

# CANADA'S MANUFACTURING, WHOLESALE AND TRANSPORTATION SECTOR

November 2018

## Vibrant supply chains drive firm sectoral growth

- Activity in the manufacturing, wholesale trade and transportation & warehousing (MWT) industries remained broadly positive so far in 2018.
- MWT industry GDP growth slowed slightly in the first eight months of 2018 following a five-year high in 2017.
- Brisk sales in machinery & equipment and personal & household goods supported the strong gain in wholesale trade.
- Regionally, all provinces are experiencing positive growth in manufacturing sales. Wholesale sales are rising in all provinces except Newfoundland & Labrador.
- The volume of goods carried by railway is increasing, though at a slower pace compared to last year.
- Canadian real merchandise exports grew at a stronger clip this year despite trade tensions. Those tensions somewhat eased with the agreement on NAFTA replacement, the USMCA.
- Overall, hiring by MWT firms is picking up in 2018.
- The general economic landscape is expected to remain positive in the latter part of 2018, although GDP growth is forecast to moderate to levels closer to the economy's long-run potential rate after experiencing an outsized gain in 2017. We expect the Bank of Canada's hawkish stance on interest rates to have the desired effect of easing growth to 2.1% this year.
- The U.S. economy has been beating expectations with above-potential growth in the last two quarters, rising 4.2% and 3.5% in Q2 and Q3 respectively. RBC Economics forecasts 2.9% growth overall in 2018.
- After a slight drop in the first half of this year, RBC expects the dollar to trend sideways against the U.S. dollar, ending 2018 at 78 U.S. cents.
- The outlook for MWT industries is being tempered by mounting cost pressures arising from elevated energy prices and a tight labour market.

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

	2010	2011	2012	2013	2014	2015	2016	2017	2018 ytd*
<b>Manufacturing</b>	4.6	3.5	1.6	-0.7	3.3	0.4	0.7	3.2	2.8
<b>Wholesale trade</b>	7.5	7.6	3.2	4.3	2.5	1.1	0.1	5.6	4.6
<b>Transportation and warehousing<sup>1</sup></b>	6.7	4.9	2.6	2.8	7.8	3.9	3.8	5.4	3.7
<b>Total supply chains industries</b>	<b>5.7</b>	<b>4.9</b>	<b>2.2</b>	<b>1.3</b>	<b>3.8</b>	<b>1.2</b>	<b>1.0</b>	<b>4.3</b>	<b>3.5</b>

<sup>1</sup>Transportation consists of air, rail, water, trucking and support activities.

\* January to August period

Source: Statistics Canada, RBC Economic Research



**CURRENT TOPICS**

**USMCA not so different from NAFTA**

The contents of United States-Mexico-Canada Agreement announced at the end of September were largely unsurprising, with many of the points in the reworked NAFTA replacement well telegraphed during the negotiation process. Canada's most significant concession was greater U.S. access to the Canadian dairy market up to  $-3 \frac{1}{2}\%$ , which was largely expected with similar quotas given up in CETA and CPTPP negotiations. Canada also agreed to stricter rules of origin in the auto sector, including a clause for higher-wage labour, and a higher 'de minimis' threshold for online purchases. In return, Canadian negotiators were able to hold some red lines—most significantly keeping Chapter 19's dispute resolution largely intact—and were assured of an exemption from punitive auto tariffs threatened by the U.S. side (at least up to a specified limit well above current production levels).

The USMCA provides welcome relief from much of the trade uncertainty facing Canadian businesses and should release some pent up business investment, but we don't think that will be enough to move the needle much on GDP growth in the near term. While trade uncertainty has not fully disappeared—steel and aluminum tariffs between the U.S. and Canada are still in place and the China-U.S. trade spat continues—the effects are likely not big enough to put a meaningful dent in growth. For Canada, longer-run competitiveness and labour supply issues are a greater concern.

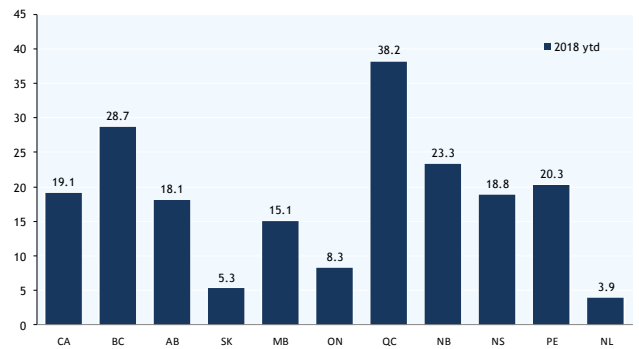
**Businesses feel the squeeze of a tight labour market**

In 2018, unemployment rates across Canada have hit lows almost unheard of in modern times. Job prospects are looking good for workers but it's a different story for employers, who are seeing an increasing amount of positions going unfilled.

