Canadian Manufacturers Are Grappling With An Inventory Overhang

- **Shipments fell again…**
- **...and reinforce expectations for no GDP growth…**
- **...in either November or Q4**
- **The latest figures are distorted by auto and rail strikes...**
- **...but a diversified inventory overhang is depressing manufacturing trends**
- **Inventories as a share of sales are at a cycle high**
- **Trends in the new and unfilled orders books point to continued challenges**

CDN manufacturing shipments, m/m % change, November:
Actual: -0.6
Scotia: -1.0
Consensus: -0.5
Prior: -0.2 (revised from -0.7)

Although it's difficult to sift through the effects of distortions like strikes in the auto and rail sectors during October and November respectively, the trends continue to portray an unfavourable depiction of the manufacturing sector's health and the diversified inventory overhang remains a serious challenge to the outlook.

In dollar terms, shipments fell by 0.6% m/m and the prior month was revised up to a smaller decline.

Total shipment volumes fell by 0.8% m/m. Total shipment volumes actually fell by 1.6% m/m after taking out a rebound in shipments within the transportation sector that was driven by a rebound at auto parts producers following the cessation of the GM strike.

In volume terms, shipments are tracking a 2.1% q/q SAAR (seasonally adjusted at an annualized rate) drop in Q4 after a 3.75% decline in Q3. Thus, the 1.9% rise in Q1 and the 6.4% rise in Q2 are being substantially reversed and the H1 gains were fed by a combination of transitory factors.

Breadth in terms of the dollar change in shipments was mixed as 11 of 21 sectors fell. Chart 1 shows weighted contributions to the overall change in the value of shipments and that a small handful of sectors were on the plus side of the ledger and mostly only because of a rebound effect after the GM strike.

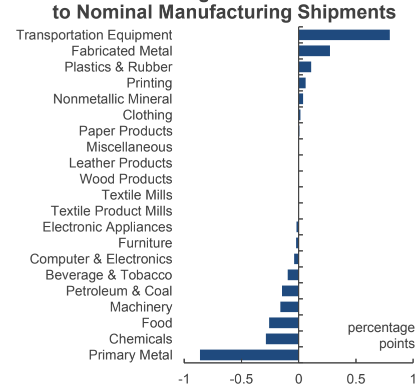
In volume terms, 12 out of 21 sectors saw declines in the volume of shipments. Chart 2 shows the weighted contributions to the change in total shipment volumes and how most sectors were flat to lower.

New orders increased by +1.9% m/m after a big prior drop of 4.2% m/m in October. Half of that rise was due to higher prices as the volume of new orders increased by 0.9% m/m. For the quarter as a whole, new orders are tracking a 3.3% q/q annualized decline in dollar terms and a 4.2% decline in volume terms.

CONTACTS

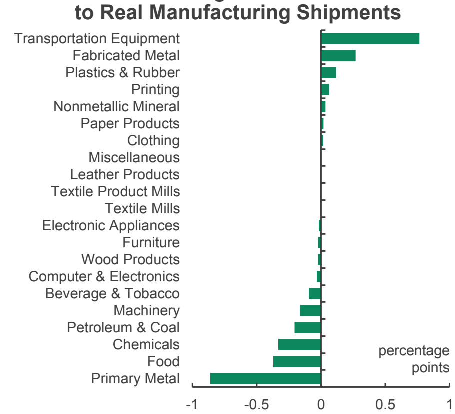
Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

November Weighted Contributions to Nominal Manufacturing Shipments



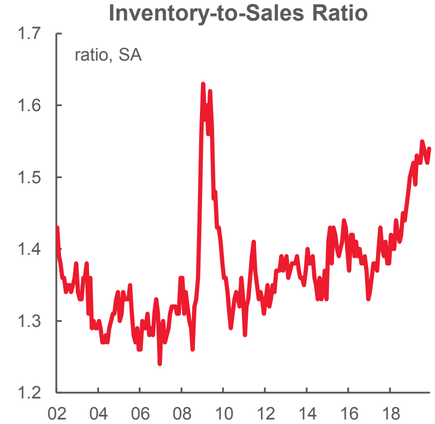
Sources: Scotiabank Economics, Statistics Canada.

November Weighted Contributions to Real Manufacturing Shipments



Sources: Scotiabank Economics, Statistics Canada.

Inventory-to-Sales Ratio



Sources: Scotiabank Economics, Statistics Canada.

Unfilled orders were flat in November after a prior 1.4% m/m decline. In volume terms, unfilled orders were flat after a 1.0% m/m prior decline. Unfilled orders are tracking a decline of 1.4% q/q in Q4 in value terms and a 0.7% drop in volume terms.

Inventories climbed by 0.5% m/m so higher production went further into inventories and popped the inventory-to-sales ratio higher. **The inventory to sales ratio increased to 1.54 and remains around a cycle high with no progress toward reducing the inventory overhang (chart 3).**

The run-up in the inventory-to-sales ratio since the end of 2016 has been driven by the beverage/tobacco, paper, wood, primary metals, transportation equipment, computers/electronics, electric equipment/appliances and furniture & related industries.

Ontario carried the day but sales fell in eight of ten provinces for high regional breadth to weakness.

GDP is tracking roughly flat in November and overall for Q4 based on the production side GDP figures. November GDP is weighed down by a 0.3% drop in hours worked and a 0.8% drop in shipments with starts up 0.7% and pending retail and wholesale figures plus bottom up special factors.

As explained in the week ahead, what matters from a BoC perspective is how strong they go on 2020Q1/Q2. They have not published their quarterly forecasts for 2020 yet given the practice of only publishing two quarters out at a time. The October MPR was still forecasting Q3 GDP and then Q4. What they do with Q1/Q2 will inform the extent to which they think such softness is transitory or exposing deeper risks.