MANUFACTURING PULSE

QUARTERLY ECONOMIC UPDATE

Summer 2016

Highlights:

- After hitting an all-time high in January, manufacturing sales fell sharply as auto plants retooled and demand from the US softened.
- Manufacturing employment has been volatile, shedding 36,100 positions from February to May, after adding 25,400 jobs from September to December. Recent job losses have been concentrated in BC, Ontario and Alberta.
- Sluggish economic growth in Canada and abroad is dampening new orders for manufactured goods. On the whole, orders fell 0.9 per cent in Q1, although most of that drop was in aerospace.
- Capital investment intentions in manufacturing are lower in 2016. Planned spending is estimated to be $17.0 billion this year, down from $19.1 billion in 2015.
- Future business conditions for manufacturers remain clouded as the impact of the Brexit vote is still playing out in financial markets. Here at home, the Fort McMurray wildfires will be a blow to the economy in the short term, but will increase demand for manufactured goods in the longer term as the city rebuilds.

Mike Holden
Chief Economist

CMC

Summer 2016

Current Manufacturing Sales Activity

Manufacturing sales fell sharply in early 2016 after hitting a record high in January. Although petroleum refiners enjoyed a modest turnaround, most other industries saw sales decline.

Total Sales

After reaching an all-time high of $52.5 billion in January, monthly manufacturing sales fall sharply in February and stayed flat through the early spring. Sluggish economic growth in the United States and a rapid increase in the value of the Canadian dollar were key contributors to the decline.

In spite of the drop since January, manufacturing sales are still tracking above 2015 levels. Through four months, sales in 2016 are 1.4 per cent higher than they were over the same period last year.

Sales by Industry

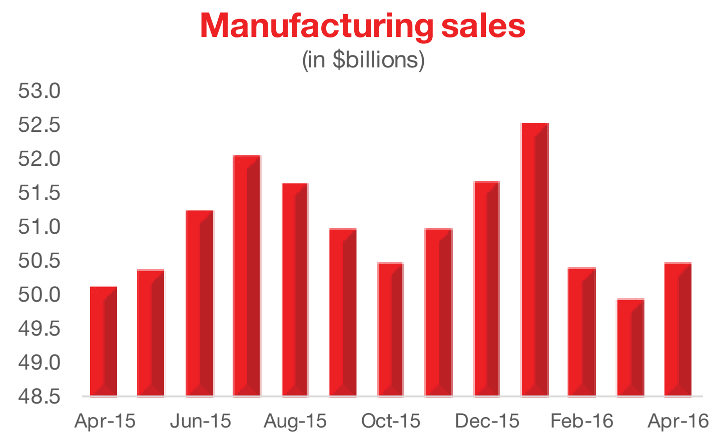
The January to April period in 2016 saw an abrupt reversal of fortune for two of Canada's most important manufacturing industries. After an exceptional 2015, automobile and parts manufacturers saw output fell 10.5 per cent from January to April as businesses retooled their facilities and drew down their inventories. Meanwhile, a recovery in crude oil prices helped the value of refinery output to rise by 5.3 per cent.

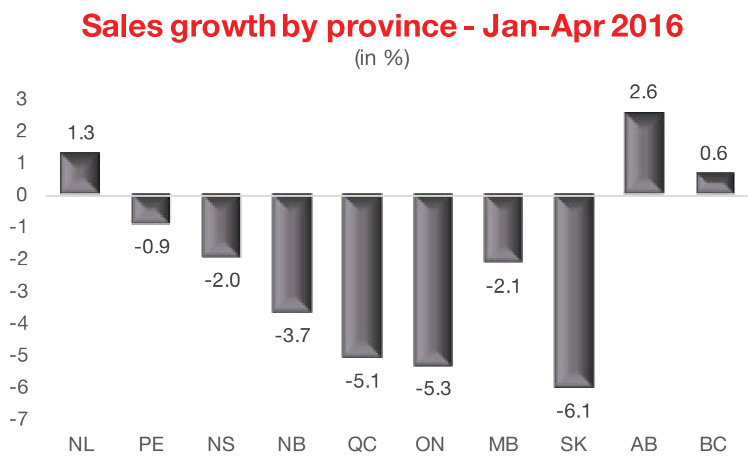
Most other major industries saw manufacturing sales fall in early 2016. There were notable declines in aerospace (-8.5 per cent), paper (-6.0 per cent), and plastics and rubber products (-4.7 per cent).