We believe that a tight supply of labour is already restraining economic growth in several provinces this year. Business surveys are increasingly reporting that capacity constraints, not lack of demand, are the most pressing concern at the moment in much of the country. The Bank of Canada's Business Outlook Survey (BOS) revealed that more than half of Canadian businesses indicated that they would have difficulty meeting unexpected demand growth and often pointed to difficulties finding new staff.

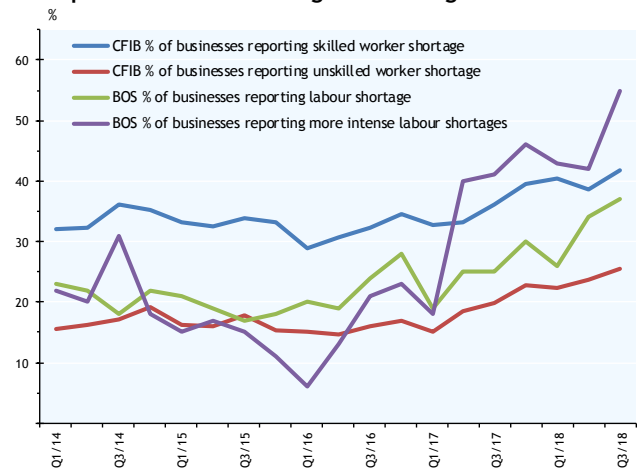
Wage growth has lagged despite tight labour markets—hourly pay growth slowed in September for a fourth consecutive month and is now well short of where we should be with sub-6% unemployment. But rising business need for workers still means wage growth is more likely to strengthen than slow further going forward.

**Unfilled positions have surged in Quebec, BC and elsewhere**  
Annual % change in job vacancies



Source: Statistics Canada, RBC Economic Research

**Reports of labour shortages are rising**



Source: Bank of Canada (BOS survey), CFIB business barometer, RBC Economic Research



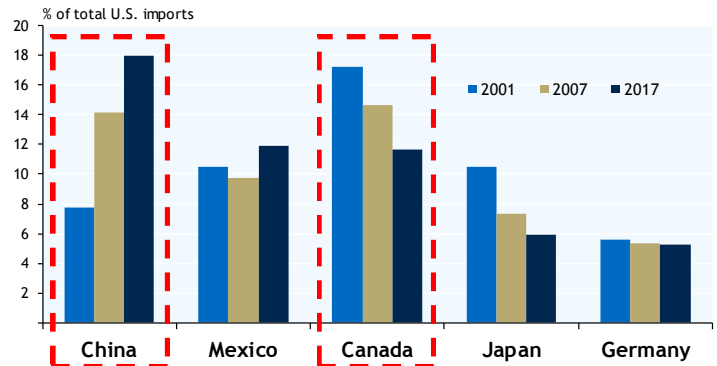
**CURRENT TOPICS**

**Competitiveness concerns linger**

Canada has been steadily losing U.S. import share— dating back to well-before the latest trade spat.

- Decline pre-dates the 2008/09 recession and U.S. tax cuts.
- Canada ranked as the third largest U.S. import market last year. Canada was #1 up until 2008 before falling behind China (in 2009) and then Mexico (in 2016).
- China went from 8% of U.S. total imports in 2001 - the year they joined the WTO - to about 18% last year
- Canada accounted for about 12% of U.S. exports last year, down from 17% in 2001.

