

CANADA'S MANUFACTURING, WHOLESALE, AND TRANSPORTATION SECTOR

June 2019

Solid gains despite a rocky ride in 2018

- Canada's manufacturing, wholesale, and transportation (MWT) sector achieved more moderate but still robust GDP growth in 2018 after expanding at the fastest pace in 6 years in 2017
- Transportation and warehousing grew the fastest of the MWT sector's three pillars in 2018, bolstered by strong gains in warehousing & storage and air transportation.
- Manufacturing sales grew in nearly all provinces in 2018, save for a decline in New Brunswick following a double-digit gain in the previous year. Wholesale sales rose in all provinces except New Brunswick and Newfoundland & Labrador.
- The volume of goods carried by railway reached multi-decade highs in 2018.
- Employment growth across MWT industries accelerated from 1.5% in 2017 to 3.0% in 2018— the fastest growth in more than five years and the second fastest since 2007. In Canada, the unemployment rate has reached record lows and continues to hover under the 6.0%-6.5% full employment level.
- The Canadian dollar ended 2018 on a low note, weighed down by trade concerns and a drop in oil prices. RBC expects the loonie will end 2019 at 74 US cents.
- The general economic landscape has remained mostly positive despite a slowdown over the past two quarters. We expect GDP growth will moderate to levels closer to the long-run potential rate, reaching 1.4% in 2019 and 1.8% in 2020.
- Citing recent improvements in domestic data, the Bank of Canada held the overnight rate steady at 1.75% for a fifth consecutive meeting. RBC's current forecast assumes the overnight rate will remain at 1.75% through 2020.
- International trade tensions have escalated again, threatening the North American manufacturing sector.
- MWT industries can expect increased or sustained capital investment in 2019 but also challenges arising from labour market tightness, trade uncertainty, and rising energy prices.

Growth in manufacturing, wholesale, and transportation sector real GDP (%)

	2010	2011	2012	2013	2014	2015	2016	2017	2018
Manufacturing	4.6	3.5	1.3	-0.4	3.0	0.7	0.9	4.0	3.0
Wholesale trade	7.5	7.4	3.4	4.2	2.6	-3.1	0.7	5.9	2.1
Transportation and warehousing *	6.5	4.7	2.6	2.9	7.7	3.3	3.8	5.3	3.2
Total supply chains industries	5.6	4.7	2.1	1.4	3.6	0.0	1.3	4.7	2.8

* Transportation consists of air, rail, water, trucking and support activities.

Source: Statistics Canada, RBC Economic Research



CURRENT TOPICS

Capacity limits trump trade tensions in global growth slowdown

The ongoing US-initiated global trade spats have rattled businesses and policy circles alike, with an eye-popping \$340 billion of bilateral US-China trade subjected to new tariffs over the last year and persisting uncertainty over the ratification of NAFTA's replacement. Since then, the US has hiked tariffs on about \$200 billion worth of Chinese imports from 10% to 25% and Canada has developed its own trade issues with China including import restrictions on Canadian canola. To date, the economic data has continued to look okay, but higher tariff costs are beginning to weigh on the US industrial sector. Beyond tariff costs, the economy is running close to long-run capacity limits, making it tougher to grow significantly above longer-run trend rates even if tensions ease in the near term.

Trade tiffs in context

Relatively speaking, the total amount of bilateral US-China trade subjected to new tariffs is not that big compared to the total trade flows of the two countries. The Bank of Canada estimated those measures would subtract about 0.2% from US GDP by the end of 2020 - a manageable drag, particularly given boosts from federal tax cuts and spending increases. An effective ban on imports of Canadian canola imposed by China may cause some disruption to near-term trade flows, however global supply and demand conditions typically matter more than bilateral trading relationships in determining price for products like field crops. Canola prices are down year-to-date, but this is true in other food commodities as well, and most of the decline in Canada came before Chinese import restrictions were announced.

Tensions between the US and Canada have eased with the removal of steel and aluminum tariffs, but integrated supply chains mean anything that hurts the US manufacturing sector is likely to spill over to Canada. The US industrial sector has borne the brunt of US trade actions to-date, and activity in the sector has already started to look wobbly. Though the risk remains that these tariff wars will pack a punch in the quarters ahead, their actual economic impact thus far has not been very large for Canada.

