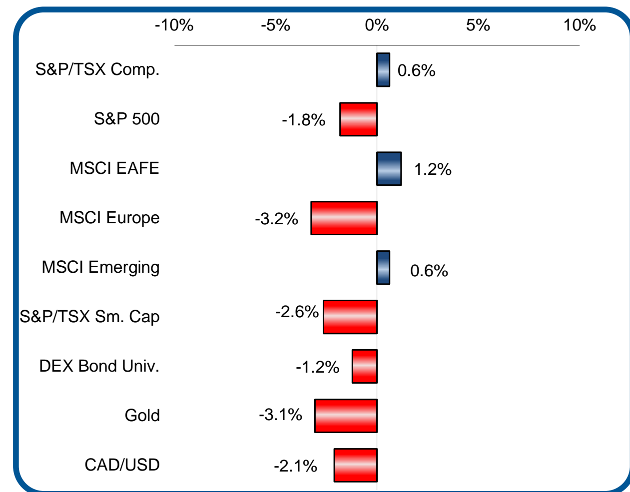
The future looks bright for the aspects of the recently signed deal. In addition to boosting the profits of companies, one of the key benefits lies in improving the nation's economic strength by greatly diversifying its export destinations. This will aid in lessening the current heavy reliance on our neighbor to the south. During times when there are increasing cries to sever global ties around the globe, Canada may find significant strength through increased trade.

---

[4] Sourced from: "Key Sectors." Government of Canada, 2016. Web. 11 Nov. 2016.

Monthly Overview

Global equities were mixed during October. The S&P/TSX Composite finished the month up 0.62%. The return for the index year to date as of the end of October stood at 16.5%, putting it near the top of the list of major markets globally. The financials sector posted the largest gain during the month, rising 2.15%. Canadian health care stocks were the biggest losers, shedding 17.82%, thanks primarily to the 25.6% decline in shares of Valeant Pharmaceuticals. In the U.S., the S&P 500 traded down 1.82% for the month, however remains firmly in the green year-to-date, up 5.8%. Losses were chalked up in Europe, with the Stoxx Europe 600 Index ending the month 1% lower. In Asia, the MSCI Asia Pacific Index lost 0.47%. (All returns in local currency terms)



Source: Bloomberg, All Returns are TR and in Local Currency

Rising inflationary pressures, a strengthening labour market, and other positive economic data out of the U.S. during October have heightened expectations for a Fed rate hike in December. According to CME Fed Fund futures prices, investors are now assigning a 94% chance of a rate increase in the last month of the year. It is worth noting that one of the Fed's covets for a rate move is to not take markets by surprise. Consumer prices picked up in September with headline CPI rising 1.5% year-over-year, to its fastest pace since October 2014 and following a 1.1% gain in August. The gain is attributed to a 5.8% rise in gasoline prices from the previous month. If oil prices stabilize at current levels, the base effect of prices from a year ago will likely continue to act as a tailwind for headline inflation in the months to come. Furthermore, with an average price of WTI crude at $49.86 USD per barrel in October relative to $45.13 USD in September, headline CPI for October could experience another strong month-over-month rise. October core CPI (excluding the effects of energy and food) fell slightly to 2.2% (from 2.3%) on an annualized basis. September retail sales also came in strong, indicating that consumers are still alive and well and bodes well for the overall growth picture. The monthly figure rose 0.6%, more than offsetting the 0.2% decline in August. Motor vehicle sales and a nominal rise in gas prices helped spur the increase over the previous month. Non-farm payroll data for September increased by 156,000 positions, undershooting both the monthly average increase so far this year and the expectation for the month of 178K and 172K respectively. Although the employment figure fell short of expectations and the unemployment rate ticked up a tenth of a percent to 5%, the underlying data continues to indicate a strengthening labour market as there was an increase in the number of individuals returning to the workforce and annual wage growth increased at a pace of 2.6%. The growth in wages compares to increases of 2.3% and 2.1% in 2015 and 2014 respectively. Near the close of the month, we got our first look at the advanced Q3 GDP number, which came in much higher than expected - at 2.9% (2.5% exp.) - the fastest pace in two years. Although consumer spending was a supportive pillar, a rise in exports and a surge in inventory investment were the main factors backing the large increase.