**U.S. import market shares by country**



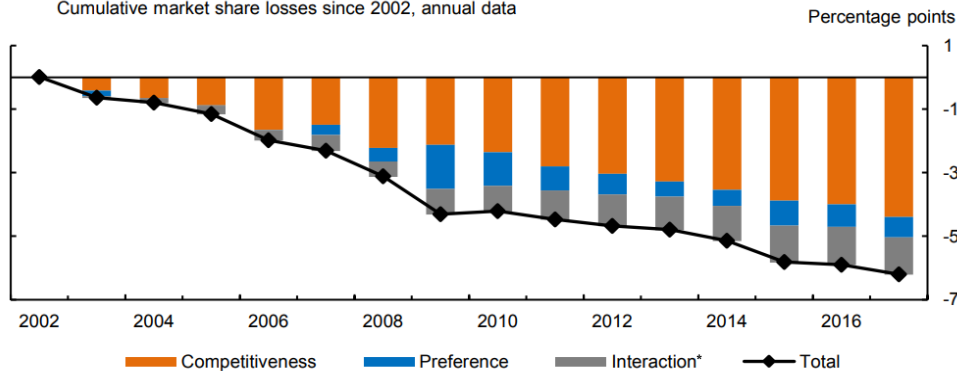
Source: Census Bureau, RBC Economic Research

**‘Competitive’ losses explain much of the import share loss**

- Bank of Canada staff researchers recently attributed ~70% of the loss of Canadian share of the U.S. non-energy import market since 2002 to competitiveness issues.
- According to the BoC, the bulk of the market share losses come from motor vehicles and parts, consumer goods, and metal and non-metallic mineral products - all sectors that have faced increasing competition from jurisdictions with lower relative prices such as Mexico and China.

**More than 70 per cent of Canada’s market share losses in US imports of non-energy goods from 2002 to 2017 result from competitiveness losses**

Cumulative market share losses since 2002, annual data



Example: The orange bar shows -4.4 percentage points for 2017, meaning that shifts in competitiveness explain 4.4 percentage points out of the 6.2 percentage point drop in Canada’s market share in US imports of non-energy goods from 2002 to 2017.

\*compound effects of shifts in competitiveness and in preference

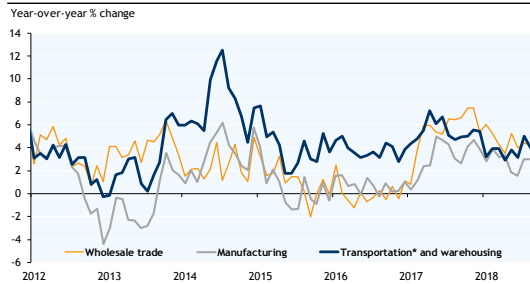
Last observation: 2017

Source: UN Comtrade, Bank of Canada



## INDUSTRY TRENDS

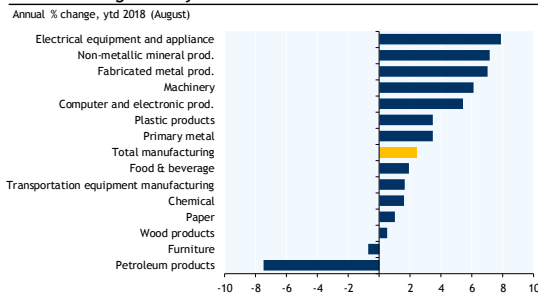
### MWT real GDP: Canada



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

Growth in real GDP for the manufacturing, wholesale trade, and transportation & warehousing industries moderated to 3.4% in the first eight months of 2018 following a five-year high of 4.3% in 2017. Wholesale trade slowed from last year but still remained strong at 4.7%. Transportation & warehousing increased by 3.7% while manufacturing grew by a more modest but still robust 2.9%.

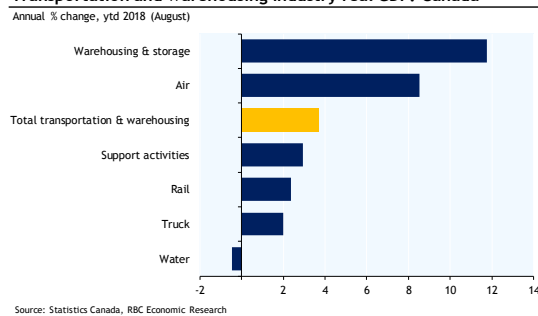
### Manufacturing industry real GDP: Canada



Source: Statistics Canada, RBC Economic Research

The manufacturing sector expanded in 12 of 14 sub-industries. Electrical equipment & appliance manufacturing grew at a solid pace of 7.9%, followed closely by non-metallic mineral production at 7.2%. Petroleum products manufacturing saw a sizable decline of -7.5%. Transitory refinery shutdowns in the spring were behind the decline in refinery production.