Limited upside from easing tensions

An underlying barrier to growth is that the Canadian economy is already running close to its long-run capacity limit. With unemployment hitting record lows, businesses continue to report labour shortages as a major obstacle to expansion. Growth in the pool of available labour will continue to be restrained by an aging population as roughly 1 ¼% of the labour force are retiring each year. Indeed, the resolution of trade disputes may provide a jolt to business investment, but it's important to remember that foreign trade issues are not the only concerns for Canadian businesses.

CFIB: Factors Constraining Production
% of respondents, 3-month moving average as of Apr/2019



Source: CFIB Business Barometer. RBC Economics Research

MWT capital expenditure ramps up with big investments in transportation & warehousing

- Statistics Canada's latest CAPEX intentions survey suggests a third consecutive annual increase in capital spending in 2019. Overall intentions are to rise 2.5% in 2019, with increases in both public and private spending.
- Expect record levels of spending in transportation and warehousing as capital investment is slated to rise 12.6%, largely driven by a 19.6% rise in transit and ground passenger transportation. Investment in support activities for transportation are to increase by 22.6%.
- Investment in manufacturing is anticipated to rise 4.9%, with growth more broadly-based than last year. 17 of 21 subsectors reported increases in 2019 compared to 12 in 2018 - perhaps an early sign that the equipment tax write-off in the Fall Economic Statement 2018 is having the intended effect of encouraging business investment.

CURRENT TOPICS

- Capital expenditure in wholesale trade is expected to increase by a modest 0.5% following healthy gains in the previous two years.
- The report was consistent with the Bank of Canada's Business Outlook Survey and RBC's tracking of private sector investment data, which called for increased investment - particularly in transportation.
- The survey was conducted prior to a re-escalation of US-led global trade tensions. Heightened uncertainty has dampened Canadian business confidence and may act as a drag on investment.

Canada Capital and Repair Expenditures Survey

	2017	2018	2019
Total planned CAPEX	4.3%	2.5%	2.5%
Private	1.4%	0.7%	2.8%
Public	10.2%	5.9%	2.0%
Manufacturing	-6.8%	18.8%	4.9%
Wholesale trade	3.8%	7.1%	0.5%
Transport. & Warehousing	4.2%	9.1%	12.6%

Source: Statistics Canada, RBC Economics Research

The RBC commodity price index bounces back in 2019

- The index saw a dramatic rise and fall in 2018, climbing 13.7% through May 2018 and dropping 18.7% thereafter.
- On average, the index was still 15.1% higher in 2018 than in the previous year.
- Despite advances in the three months ending March 2019, the index was down 1.4% quarter-over-quarter, largely due to weakness in the energy products sub-index
- Excluding energy products, the index was up 4.0% over the previous quarter in Q1/2019.