Here at home, inflation has remained subdued. September headline CPI crept up slightly to 1.3% (from 1.1% in August), however, fell below expectations of 1.5%. Although the gain reflects a rise in gasoline prices, a drop in the food component which is generally quite volatile weighed on the measure. Core CPI remained steady from the August at 1.8%; the reading had been at or above 2% for all but 4 of the past 26 months. Continued stability in energy prices could continue to buoy price measures or contribute to a rise given base price effects. Employment data for September came in stronger than expected, with the country's labour force adding 67,200 new jobs during the month. More than two-thirds of new jobs added were considered either part time or self-employed positions, however, while full time or paid employee positions made up the balance. The unemployment rate remained at 7% as more people joined the workforce. In addition to putting out what was perceived as a more dovish Monetary Policy Report, BoC governor Stephen Poloz commented that the Bank's council had "actively discussed" a rate cut at

its meeting. Prior to the central bank's policy announcement on October 19th, markets were pricing in an almost zero chance of a rate cut by January. Futures markets are now pricing in a cut with an 8.5% possibility for January 2017 and 11.4% for March. The over-heating housing market had previously kept the likelihood of further monetary stimulus off the table. However, with the concern of lower rates further pressuring real estate prices now absent, the consideration by the Bank to lower rates to buoy the economy is more plausible now as the new mortgage rules essentially remove the connection between central bank rate changes and mortgage rates. The BoC also downgraded its growth forecasts for 2016 and 2017. For 2016, Q3 growth is expected to come in at 3.2% (3.5% prev.), Q4 growth was cut substantially to 1.5% (2.8% prev.) and the economy is expected to grow by 2% in 2017 (down from 2.2%). Officials at the Bank cited housing investment as the main catalyst negatively impacting the growth outlook, but remain optimistic about the ramifications of the recent fiscal policy actions by the federal government.

Ottawa introduced the new mortgage rules across the country on October 17th in an attempt to prevent Canadians from taking on too much debt when purchasing a home. The aim is to restrict the total amount that buyers may qualify for by requiring banks to essentially stress-test new insured mortgages by having purchasers approve under the higher posted rates. To put the new changes into perspective, a study by www.ratehub.ca, showed that a purchaser with a $100,000 income and a $40,000 down payment could previously afford a $665,435 home (at rate of 2.17%). After the changes, that amount would now be $505,762. Although the new measures will make the purchase of a home more difficult for first-time homebuyers, it is expected to aid in curving the effects that are driving prices higher on the market as a whole.

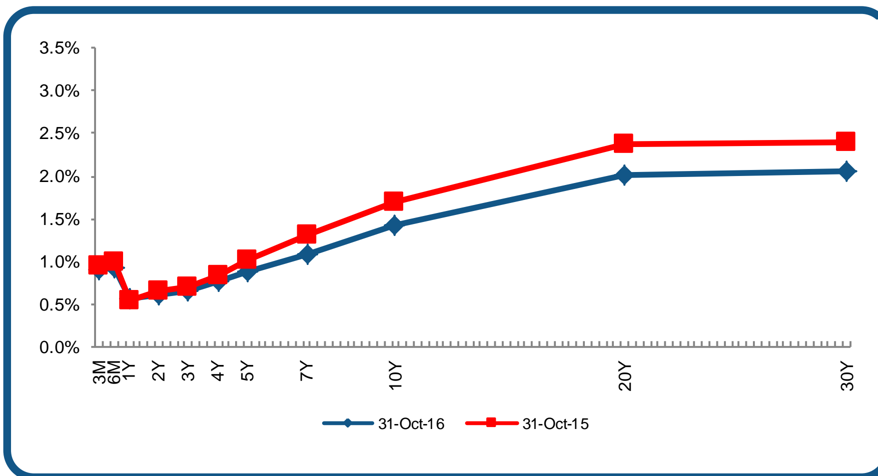
Market watchers continue to keep a close eye over news out of the UK to assess both the current and future impact of the referendum vote. Early in the month, financial markets were rattled and the British pound once again plunged to a three-decade low after Prime Minister Theresa May promised to trigger the European Union (EU) exit proceedings by the end of March 2017, meaning that the UK could be officially leave the EU by early 2019. The International Monetary Fund increased its UK growth outlook for 2016 to 1.8% given that any immediate negative impacts as a result of the referendum have been muted thus far. The IMF lowered its 2017 estimate to 1.1%, however, citing the uncertainty about the future trade ties with the EU and the impact on the UK's economy. The economy grew at a pace of 0.5% in the third quarter (2% annualized), only showing modest signs of slowing from the second quarter. The GDP reading was widely awaited for given that it provides the most comprehensive measure of the health of the economy since the referendum vote. The better-than-expected data point joins an array of economic data that has held up well so far.