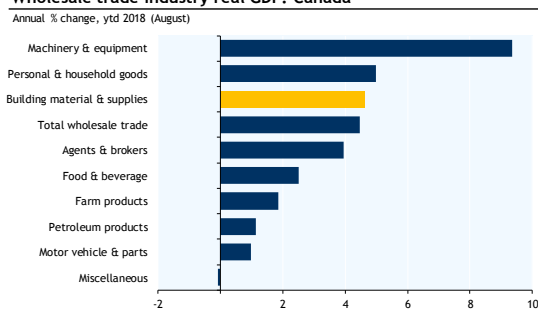
### Transportation and warehousing industry real GDP: Canada



Source: Statistics Canada, RBC Economic Research

Transportation & warehousing expanded in 5 of 6 sub-industries. Warehousing & storage surprised to the upside, topping the chart with an increase of 11.7%. Growth in air transportation eased slightly from last year but remained strong at 8.5%.

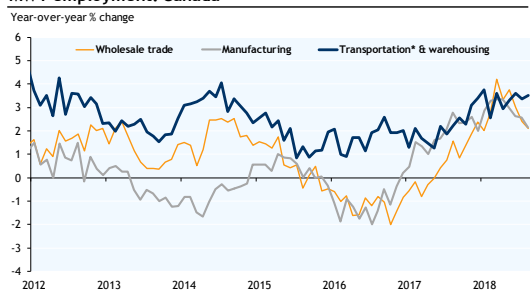
### Wholesale trade industry real GDP: Canada



Source: Statistics Canada, RBC Economic Research

Wholesale trade's robust growth rate continued to be buoyed by rapid gains in the machinery & equipment sub-industry, which grew by 9.3% in the first eight months of 2018. Aside from a marginal decrease in the miscellaneous category, growth remained positive in all other sub-industries. Still, only the personal & household goods and building material & supplies segments increased at a faster rate compared to last year.

### MWT employment: Canada



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

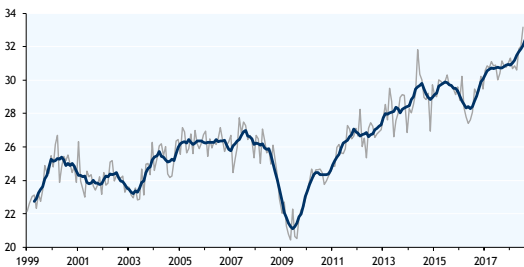
Overall employment growth in MWT industries accelerated from 1.6% in 2017 to 3.0% in the first eight months of 2018. Growth in transportation & warehousing industry payrolls, which has remained in positive territory dating back to 2010, led the pack at 3.3%. Wholesale trade industry payrolls saw the sharpest acceleration, rising from 0.6% in 2017 to 2.9% in the first part of 2018.



## INDUSTRY TRENDS

### Railway carloadings: Canada

Traffic carried, million tonnes, SA

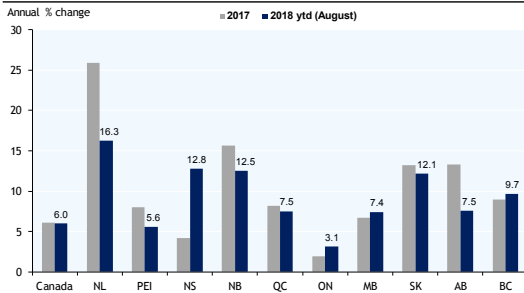


Source: Statistics Canada, RBC Economic Research

The volume of goods carried by railway grew by 3.2% in the first eight months of 2018 following a jump of 6.7% in 2017. Growth slowed in most categories except petroleum products and primary metals. Lumber and wood products were the only category to decline, falling by 1.8%.

### Manufacturing sales by province

Annual % change

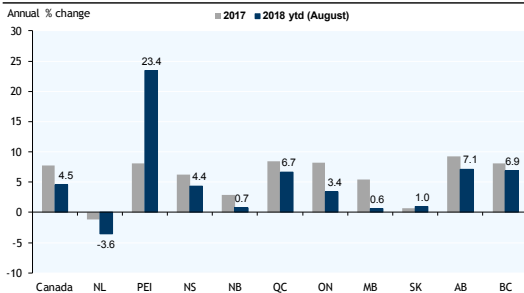


Source: Statistics Canada, RBC Economic Research

Manufacturing sales (unadjusted for price changes) grew by 6.0% in the first eight months of 2018. The expansion was the result of positive growth across all provinces. The pace in Nova Scotia, Ontario, Manitoba, and BC accelerated compared to 2017.