RBC commodity price index

January 1994 = 100

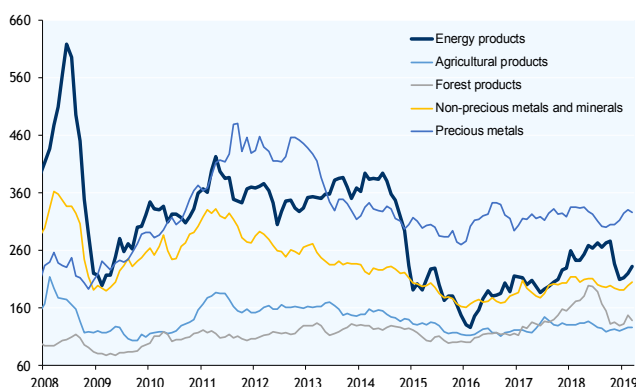


Source: RBC Economics Research

- The **energy products sub-index** rose 6.6% in April. Crude oil prices jumped 9.8% to sit just under 2018's monthly average. The increase in oil prices reflects falling inventories over the last four months and more recent oil supply risk worries as the US ended Iranian oil sanction waivers.¹ Despite a consistent recovery since the beginning of 2019, the energy sub-index was down 2.3% year-over-year and remains 10% below its October 2018 peak.
- The **agricultural products sub-index** fell 4.5% in April. Canola prices continued to hover around multi-year lows, while wheat prices fell a sizeable 12.4% in the month. Supply disruptions relating to African Swine Fever boosted the price of live hogs by 28.4%, slightly offsetting declines in the prices of field crops.² The agricultural sub-index was 10.4% below its year-ago level.
- The **forest products sub-index** dropped 7.2% in April. Lumber prices fell another 12.1% after declining in the previous month, undoing the rest of February's 21.3% jump. Newsprint prices saw a modest gain, while pulp prices remained flat. The overall sub-index was down 28.7% compared to the previous year.
- The **non-precious metals & minerals sub-index** rose 1.6% in April, buoyed by an 8.4% increase in iron ore prices. Iron ore prices are up a hefty 42.5% compared to last year, largely driven by a surge in Chinese steel demand.³ The non-precious metals & minerals sub-index was 0.2% lower than in April 2018.
- The **precious metals sub-index** fell 1.1% in April after rising in five of the six previous months. Gold prices dropped 1.1% while silver prices declined 1.6%. The precious metals sub-index was 4.1% below its year-ago level in April.

RBC commodity price sub-indices

January 1994 = 100

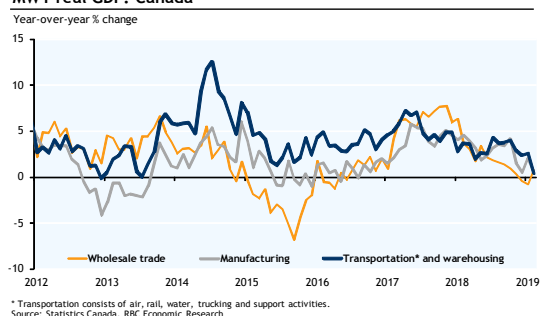


Source: RBC Economics Research

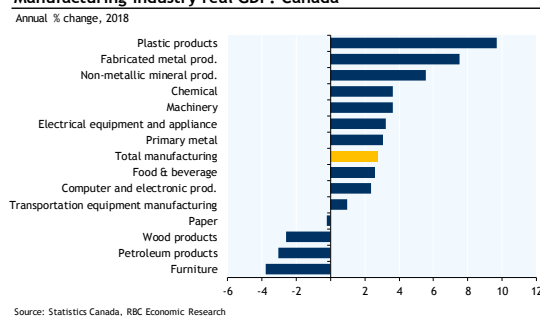


INDUSTRY TRENDS

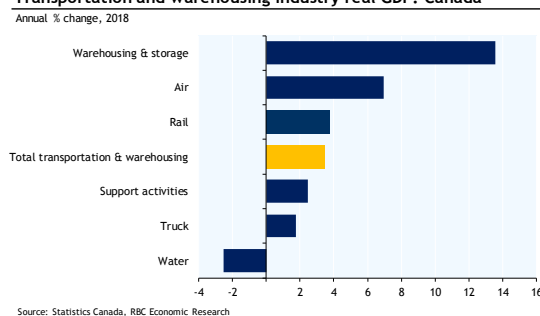
MWT real GDP: Canada



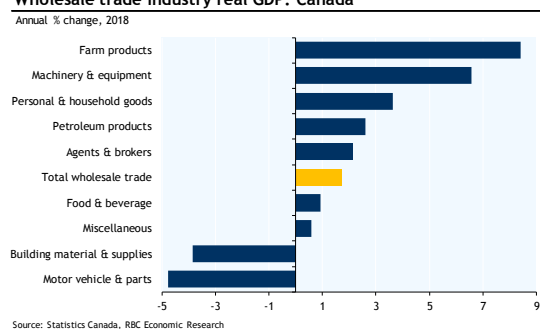
Manufacturing industry real GDP: Canada



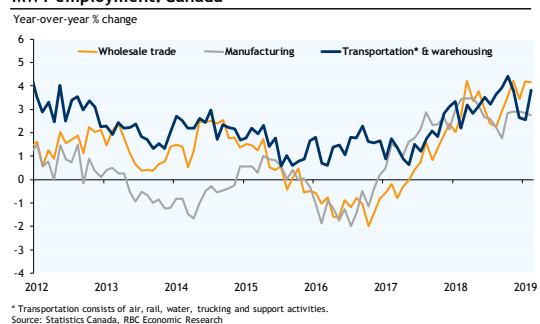
Transportation and warehousing industry real GDP: Canada



Wholesale trade industry real GDP: Canada



MWT employment: Canada



Growth in real GDP for the manufacturing, wholesale trade, and transportation & warehousing industries moderated to 2.8% in 2018 after hitting a six-year high of 4.7% in 2017. Wholesale trade growth slowed the most compared to last year but still remained solid at 2.1%. Transportation & warehousing grew by 3.2% while manufacturing grew by 3.0%.