Monthly Market Statistics: October 2016

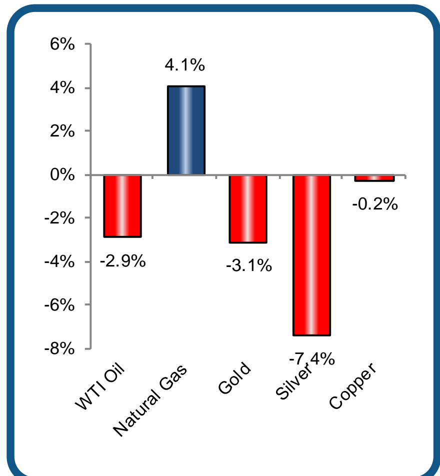
Total Return Index Returns (Annualized After One Year)

	Local Currency Returns							Canadian Dollar Returns						
	1M	3M	6M	YTD	1YR	3YR	5YR	1M	3M	6M	YTD	1YR	3YR	5YR
TSX Composite	0.6%	2.1%	7.5%	16.5%	12.7%	6.6%	7.0%	0.6%	2.1%	7.5%	16.5%	12.7%	6.6%	7.0%
S&P 500	-1.8%	-1.7%	4.1%	5.9%	4.5%	8.8%	13.6%	0.3%	0.9%	11.1%	2.6%	7.1%	18.3%	20.5%
MSCI EAFE	1.2%	2.5%	5.4%	0.0%	-1.4%	5.1%	10.6%	0.1%	1.8%	6.8%	-2.9%	-0.3%	7.8%	12.0%
MSCI World	-0.6%	0.1%	4.8%	3.9%	2.4%	7.1%	12.0%	0.2%	1.3%	9.5%	0.9%	4.4%	13.5%	16.4%
MSCI Pacific	2.8%	3.8%	4.7%	-4.3%	-4.9%	5.2%	12.0%	2.4%	4.6%	12.9%	2.5%	8.3%	11.0%	13.0%
MSCI Emerging	0.6%	3.9%	9.3%	12.3%	8.2%	3.6%	5.6%	2.4%	6.8%	17.1%	13.1%	12.4%	6.9%	7.1%
TSX Small Cap	-2.6%	-3.2%	7.2%	30.7%	26.5%	4.4%	2.3%	-2.6%	-3.2%	7.2%	30.7%	26.5%	4.4%	2.3%
Global Small Cap	-2.3%	-0.7%	4.9%	5.4%	4.7%	6.7%	12.8%	-1.5%	0.5%	9.7%	2.8%	7.3%	13.4%	17.4%
CDA Bond Uni.	-0.9%	-0.6%	3.0%	4.3%	5.6%	5.3%	4.3%	-0.9%	-0.6%	3.0%	4.3%	5.6%	5.3%	4.3%
CDA 1-5 Yr Bond	0.0%	0.3%	1.3%	1.6%	2.0%	2.4%	2.3%	0.0%	0.3%	1.3%	1.6%	2.0%	2.4%	2.3%

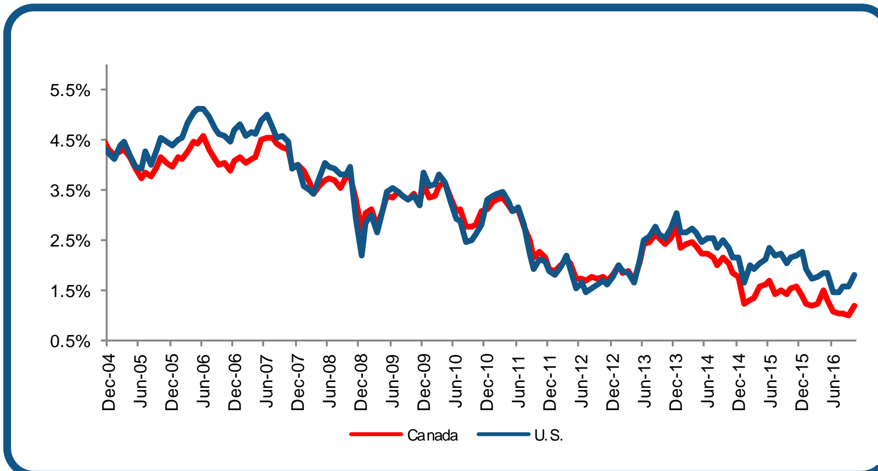
Canadian Yield Curve



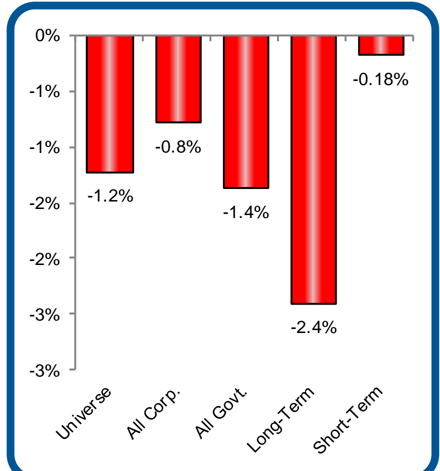
Commodities Performance (1M)