### Wholesale sales by province

Annual % change

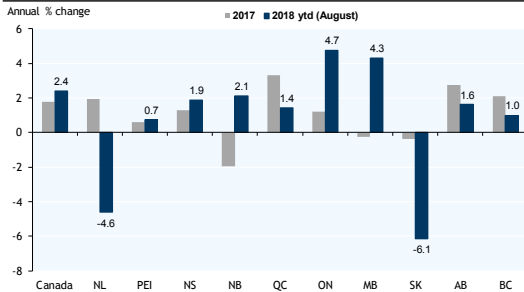


Source: Statistics Canada, RBC Economic Research

Wholesale sales (unadjusted for price changes) grew by 4.5% nationwide so far in 2018, building upon a trend dating back to 2010. With the exception of PEI, which experienced double-digit gains of 23.4%, growth across all provinces moderated after a surge in 2017.

### Transportation and warehousing employment by province

Annual % change



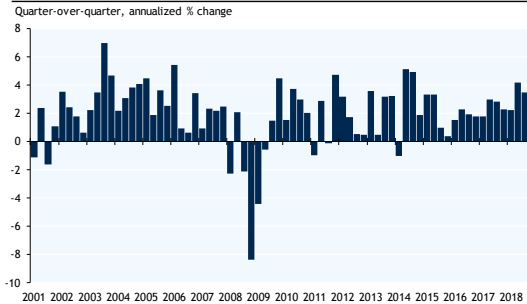
Source: Statistics Canada, RBC Economic Research

Payrolls in Canada's transportation & warehousing industry expanded by 2.4% in the first eight months of 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.



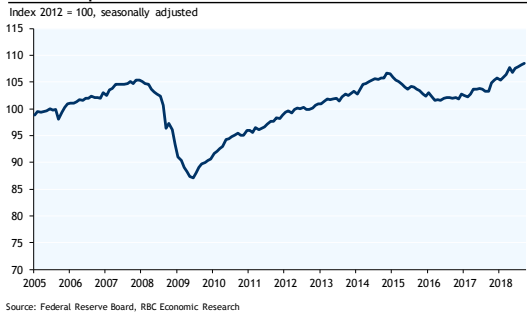
## MACROECONOMIC CONTEXT

### U.S. real GDP



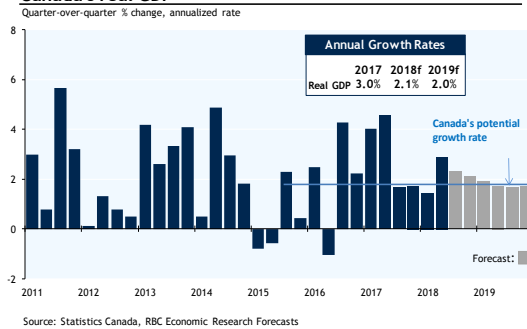
The U.S. Q3 GDP report implied continued solid above-potential growth of 3.5% following a sizable gain of 4.2% in Q2. The strengthening in GDP largely reflected increases in consumer spending and inventory change, while declines in residential investment and net exports were a drag on growth. The solid above-potential growth reported in the last two quarters is pushing the U.S. economy even further beyond capacity. We expect the Fed will keep tightening policy, with another 25 basis point hike before the end of 2018.

### Industrial production: U.S.



U.S. industrial production grew by 3.8% in the first nine months of 2018, more than doubling the 1.6% increase in 2017. The headline number was boosted by strong growth in mining at 11.7%. Manufacturing growth picked up to 2.3%, while electric & gas utilities experienced a change in fortunes growing by 4.8% after declining by 1.3% in 2017.

### Canada's real GDP



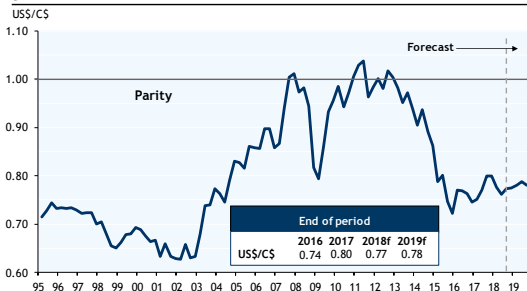
Following a disappointing gain of 1.4% in Q1 Canadian GDP growth strengthened to an annualized 2.9% in Q2, largely reflecting gains in exports and consumer spending. Growth has remained strong going into Q3. Looking through monthly wiggles, the data remains consistent with GDP rising 2% in Q3 – broadly in line, and perhaps slightly stronger than the Bank of Canada's 1.8% forecast. We expect annual GDP growth will steady at around 2% this year and next.