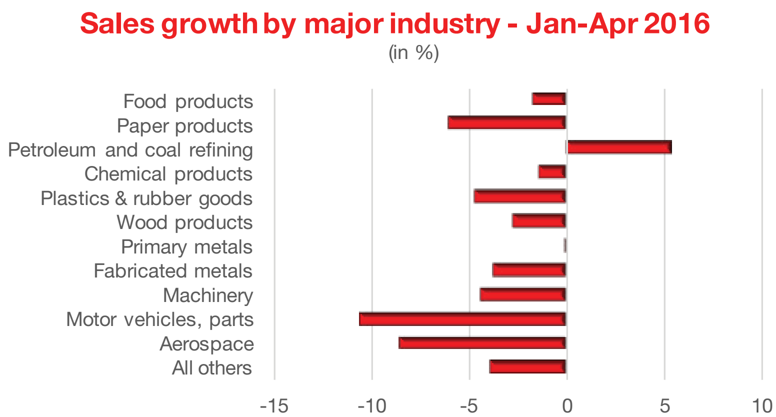
Sales by Province

Sales were down in most provinces in early 2016. The steepest decline was in Saskatchewan, where a scaling back of potash mining hurt the province's fertilizer output. Ontario and Quebec also saw sales fall due to weaker activity in automobile and aerospace production, respectively.

Thanks to its refinery output, Alberta was one of the only provinces to see solid manufacturing growth through April. However, this reprieve for Alberta's struggling manufacturers will come to a sudden end when the impact of the Fort McMurray wildfires begins to appear in manufacturing statistics.







Manufacturing Labour Markets

Manufacturing employment has fallen off in the spring, although concerns with official statistics call for caution in interpreting results.

Employment and Unemployment

Manufacturing employment has been on a rollercoaster ride since last fall. Manufacturers added 25,400 net new jobs from September to December, then shed 36,100 positions from February through May. Recent losses cannot be explained by any specific closures and coincide with similar-sized gains in other industries. Moreover, they have not affected the manufacturing unemployment rate, which was 4.7 per cent in May.

Taking labour market data at face value, job numbers are nevertheless modestly higher so far in 2016. From January through May, manufacturing employment is 0.3 per cent higher than over the same period in 2015.

Employment by Province

Recent job losses have been concentrated in BC, Ontario and Alberta. Compared to February, there were nearly 14,000 fewer manufacturing jobs in BC in May, while Ontario lost 11,300 positions and Alberta, 11,000 over that same period.

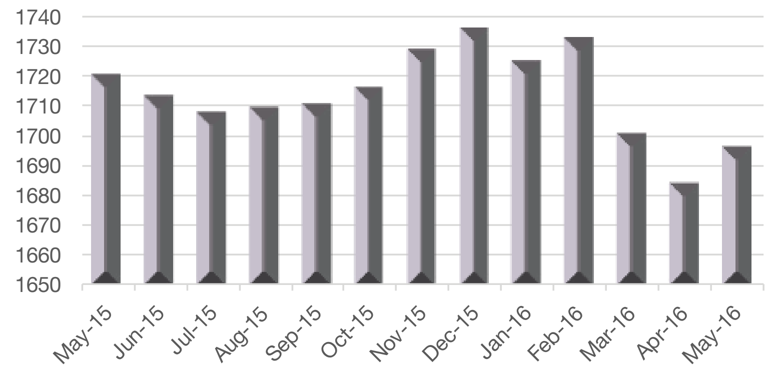
Even so, manufacturing employment in most provinces – including BC and Ontario – is still tracking about 2015 levels. Leading the way is Nova Scotia, where there has been a 7.7 per cent increase in manufacturing jobs so far in 2016. At the other end of the spectrum, Alberta's manufacturing workforce is 16.0 per cent smaller than it was through the first five months of last year.

Wages and Salaries

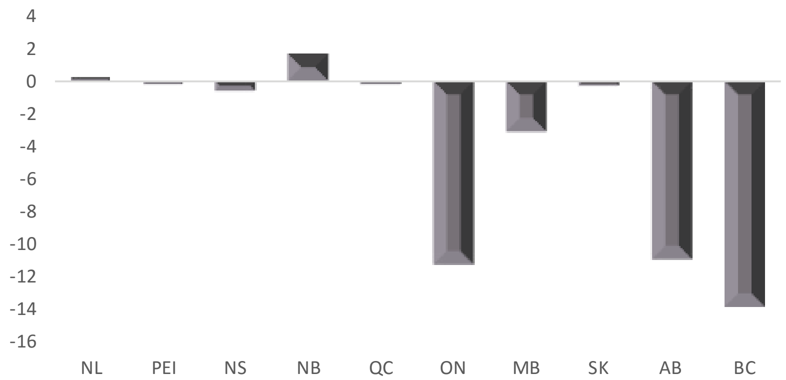
Manufacturing wages have come down in early 2016 as labour demand has flattened. Weekly earnings fell by 1.6 per cent in the first quarter of the year to just under $1,081. That drop offset most of the 2.4 per cent spike in earnings at the end of 2015.