10YR Government Bond Yields



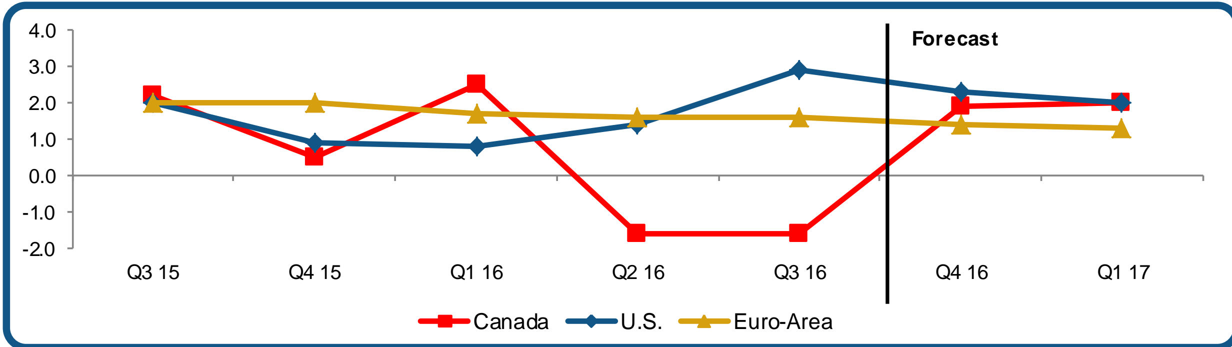
FTSE/TMX Bond ETFs (1M)



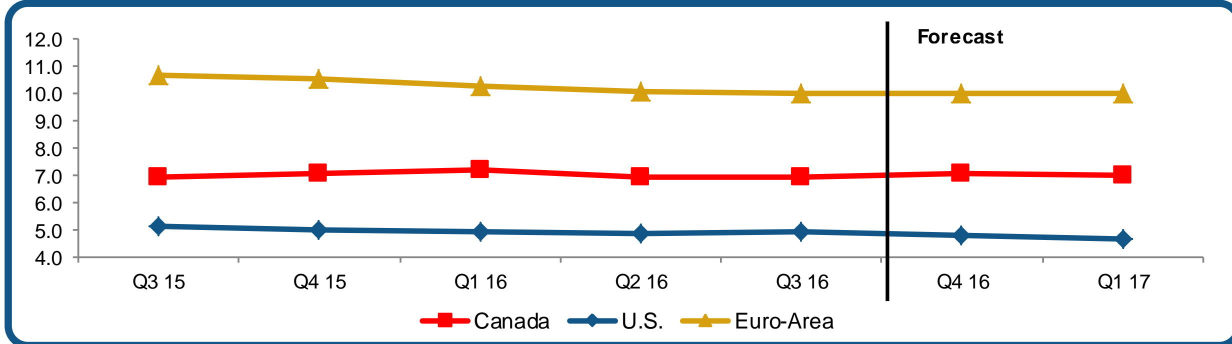
Source: Bloomberg, iShares.ca

Economic Statistics

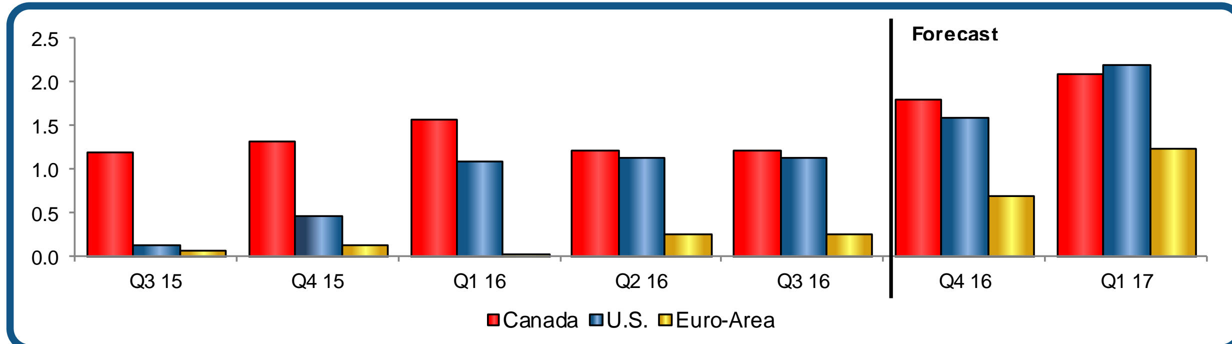
Real GDP (%)