### Real merchandise trade: Canada



Canadian exports grew by 1.7% in the first three quarters of 2018, with the effect of U.S. steel and aluminum tariffs largely offset by gains in other sectors and strong growth in the months preceding the tariffs. Imports increased at a robust 4.6%, up from 2.6% in the same period last year. RBC expects exports to grow at a solid pace of 2.9% in 2018 with imports forecasted to grow by 3.6%.

### Canadian dollar forecast

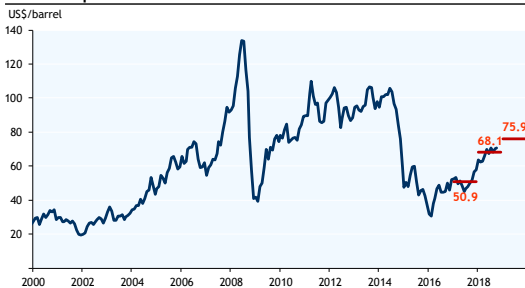


After a strong upward trend through 2017 the Canadian dollar depreciated over the first half of 2018 with trade uncertainty contributing to short-term CAD weakness. The Canadian dollar dipped to 76 cents in June but recovered slightly after the Bank of Canada raised the overnight rate to 1.50% in July and to 1.75% in October. Looking forward, RBC expects the C\$ to trend mainly sideways as the Bank of Canada continues raising rates. RBC forecasts the C\$ to end 2018 at 0.78 US\$.



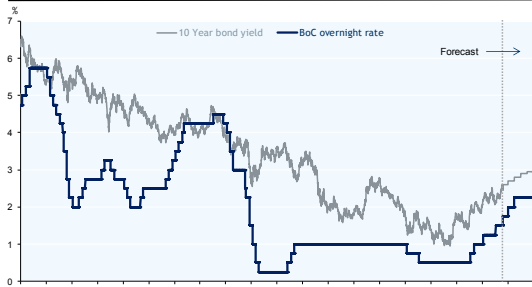
## MACROECONOMIC CONTEXT

Crude oil prices WTI



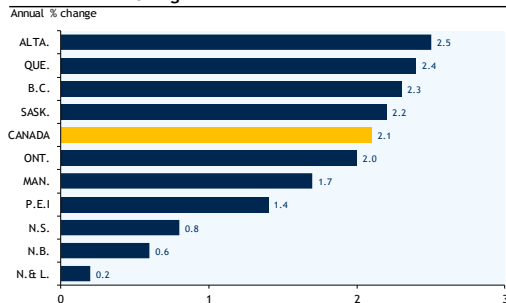
Source: Wall Street Journal, Haver Analytics, RBC Economic Research

Interest rates: Canada



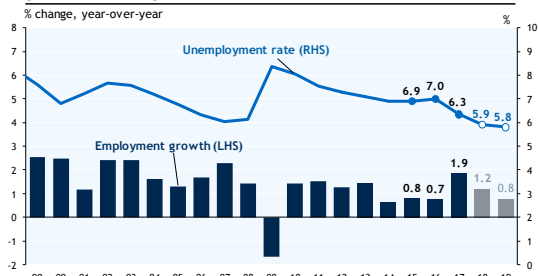
Source: Bank of Canada, RBC Economic Research

Provincial real GDP growth in 2018



Sources: Statistics Canada, RBC Economic Research

Job market in Canada



Source: Statistics Canada, RBC Economic Research

Declining inventory levels and heightened geopolitical risks temporarily pushed WTI oil prices up to nearly \$70 per barrel for the first time since late-2014. Lack of transportation infrastructure remains a significant issue for Canadian energy producers. Western Canadian oil has been selling at a sharp discount to global benchmark prices. RBC expects WTI prices to average \$68.1 per barrel in 2018 and \$75.9 in 2019.