Weekly earnings were down in all ten province in Q1. The largest decreases were in New Brunswick (2.9 per cent) and Alberta (2.5 per cent). The smallest was in Quebec, where earnings fell by 1.0 per cent.

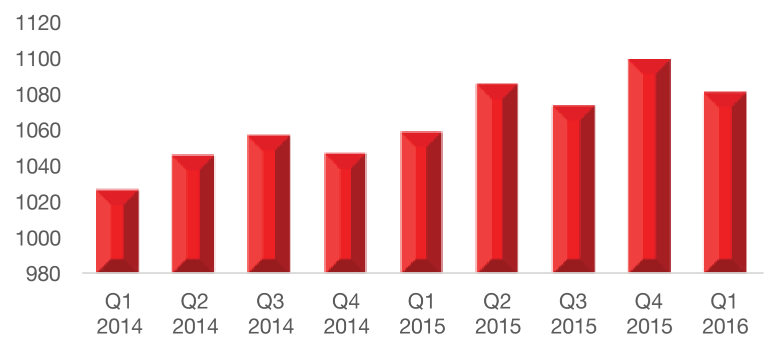
Manufacturing employment
(000s of jobs)



Manufacturing employment growth
(February to May 2016, in 000s of jobs)



Average weekly earnings in manufacturing
(over previous quarter, in %)



Manufacturing Indicators

Forward-looking indicators were mixed in Q1 as new orders were flat while inventories continued to fall. However, a spike in new orders in April could portend higher output in future.

New Manufacturing Orders

New orders for manufactured goods opened the year to the downside, falling by 0.8 per cent in Q1 2016 compared to the previous quarter. Most of that decline was in the volatile aerospace sector, where new orders were down 40 per cent.

Non-aerospace orders were essentially flat in Q1, with gains in transportation equipment (autos, rail and shipbuilding) offsetting declines in machinery, computers and electronics, and refining. However, April's numbers saw new orders recover in many of those areas of weakness, suggesting stronger growth ahead.

Manufacturing Inventories

After stockpiling goods through much of 2015, manufacturers have reversed course and are working on selling off their inventories. Inventories fell 1.5 per cent in Q1 2016, adding to a 0.6 per cent drop to end last year. Most of the decline in Q1 came in autos, aerospace and other transportation equipment, as well as primary and fabricated metals, and paper products.

Meanwhile, inventories were higher for producers of chemicals, plastics and rubber products, and electrical equipment and components.

Capacity Utilization

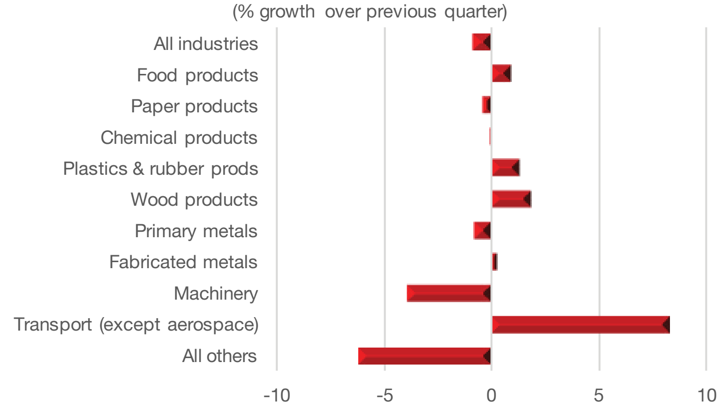
In spite of the decline in sales in early 2016, capacity utilization in manufacturing continued to edge higher, climbing from a revised 83.0 per cent in Q4 2015 to 83.2 per cent the following quarter.

Capacity continues to be extraordinarily tight in a number of industries. Paper and wood products facilities are operating at 97.6 per cent and 96.9 per cent capacity, respectively. Capacity is also tight in transportation equipment (94.8 per cent) although recent data revisions indicate that previous estimates (98 per cent) were overstated.

