

Another Weak Canadian Manufacturing Report

- Headline shipments fell by less than expected...
- ...because higher prices offset a sharper hit to volumes
- Sales volumes are down in 3 of 4 months, 5 of 9 ytd
- Inventory stockpiling may be slowing...
- ...which drags on GDP growth
- September GDP is tracking little to no growth again...
- ...and inventories could put downside risk to the BoC's soft Q3/Q4 forecast
- GM strike and refinery shutdowns hit the numbers...
- ...but even excluding these effects indicates weakness
- The order pipeline has weakened

CDN manufacturing shipments, m/m % change, Sept:

Actual: -0.2

Scotia: -1.0

Consensus: -0.5

Prior: +0.8

Markets largely shrugged off a manufacturing report that posted a smaller than expected decline in the value of shipments but that registered weak underlying details. That could either be because of grander concerns in markets than backward looking domestic data, or a mixed feel for the overall tone of the report. Implications for future momentum, inventory stockpiling and GDP growth are assessed below.

The overall figures are consistent with the second half slowdown narrative after transitory drivers of gains in Q2. BoC communications from SDG Wilkins today and Governor Poloz on Thursday take on heightened significance given the dovish turn at the October 30th meeting, the fragile state of US-China trade negotiations including the interplay with developments in Hong Kong, and souring Canadian macro data (jobs, trade, manufacturing, scant monthly GDP growth etc). **It bears repeating that Canadian data has generally soured since the last BoC meeting and so it would be a tad inconsistent for the BoC or markets to walk back the cautious tone.**

Higher prices insulated some of the headline hit as the volume of sales fell by 0.7% m/m.

Sales volumes fell by about 2.9% in Q3 over Q2 at a seasonally adjusted and annualized rate (SAAR). The hand-off suggests sales volumes are tracking a small rise of just 0.8% q/q SAAR in Q4 before we get any actual Q4 data. This could rise or fall as data comes in but it gives an idea of what is baked into the numbers thus far.

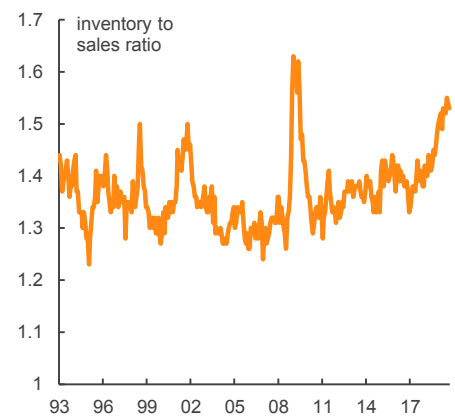
Inventories remain problematic. The inventory to sales ratio was 1.53 which is a statistically insignificant downward tick from the prior month. See chart 1 that shows that **the inventory-to-sales ratio is still trending around its highest since the 2009 recession.**

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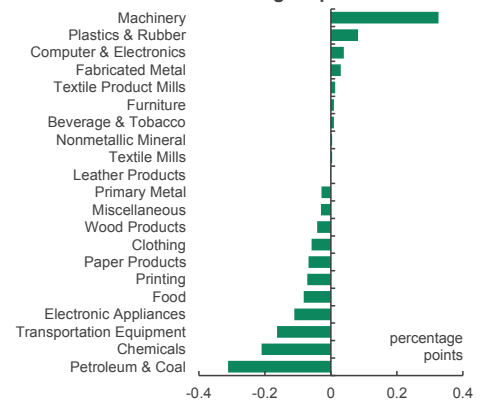
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Canadian Manufacturing Inventories



Sources: Scotiabank Economics, Statistics Canada.

September Weighted Contributions to Real Manufacturing Shipments



Scotiabank Economics, Statistics Canada.

That said, inventory stockpiling is slowing from a prior torrid pace of expansion. Inventories were up by 2.4% in volume terms during Q3 after a whopping 13½% gain in Q2 and a Q1 rise of 7 ½%. On a very preliminary basis, inventories are tracking a drop of 2½% in Q4. If that holds, then **inventory changes should be a drag effect on Q3/Q4 GDP growth over 2019H2**. The noted patterns are generally true for both big-ticket durable and nondurable goods. **Efforts to contain inventory stockpiling could be a negative for production and hiring into 2020 and this is also true stateside as North American supply chains face inventory overhangs.**

Shipments weakness was widespread across categories. While the **GM strike** weighed upon the numbers through a 4.3% m/m drop in auto parts shipments, assembled vehicle shipments rose by 2.9%. In weighted contribution to growth terms, the energy patch, chemicals, transportation, appliances, food and several other categories were responsible for the softness as really only two sectors registered notable gains (machinery and plastics/rubber). See chart 2 for a weighted contribution break down.

The breadth of weakness is what should contain some of the temptation to write off the report as a function of the GM strike and partial shutdowns at some Canadian oil refineries. **Excluding the entire petroleum and coal products plus the entire transportation sector that was also weighed down by a 3.7% drop in shipments of aerospace products would have resulted in a gain of just 0.2% m/m in manufacturing shipment volumes.** That's over-correcting for these sectors but it gives a sense of the widespread weakness.

New order volumes fell by 1.4% m/m to reverse half of the prior month's gain and they've been lower in three of the past four months. Order volumes fell 6.9% q/q SAAR in Q3 to unwind much of the 8% Q2 rise. Order volumes are tracking flat so far in Q4.

Unfilled orders fell by 0.4% m/m. They fell by 6.8% q/q SAAR in Q3 after a -0.3% drop in Q2 and are tracking a 1% decline in Q4.

The dollar value of shipments fell in 7 of 10 provinces. Only BC (+3.7%), NB (+9.9%) and Newfoundland and Labrador (+3.1%) escaped the declines that were posted elsewhere including Ontario (-0.1%), Quebec (-0.5%) and Alberta (-3.2%).

The implication for GDP tracking when combined with what we know so far across other indicators points to little to no growth during September. Hours worked fell by 0.3% m/m, manufacturing shipment volumes fell by 0.7% and housing starts fell by 2.2%. Retail (Friday) and wholesale (next week) reports are pending. Monthly GDP growth has been trending at a 0.1–0.2% m/m pace for five months including the estimate for September. That would suggest quarterly GDP growth in the ballpark of the BoC's 1.3% forecast for Q3 using monthly income side figures whereas the BoC forecasts expenditure-based GDP. The difference between the two can include inventory and import leakage effects, with inventory effects transitioning toward a drag. If inventories are indeed an economy-wide drag in Q3/Q4 relative to H1, then the implications could point to downside risk to the BoC's forecasts.

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