The manufacturing sector expanded in 11 of 15 sub-industries in 2018. Plastic products manufacturing grew at a solid pace of 9.7%, followed by fabricated metal products manufacturing at 7.5%. Petroleum products manufacturing fell by 3.1% as transitory refinery shutdowns weighed on refinery production. Furniture manufacturing was the worst off, declining by 3.8%. A soft housing market and rising interest rates contributed to a drop in furniture sale volumes over the second half of last year.

Transportation & warehousing expanded in 5 of 6 sub-industries in 2018. Warehousing & storage surprised to the upside, topping the chart with an increase of 13.6%. Water transportation declined by 2.5%, retracing part of a 5.6% increase in the previous year.

Wholesale trade's sustained growth in 2018 continued to be buoyed by rapid gains in the machinery & equipment sub-industry (6.6%) and the farm products sub-industry (8.4%). While the building material & supplies and motor vehicle & parts sub-industries suffered under a housing slowdown and rising interest rates in 2018, recent data have pointed to a good start so far in 2019.

Employment growth in MWT industries doubled from 1.5% in 2017 to 3.0% in 2018. Growth in transportation & warehousing industry payrolls led the pack at 3.3%, peaking in October at the highest level in more than five years and the second highest since 2007. Wholesale trade industry payrolls saw the sharpest acceleration, rising from 0.6% in 2017 to 3.2% 2018.

INDUSTRY TRENDS

Railway carloadings: Canada

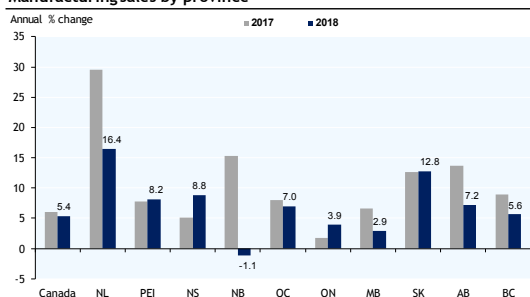
Traffic carried, million tonnes, SA



Source: Statistics Canada, RBC Economic Research

The volume of goods carried by railway grew by 4.1% in 2018 following a jump of 6.7% in 2017. Growth slowed in most categories save for a marginal increase in coal products and a substantial jump in petroleum products, which clocked in at a whopping 22.5%. Lumber and wood products were the only category to decline, falling by 2.3%. Railway carloadings took a dive in February 2019 due to bad weather and oil production curtailments in Alberta.

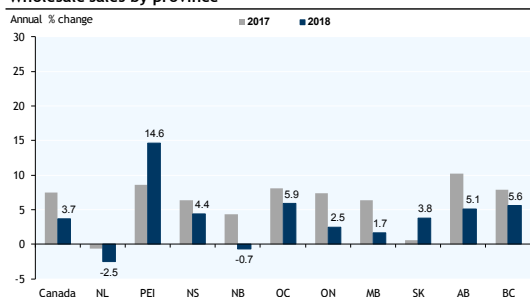
Manufacturing sales by province



Source: Statistics Canada, RBC Economic Research

Growth in manufacturing sales (unadjusted for price changes) slowed slightly to 5.4% in 2018 from 6.0% in 2017. Growth remained positive in all provinces except New Brunswick. The pace in PEI, Nova Scotia, and Ontario accelerated compared to the previous year.

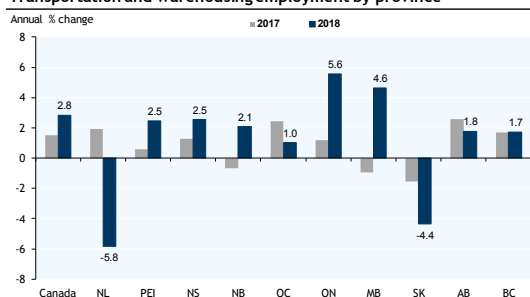
Wholesale sales by province



Source: Statistics Canada, RBC Economic Research

Growth in wholesale sales (unadjusted for price changes) moderated to 3.7% in 2018 after achieving a supercharged 7.8% in 2017 - the fastest growth since 1999. Growth slowed in all provinces except PEI and Saskatchewan, with PEI experiencing a double-digit gain of 14.6%.