Available plant capacity is also tightening in food processing, primary metals and furniture, while it is opening up for producers of machinery, chemicals, and computer and electronic goods.

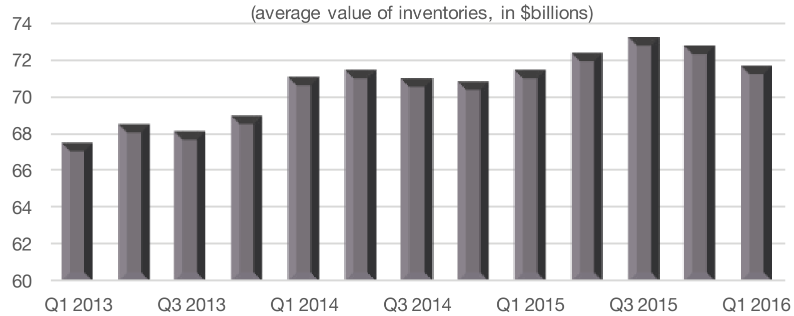
New manufacturing orders by major industry - Q1 2016

(% growth over previous quarter)



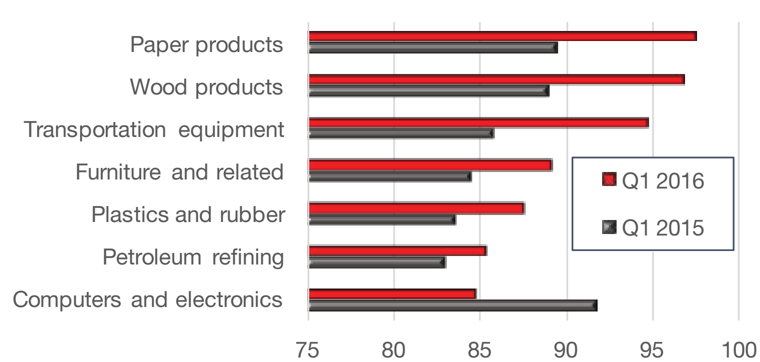
Manufacturers draw down their inventories in Q1 2016

(average value of inventories, in $billions)



Plant capacity is tightening for many manufacturers

(capacity utilization rate, in %)



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Manufacturing Competitiveness

Indicators of manufacturing competitiveness were mixed in early 2016. While productivity growth was solid, higher machinery and equipment costs and lower capital spending plans are cause for concern.

Productivity

Manufacturing productivity rose for the third straight quarter in Q1, increasing by just under 1.0 per cent (an annualized rate of 3.8 per cent). Although productivity has increased by 2.3 per cent since the spring of 2015, that growth has not been enough to overcome losses in late 2014 and early 2015. Productivity levels remain about 1.0 per cent below their summer 2014 peak.

Even so, manufacturers are far outpacing their counterparts elsewhere in Canada in improving productivity. Over the last five years, manufacturing productivity has increased by 6.1 per cent compared to just 3.1 per cent for the economy as a whole.

Machinery and Equipment Costs

The cost of buying new productivity-enhancing machinery and equipment continues to rise for manufacturers. Prices for imported M&E grew by 3.2 per cent in Q1 2016 compared to the final quarter of 2015 and have risen in six of the last seven quarters. In just two years, manufacturers have seen the cost of M&E increase by nearly 26 per cent.

Business Capital Spending

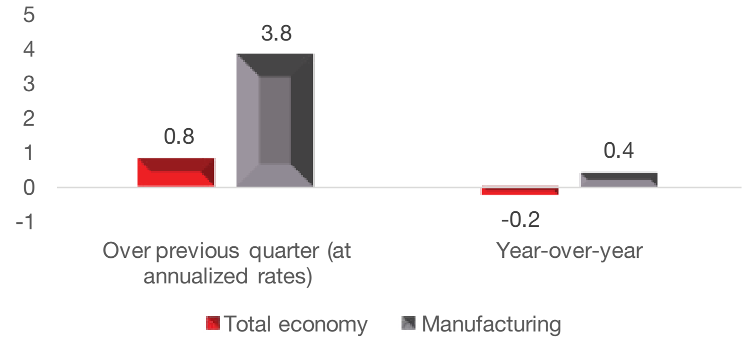
New data shows that manufacturers are planning to make fewer capital expenditures this year. Total investment intentions in manufacturing for 2016 are estimated at $17.0 billion, down from $19.1 billion last year and $17.9 billion in 2014.

