Weakness In Canadian Manufacturing Is Likely To Continue

- Shipments fell in dollars and volumes and breadth was soft
- The economy is tracking no growth in October…
- ...and well below the BoC's forecast for Q4
- A very weak order book and stockpiling inventories…
- …suggest that better manufacturing prospects will remain elusive

CDN manufacturing shipments, m/m % change, October:
Actual: -0.7
Scotia: 0.3
Consensus: 0.0
Prior: -0.2

Meh, it's just one jobs report, so walk it off. That line of reasoning suffered yet another blow in a weak all around manufacturing report that adds to the stream of negative surprises that is driving Q4 GDP growth closer toward nothing by the release. We're sticking to our Q1 BoC cut call.

The 0.7% m/m decline in the value of shipments was driven by a 0.4% decline in volumes and lower prices. Tracking for Q4 is pointing toward a 2.1% q/q decline in shipment volumes at a seasonally adjusted and annualized rate (SAAR).

Is manufacturing weakness transitory? There are two arguments against this suggestion. One is that inventories are bloated. Two is that the order pipeline is very weak and so that portends ongoing trend softness in shipments.

The inventory-to-sales ratio in the manufacturing sector remains at its highest since the 2009 recession and the wholesale sector is trending around its highest since 1995. Since inventories are costly to finance and store, this counsels further production restraint and along with that hesitation toward hiring.

New order volumes fell by 4.7% m/m and are tracking an 11% q/q drop at a seasonally adjusted and annualized rate (SAAR) after a 3.5% drop in Q3. Unfilled orders fell by 1.5% m/m and unfilled orders are tracking a 2.6% Q4 decline after a 4.6% decline in Q3.

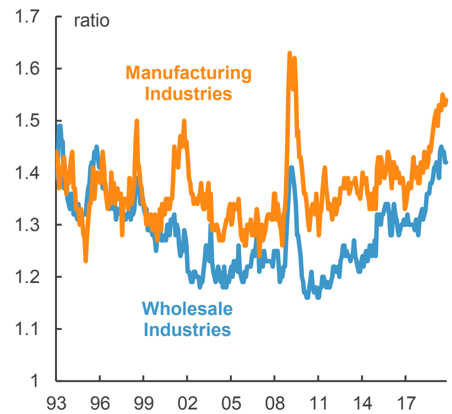
Shipment volumes are tracking a 2% q/q SAAR decline after a 3.8% q/q decline in Q3 such that all of the 6.4% transitory advance in Q1 has been reversed. Further, all of the 6.4% jump in shipment volumes in Q1 has been reversed, the 8% rise in new order volumes in Q1 has been more than unwound and the unfilled order book has shrunk throughout the year.

Canada will be lucky to get any GDP growth for the month of October. GDP growth is tracking around 0% m/m slightly depending upon depending upon wholesale trade (Thursday) and retail trade (Friday). Hours worked were little changed (+0.1%) in October but fell by 0.3% before and after that month. Manufacturing shipments volumes fell 0.4% m/m and housing starts fell by 9.3% m/m in November.

CONTACTS

Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

High Inventories Are a Risk to Production and Jobs

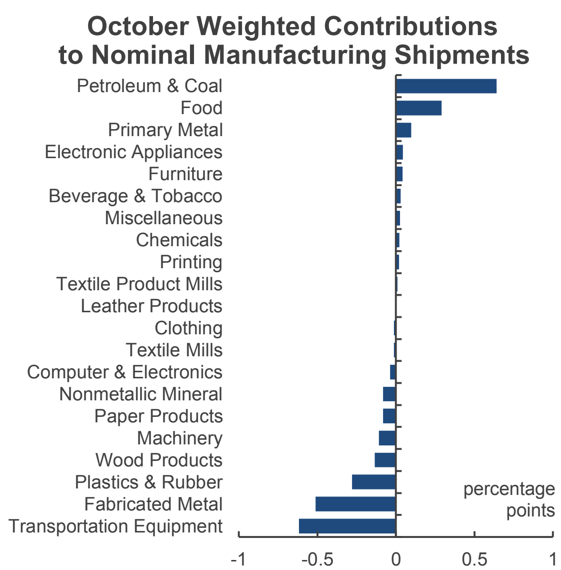


Sources: Scotiabank Economics, Statistics Canada.

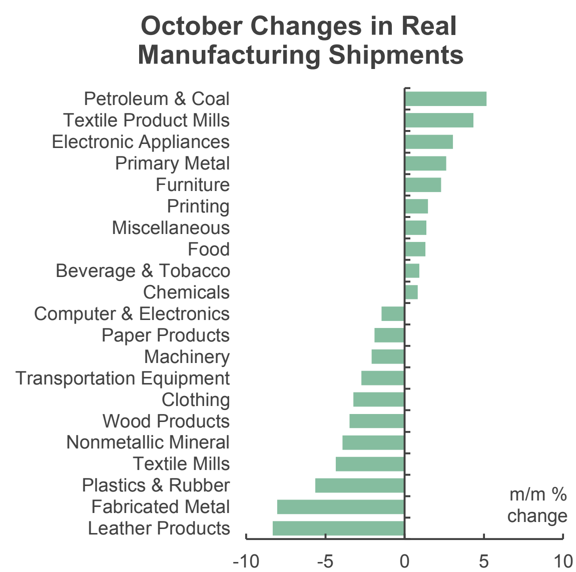
Breadth was soft. Eleven out of 21 industries saw weaker shipments and so don't dismiss the overall report as just a GM strike distortion. Motor vehicle shipments fell by 4.7% m/m and parts fell by 4.6%. There were also *positive* transitory distortions like a 6.2% m/m jump in petroleum and coal products shipments as production recovered at several refineries following unusually timed maintenance shutdowns. Beyond the transitory decline and transitory surge components, the rest of the report was fairly weak. Shipments of textiles fell by 4.7% m/m, clothing fell by 3.2%, wood products fell 3.3%, paper fell 2.1%, plastics and rubber products fell 5.7%, non-metallic mineral products fell 3.7%, fabricated metal products fell 8.2%, machinery fell 1.7%, computer and electronics fell 1.7%.

The broader evidence does not support the BoC's official public line of reasoning that weakness is just in one jobs report. Even on jobs, Canada has lost over 90k jobs in two months excluding October's temporary election hiring. Hours worked have fallen in two of the past three months. StatsCan's payrolls and ADP payrolls reports have also shed jobs in their latest readings. Further, GDP growth is tracking poorly at around 0.5% SAAR in Q4 which is materially below the BoC's 1.3% forecast. The economy is stalling and fiscal stimulus is shaping up to be a rounding error on the forecast. That continues to keep the focus upon watching for a potential turn in monetary policy.

The accompanying charts show the drivers of the drop in the value of shipments (chart 2) and the volume of shipments (chart 3) on a weighted basis by sector.



Sources: Scotiabank Economics, Statistics Canada.



Sources: Scotiabank Economics, Statistics Canada.