Transportation and warehousing employment by province

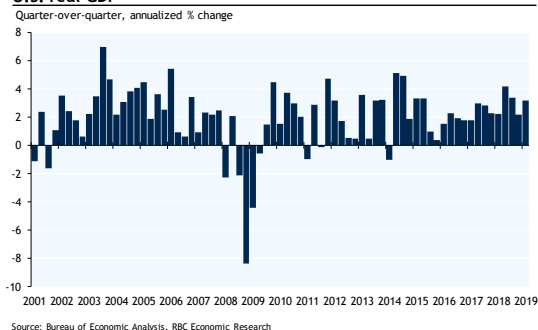


Source: Statistics Canada, RBC Economic Research

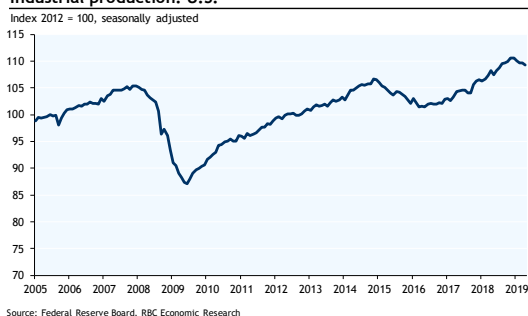
Payrolls in Canada's transportation & warehousing industry expanded by 2.8% in 2018. Stronger performances in PEI, Nova Scotia, New Brunswick, Ontario, and Manitoba were tempered by declines in Newfoundland & Labrador and Saskatchewan. Payroll strength in Quebec, Alberta and BC carried forward from 2017.

MACROECONOMIC CONTEXT

U.S. real GDP



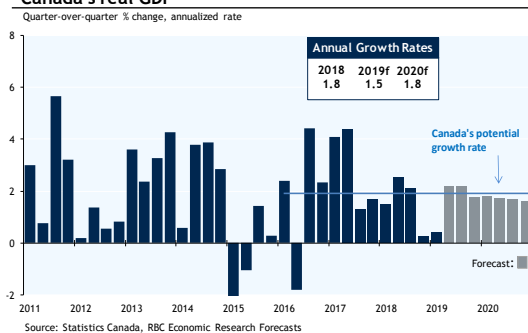
Industrial production: U.S.



US GDP increased a stronger-than-expected 3.1% in Q1/2019, largely due to big adds from net trade and inventories which are unlikely to be repeated. Domestic spending grew at its slowest quarterly pace in three years, as growth in both household spending and business fixed investment slowed to about half the previous quarter's rate. Moving forward, we expect headline GDP growth to slow from Q1's strong pace, but the composition should be much healthier.

US industrial production grew by 4.0% in 2018 following a 2.3% increase in the previous year. The headline number was buoyed by increases across all industry groups, with growth in mining leading the pack at 12.4%. Manufacturing growth picked up to 2.3%, while electric & gas utilities grew by 4.3% after declining by 0.8% in 2017. Growth slowed materially in 2019 with industrial production falling in 3 of the first 4 months of the year.

Canada's real GDP



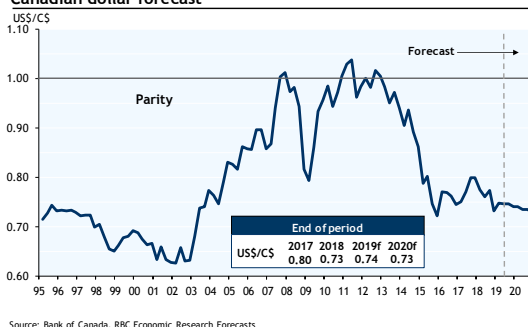
Canadian GDP growth moderated to 1.8% in 2018 from 3.0% in 2017. Growth slowed to 0.3% in Q4/2018 and 0.4% in Q1/19, in large part due to lower oil prices and mandated production cuts in Alberta. But the increase in Q1 is better than it looks. Excluding the oil & gas sector, output rose by ~1½% despite weather-related disruptions in February. Firmer details and a 0.5% surge in March GDP bodes well for a return to stronger growth rates in Q2. Still, trade concerns weigh on future growth prospects.