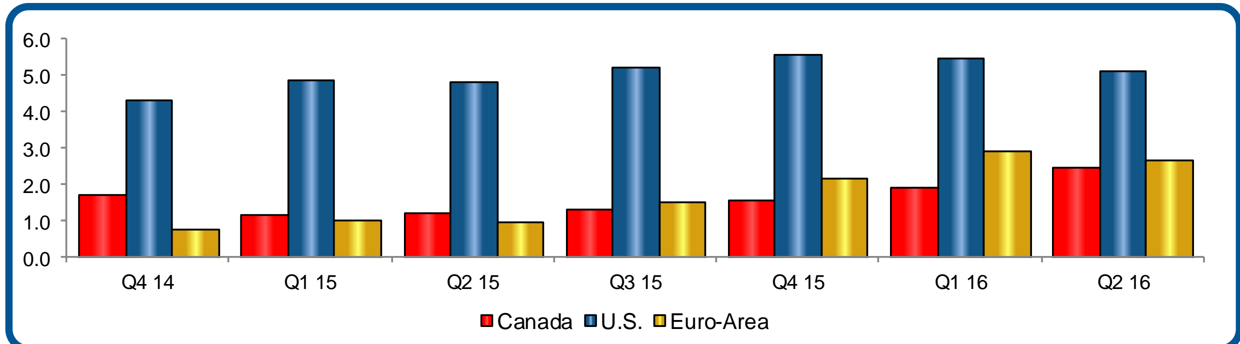
Unemployment Rate (%)



Consumer Prices (YoY %)



Housing Prices (YoY %)



Source: Bloomberg

Important Disclosures

This material does not include or constitute an investment recommendation, and is not intended to take into account the particular investment objectives, financial conditions, or needs of individual clients. Before acting on this material, you should consider whether it is suitable for your particular circumstances and talk to your investment advisor. This report has been prepared by HollisWealth™ (a division of Scotia Capital Inc.).

General Disclosures

HollisWealth prepares this report by aggregating information obtained from various sources as a resource for HollisWealth clients. Information may be obtained internally within HollisWealth or from the Equity Research and Fixed Income Research departments of the Global Banking and Markets division of Scotiabank. Information may be also obtained from the Foreign Exchange Research and Scotia Economics departments within Scotiabank. In addition to information obtained from members of the Scotiabank group, information may be obtained from various third party sources such as Standard & Poor's, Valueline, Morningstar CPMS, Bank Credit Analyst and Bloomberg. The information and opinions contained in this report have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made as to their accuracy or completeness.

While the information provided is believed to be accurate and reliable, neither Scotia Capital Inc., which includes HollisWealth, nor any of its affiliates makes any representations or warranties, express or implied, as to the accuracy or completeness of such information. Neither Scotia Capital Inc. nor its affiliates accepts any liability whatsoever for any direct or consequential loss arising from any use of this report or its contents.

This report is provided to you for informational purposes only. This report is not intended to provide personal investment advice and it does not take into account the specific investment objectives, financial situation or particular needs of any specific person. Investors should seek advice regarding the appropriateness of investing in financial instruments and implementing investment strategies discussed or recommended in this report and should understand that statements regarding future prospects may not be realized.

Nothing contained in this report is or should be relied upon as a promise or representation as to the future. The pro forma and estimated financial information contained in this report, if any, is based on certain assumptions and management's analysis of information available at the time that this information was prepared, which assumptions and analysis may or may not be correct. There is no representation, warranty or other assurance that any projections contained in this report will be realized.

Opinions, estimates and projections contained in this report are our own as of the date hereof and are subject to change without notice.

HollisWealth™ is a division of Scotia Capital Inc. and a member of the Canadian Investor Protection Fund and the Investment Industry Regulatory Organization of Canada.

™ Trademark of The Bank of Nova Scotia, used under license.