The Bank of Canada raised the overnight rate to 1.75% at the October policy meeting. The Governing Council dropped their “gradual” forward guidance, instead indicating that interest rates will have to rise to a “neutral stance” to keep inflation on target. RBC’s current forecast assumes two further rate increases in the first half of 2019 followed by a pause that would leave the overnight rate at 2.25% until the end of next year.

With the economy operating at capacity, the Bank of Canada assumed a more hawkish stance on interest rate hikes aimed at steering GDP growth toward its long-run potential rate. Our view is that rising interest rates will have the desired effect and contribute to overall growth in Canada easing from 3.0% last year to 2.1% in 2018. We expect growth to moderate in all provinces, with cooling housing markets and the winding down of major capital projects among the restraining factors in some of the provinces.

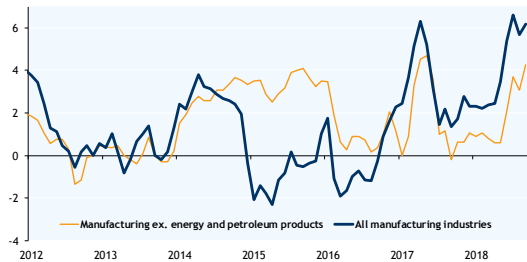
Employment increased by an average of 5k per month thus far in 2018, a marked slowing from the stellar 36k average monthly gain achieved in 2017. The unemployment rate reached a more than four-decade low of 5.8% on average this year, below the 6.0% to 6.5% full employment level. Still, weak wage growth continues to puzzle – labour demand remains healthy and surveys point to growing job shortages, yet pay growth has been slow to follow. RBC Economics forecasts employment growth of 1.2% in 2018 with the unemployment rate steadying around current levels.



## 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 4.1% in the first nine months of 2018, though they were up only 1.9% excluding energy and petroleum prices. Tobacco products and paper manufacturing provided significant lift to the headline number, growing at 10.4% and 13.8% respectively. Prices of primary ferrous metal products (including steel) have risen 7%.

### Wholesale sales prices: Canada

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

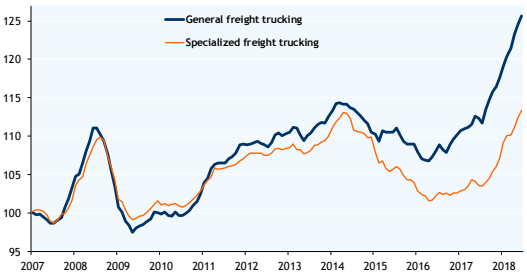


Source: Statistics Canada, RBC Economic Research

Prices received by Canadian wholesalers rose 0.6% in the first eight months of 2018, slowing from 2017's pace of 1.6%.

### For-hire motor carrier freight service price index: Canada

2007 = 100, SA



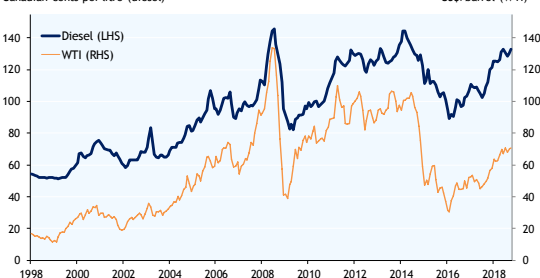
Source: Statistics Canada, RBC Economic Research

Prices charged by Canadian for-hire motor carrier freight services rose sharply in the first half of 2018 building on 2017's upswing. Prices for general freight trucking saw a sizeable gain of 8.9% over the previous year, while prices for specialized freight trucking grew by a more modest but still substantial 7.2%.

### Diesel price: Canada

Canadian cents per litre (diesel)

US\$/barrel (WTI)

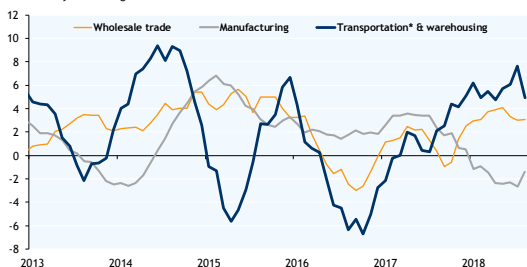


Source: Wall Street Journal, Haver Analytics, MJ Ervin & Associates Inc., RBC Economic Research

Diesel prices increased by 18.7% in the 12 months ending October 2018, adding pressure to motor carriers for their biggest cost item. WTI crude oil prices rose by 32.4% during the same period continuing a growth trend that began in 2016.