Real merchandise trade: Canada



Canadian exports grew by 3.5% in 2018 after remaining relatively flat at 0.6% in the previous year. Imports increased by 3.4%, moderating from 4.6% in 2017. RBC expects exports to grow at a pace of 1.1% in 2019 with imports forecasted to decline by 0.1%.

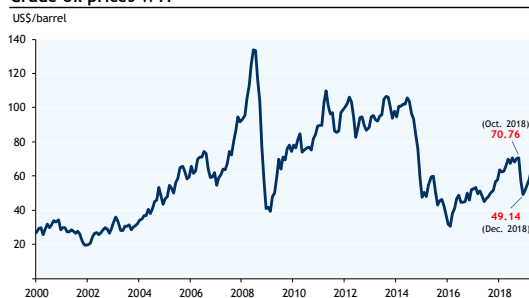
Canadian dollar forecast



The Canadian dollar ended 2018 on a sour note, dropping to a multi-year low of 73 cents. Trade uncertainty contributed to short-term CAD weakness in the first part of the year while a steep decline in oil prices at the end of 2018 pushed the dollar down further. The Canadian dollar ticked up slightly to 75 cents in Q1/2019 as oil prices recovered. Looking forward, RBC expects a slow descent for the C\$ as the BoC holds rates steady through 2020. RBC forecasts the C\$ to end 2019 at 0.74 US\$ and 2020 at 0.73 US\$.

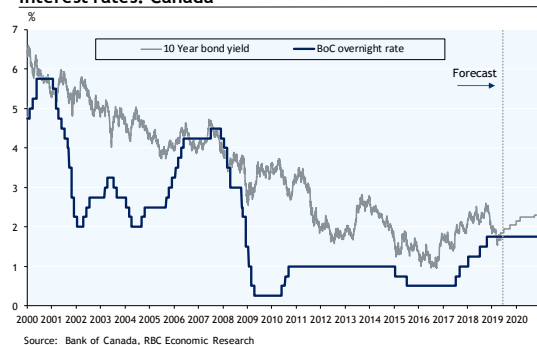
MACROECONOMIC CONTEXT

Crude oil prices WTI



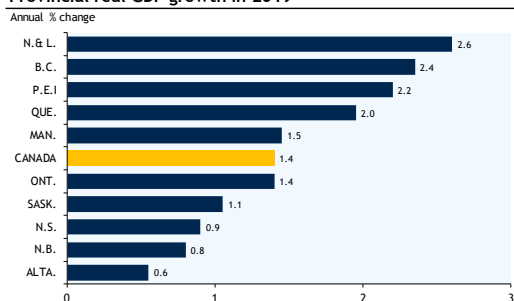
WTI oil prices saw a dramatic rise and fall in 2018, hitting a peak of \$70.76 per barrel in October then plummeting thereafter to finish the year below the \$50 mark. Record levels of production and concerns relating to global economic indicators and future oil demand were largely behind the drop in price.¹ Declining inventories and oil supply risks played a part in both the initial rise through the first part of 2018 and the rebound in Q1/2019. RBC expects WTI prices to average \$63.88 per barrel in 2018 and \$75.88 in 2019.

Interest rates: Canada



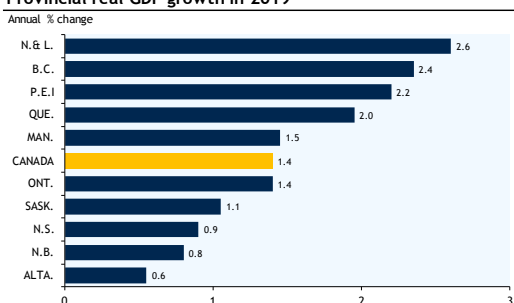
The Bank of Canada kept their neutral bias at the May policy meeting, holding the overnight rate steady at 1.75% for a fifth consecutive meeting. With recent improvements in domestic data, the bank noted “accumulating evidence” that the economy’s slowdown over the last two quarters will be transitory. RBC’s current forecast assumes the overnight rate will remain at 1.75% through 2020.

Provincial real GDP growth in 2019



The Canadian economy faced a number of challenges in 2018 as provinces grappled with capacity constraints, trade tensions, and troubles in the oil sands. Aside from a largely anticipated contraction in Newfoundland & Labrador, growth in all other provinces remained positive. With the economy running close to capacity limits, growth slowed across the country to 1.9% in 2018, in line with the economy’s long-run potential rate.

