Scotiabank

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Canadian Manufacturers Disappoint and High Inventories Still Plague The Outlook

- **Shipment volumes unexpectedly fell**
- **Only four sectors contributed material weighted gains**
- **New orders and unfilled orders retreated**
- **Sky high inventories will continue to plague the outlook**
- **The list of excuses for the BoC not to cut is getting rather long**

CDN manufacturing shipments, m/m % change, December:
Actual: -0.7
Scotia: 1.0
Consensus: 0.7
Prior: -0.6

This was a much weaker than expected reading than anyone expected across the headline and details.

Nine out of 21 sectors saw a lower volume of manufacturing shipments, one was flat, and the other eleven were higher for a roughly even distribution of industry contributions to growth in overall shipment volumes. That said, there were only four sectors that contributed weighted gains of 0.1% m/m or higher and so breadth was softer than the raw numbers would suggest.

A 6.7% m/m drop in the volume of shipments out of the transportation sector played the largest single role given longer than usual seasonal shutdowns in the auto sector and “to a lesser extent” the closure of the GM plant in Oshawa that had been winding down well in advance. The GM output is permanently lost, but there may be a partial rebound coming in parts production as greater distance emerges from the CN rail strike in November and the October GM strike in the US. That possible rebound itself risks being transitory pending further evaluation of the coronavirus shock especially on commodity related sectors and as we monitor the illegal protests that have shut down CN’s rail system again. There was also a 15.7% m/m drop in aerospace shipments.

Obviously one can’t simply remove a sector that is nearly one-fifth of overall manufacturing in Canada (transportation) notwithstanding its outsized drag effect. Doing so is cherry picking, as an equal case could be made for removing the highest positive contributors in primary metals—that benefited from the reversal of the prior decline—and non-metallic minerals. See chart 1 for a depiction of the weighted contributions to growth in manufacturing shipment volumes by sector.

Manufacturing shipment volumes have fallen for two consecutive quarters and three of the past five (chart 2). For 2019 overall, the volume of shipments was up by only about 1% over 2018 and only thanks to the first half of the year.

The inventory to sales ratio was steady at 1.54 in volume terms and thus remains at the highest levels since the Global Financial Crisis (chart 3). This will continue to impede a manufacturing rebound. It also serves as a headwind to investment since why would one expand, at least in terms of nearer term capacity, until unsold product is sharply reduced?

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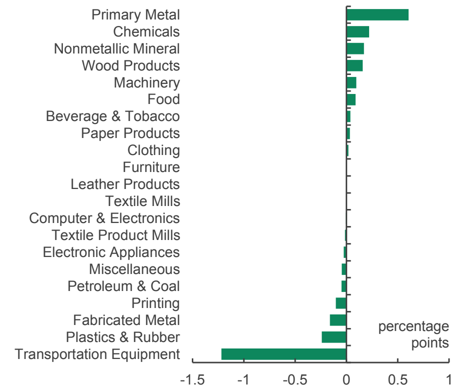
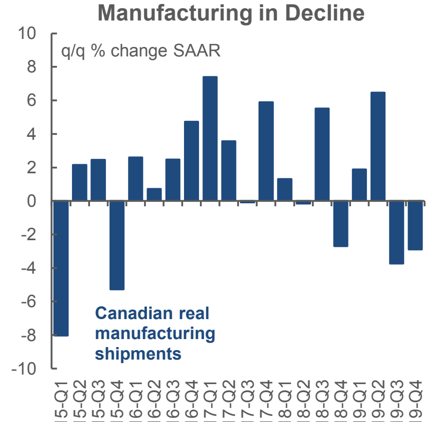
December Weighted Contributions to Real Manufacturing Shipments



Sources: Scoitabank Economics, Statistics Canada.

Manufacturing in Decline



Sources: Scotiabank Economics, Statistics Canada.

Real Inventory-to-Sales Ratio

Sources: Scotiabank Economics, Statistics Canada.

The order book was flat in volume terms (+0.1% m/m) after a 0.9% gain in November that followed a large 3.8% drop in October. Unfilled order volumes were little changed (+0.2% m/m) after -0.1% the month before and a material 1.3% drop in October.

GDP growth is tracking flat in December so far. Hours worked were flat, manufacturing shipment volumes fell 0.4% m/m and housing starts fell by 4.5%.

That leaves Q4 GDP tracking around 0% q/q growth at a seasonally adjusted and annualized rate using the monthly GDP accounts.

By province, the value of sales fell in the industrial heartland including Ontario (-1.1% m/m) and Quebec (-2.2%) plus Saskatchewan and PEI.

The excuses for the BoC not to cut on March 4th are getting to be a rather lengthy list. The economy was weak before the coronavirus shock to commodities. Slack continues to build. Inventories are sky high. Serial shocks against growth continue. All of this points to downside risk to core inflation requiring stimulus to stay on the inflation target in future. Further, I'm still of the belief that the reasons Canada saw core inflation rebound to target for the first time in a decade of trying had little if anything to do with output gaps and much more to do with idiosyncratic and transitory drivers. Finally, the greater risk to financial stability is not easing especially with no assist from overall net Federal-provincial fiscal policy.