### 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 and transportation & warehousing industries jumped 4.3% and 5.5% respectively in the first eight months of 2018, following a returning to positive growth in 2017. Growth in manufacturing wages slipped into the negative in 2018, declining 2.3% after outpacing all other sectors in the previous year.





## 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+
<b>Manufacturing</b>	<b>179,711</b>	<b>10.4</b>	<b>1,477</b>	<b>9.1</b>	<b>27,671</b>	<b>19,461</b>	<b>3,163</b>	<b>292</b>
Food	25,135	1.5	227	1.4	2,734	2,622	538	47
Beverage and tobacco	6,005	0.3	41	0.3	701	566	58	5
Textile, clothing and leather	2,436	0.1	7	0.0	1,671	686	96	4
Wood	9,946	0.6	93	0.6	1,630	1,376	273	5
Paper	7,271	0.4	54	0.3	140	252	155	9
Printing and related support activities	4,130	0.2	49	0.3	2,525	877	90	12
Petroleum and coal	7,152	0.4	18	0.1	160	158	26	4
Chemical	14,779	0.9	93	0.6	992	919	160	15
Plastics and rubber	10,167	0.6	98	0.6	742	1,113	246	24
Non-metallic mineral	5,745	0.3	51	0.3	1,000	1,107	102	2
Primary metal	14,587	0.8	55	0.3	210	244	106	26
Fabricated metal	12,659	0.7	153	0.9	3,953	3,316	285	18
Machinery	15,268	0.9	130	0.8	2,349	1,960	300	16
Computer and electronic	6,012	0.3	55	0.3	885	624	121	9
Electrical equipment, appliance and component	3,274	0.2	33	0.2	612	417	95	4
Transportation equipment	26,960	1.6	196	1.2	891	738	279	81
Furniture and related	4,444	0.3	68	0.4	2,409	1,212	148	9
Miscellaneous	3,741	0.2	57	0.4	4,067	1,274	85	2
<b>Wholesale trade</b>	<b>100,227</b>	<b>5.8</b>	<b>779</b>	<b>4.8</b>	<b>37,418</b>	<b>19,243</b>	<b>1,093</b>	<b>136</b>
Farm product	1,684	0.1	15	0.1	724	432	18	0
Petroleum product	4,991	0.3	16	0.1	554	333	13	0
Food, beverage and tobacco	11,320	0.7	114	0.7	4,574	2,359	274	12
Personal and household goods	14,672	0.8	107	0.7	4,875	1,981	186	21
Motor vehicle and parts	8,291	0.5	62	0.4	2,315	1,583	90	5
Building material and supplies	15,594	0.9	127	0.8	5,913	3,842	134	4
Machinery, equipment and supplies	27,783	1.6	212	1.3	9,174	5,544	213	17
Miscellaneous	13,226	0.8	93	0.6	5,569	2,485	119	74
Electronic markets, and agents and brokers	2,666	0.2	33	0.2	3,720	684	46	3
<b>Transportation and warehousing</b>	<b>79,651</b>	<b>4.6</b>	<b>654</b>	<b>4.0</b>	<b>55,865</b>	<b>10,721</b>	<b>1,091</b>	<b>146</b>
Air	10,077	0.6	73	0.5	619	383	78	13
Rail	7,676	0.4	45	0.3	101	112	46	12
Water	1,538	0.1	n/a	n/a	174	120	19	5
Truck	22,030	1.3	201	1.2	41,490	4,807	263	11
Transit, ground passenger, scenic and sightseeing	7,653	0.4	124	0.8	2,723	1,270	203	23
Pipeline	6,248	0.4	0	0.0	121	39	12	6
Support activities	15,377	0.9	114	0.7	6,376	2,304	208	23
Postal service and couriers and messengers	6,333	0.4	47	0.3	2,575	682	130	32
Warehousing and storage	2,719	0.2	49	0.3	1,686	1,004	132	21
<b>Total supply chains industries</b>	<b>359,589</b>	<b>20.8</b>	<b>2,910</b>	<b>17.9</b>	<b>120,954</b>	<b>49,425</b>	<b>5,347</b>	<b>574</b>

\* Excludes firms with no employees. June 2018.

\*\* In 2017, millions of 2007 dollars.

\*\*\* In 2017.

Source: Statistics Canada, RBC Economics Research

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