Provincial real GDP growth in 2019



We expect to see positive but more moderate growth across Canada in 2019, with B.C. rising through the ranks and Newfoundland & Labrador making a comeback after declining in 2018. Both provinces will get a considerable boost from capital expenditure projects in the coming year. Growth in Alberta is expected to slow from last year as oil market-access issues continue to weigh on the energy and construction sectors.

Job market in Canada

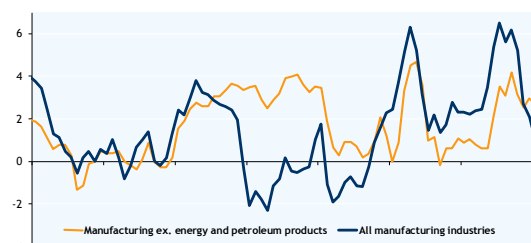


The unemployment rate reached a more than four-decade low of 5.8% in 2018 and continues to ride under the 6.0%-6.5% full employment level. Employment surged 107k in April for the largest increase on record, with another 28k jobs created in May. RBC Economics forecasts employment growth of 1.9% in 2019 with the unemployment rate slowly rising back towards full employment.

INDUSTRY PRICES AND COSTS

Manufacturing prices: Canada

Year-over-year % change, Industrial Product Price Index



Source: Statistics Canada, RBC Economic Research

Industrial product prices in manufacturing rose by 3.9% in 2018, boosted by a 15.3% gain in petroleum & coal product manufacturing. Excluding energy prices the index was up 2.1%, with paper manufacturing seeing the largest gain of 11.5%.

Wholesale sales prices: Canada

Year-over-year % change, Wholesale Sales Price Index

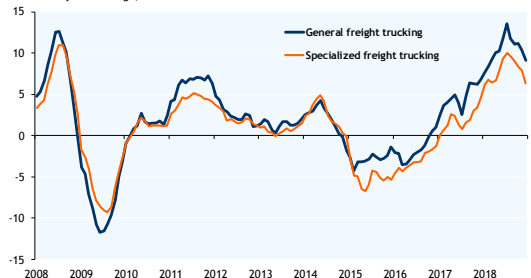


Source: Statistics Canada, RBC Economic Research

Prices received by Canadian wholesalers rose 3.2% in 2018, up from 2017's pace of 2.4%.

For-hire motor carrier freight service price index: Canada

Year-over-year % change, SA



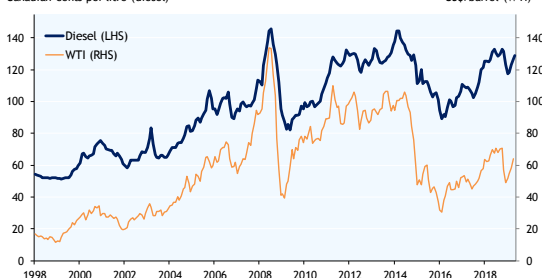
Source: Statistics Canada, RBC Economic Research

Prices charged by Canadian for-hire motor carrier freight services skyrocketed through 2018, building on an upward trend that started in 2017. Prices for general freight trucking saw a sizeable gain of 10.4% over the previous year, while prices for specialized freight trucking grew by a similarly substantial 7.9%.

Diesel price: Canada

Canadian cents per litre (diesel)

US\$/barrel (WTI)

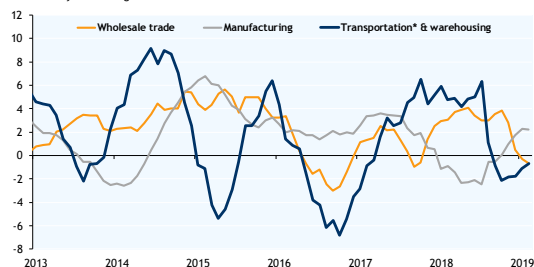


Source: Wall Street Journal, Haver Analytics, MJ Ervin & Associates Inc., RBC Economic Research

Diesel and WTI crude oil prices saw double-digit increases on average in 2018 despite a sizable dip in the last two months of the year. The price of diesel increased by 16.8% in 2018, adding pressure to motor carriers for their biggest cost item. WTI crude oil prices rose by 27.4% during the same period continuing a growth trend that began in 2016. Prices have steadily recovered through the first quarter of 2019.

MWT hourly earnings: Canada

Year-over-year % change in 8-month trend



* Transportation consists of air, rail, trucking and support activities.
Source: Statistics Canada, RBC Economic Research

Wages in the wholesale trade industry jumped 3.9% in 2018 following a 1.0% gain in the previous year. Growth in transportation & warehousing wages moderated to 2.2% from 3.4% in 2017. Manufacturing wages slipped a touch lower in 2018, declining 1.0% after rising 2.8% the year before.



Manufacturing, wholesale, and transportation sector snapshot

	GDP		Employment		Business counts by firm payroll size*			
	Million \$**	% of economy	000s***	% of economy	1-9	10-99	100-499	500+
Manufacturing	203,331	10.4	1,521	9.1	28,017	19,771	3,254	296
Food	27,566	1.4	238	1.4	2,806	2,691	556	45
Beverage and tobacco	6,882	0.4	43	0.3	756	624	62	6
Textile, clothing and leather	2,683	0.1	7	0.0	1,642	701	97	4
Wood	8,865	0.5	94	0.6	1,635	1,397	282	7
Paper	7,836	0.4	54	0.3	135	257	163	12
Printing and related support activities	5,004	0.3	50	0.3	2,506	896	95	8
Petroleum and coal	11,784	0.6	18	0.1	168	158	23	6
Chemical	21,608	1.1	92	0.6	1,000	917	158	18
Plastics and rubber	10,900	0.6	100	0.6	740	1,111	259	22
Non-metallic mineral	6,667	0.3	54	0.3	995	1,124	102	4
Primary metal	12,538	0.6	57	0.3	199	236	104	28
Fabricated metal	15,576	0.8	157	0.9	4,018	3,348	299	14
Machinery	17,631	0.9	138	0.8	2,363	1,946	322	18
Computer and electronic	6,677	0.3	57	0.3	866	634	115	11
Electrical eRuiement, appliance and component	4,182	0.2	34	0.2	614	420	92	3
Transportation eRuiement	27,309	1.4	205	1.2	875	754	278	80
Furniture and related	4,923	0.3	67	0.4	2,551	1,216	153	8
Miscellaneous	4,700	0.2	58	0.3	4,148	1,341	94	2
Wholesale trade	103,749	5.3	803	4.8	37,954	19,141	1,147	69
Farm product	2,271	0.1	15	0.1	715	438	17	-
Petroleum product	3,563	0.2	16	0.1	543	337	12	-
Food, beverage and tobacco	11,468	0.6	117	0.7	4,647	2,306	293	13
Personal and household goods	16,637	0.9	109	0.7	4,905	1,974	201	23
Motor vehicle and parts	10,321	0.5	63	0.4	2,367	1,580	95	5
Building material and supplies	14,835	0.8	130	0.8	5,959	3,804	137	4
Machinery, eRuiement and supplies	30,393	1.6	221	1.3	9,249	5,529	221	16
Miscellaneous	11,272	0.6	95	0.6	5,832	2,476	123	5
Electronic markets, and agents and brokers	2,989	0.2	38	0.2	3,737	697	48	3
Transportation and warehousing	88,174	4.5	666	4.0	57,621	10,840	1,052	138
Air	9,801	0.5	71	0.4	605	378	82	13
Rail	8,474	0.4	37	0.2	97	110	49	11
Water	1,818	0.1	n/a	n/a	175	120	20	5
Truck	21,958	1.1	206	1.2	42,966	4,873	253	9
Transit, ground passenger, scenic and sightseeing	8,896	0.5	125	0.8	2,763	1,244	173	22
Pipeline	10,052	0.5	0	0.0	115	58	12	6
Support activities	17,216	0.9	119	0.7	6,586	2,328	214	23
Postal service and couriers and messengers	6,597	0.3	51	0.3	2,644	733	111	31
Warehousing and storage	3,362	0.2	56	0.3	1,670	996	138	18
Total supply chains industries	395,254	20.3	2,990	18.0	123,592	49,752	5,453	503

* Excludes firms with no employees. December 2018.

** In 2018, millions of 2007 dollars.

*** In 2018.

Source: Statistics Canada, RBC Economics Research

¹ US Energy Information Administration, *Short-Term Energy Outlook*, May 2019.² RBC Capital Markets, *Farm to Fork: A look into the dairy and protein industries*, May 17, 2019.³ RBC Capital Markets, *From "Iron Roar" to "Iron Bore"*, May 24, 2019.

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