The largest planned capital outlays are in transportation equipment and primary metals ($2.6 billion each), and in petroleum refining ($2.1 billion).

However, transportation equipment and primary metals are also largely responsible for the overall decrease in investment this year. Planned investments in those two industries are, respectively, $1.0 billion and $654 million lower than in 2015.

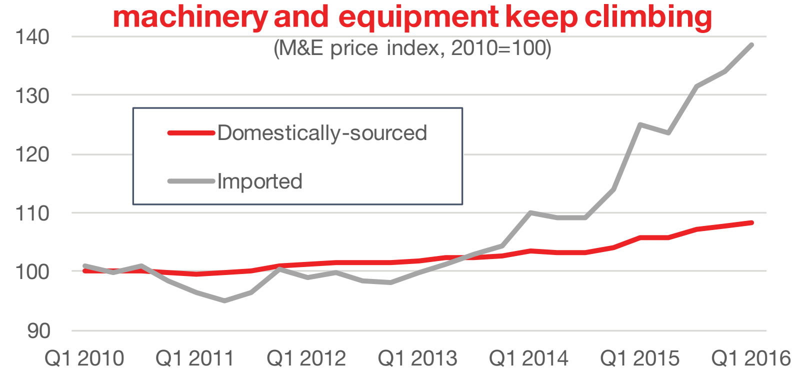
Manufacturing outpaces economy-wide productivity gains

(Growth in labour productivity, Q1 2016, in %)



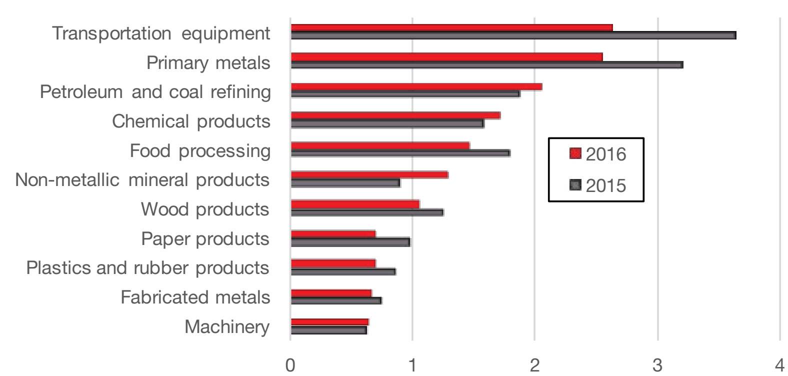
Prices for imported manufacturing machinery and equipment keep climbing

(M&E price index, 2010=100)



Capital investment by manufacturing industry

(actual and intentions, in $billions)



Business Conditions

Sluggish growth in early 2016 will only be worsened by the impact of the Fort McMurray wildfires. Meanwhile, the results of the Brexit vote are compounding business uncertainty.

Fort McMurray Wildfires

The already-sputtering Canadian economy received another blow in May as wildfires destroyed homes and livelihoods in Fort McMurray, shutting down oil production in one of Canada's largest economic engines. The impact will be deeply negative in the short term and could be enough to trigger a small nation-wide recession this year. Longer-term, however, the rebuilding process will boost GDP and will increase demand for manufactured goods.

Brexit Turmoil

The victory of the "leave" campaign in the UK referendum on EU membership caught financial markets off guard. Investors had bet heavily on the opposite result and a win for the "remain" side had already been priced into equity markets.

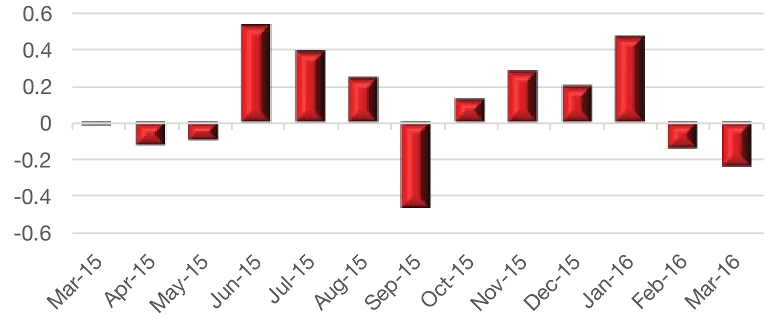
The result was a sharp drop in stock prices and the value of the British Pound, as well as a global retreat to safe havens such as the US dollar and gold. For Canadian businesses, the immediate impact is a lower exchange rate – the loonie dropped two cents in two days following the victory – and yet more financial uncertainty.

Interest Rates

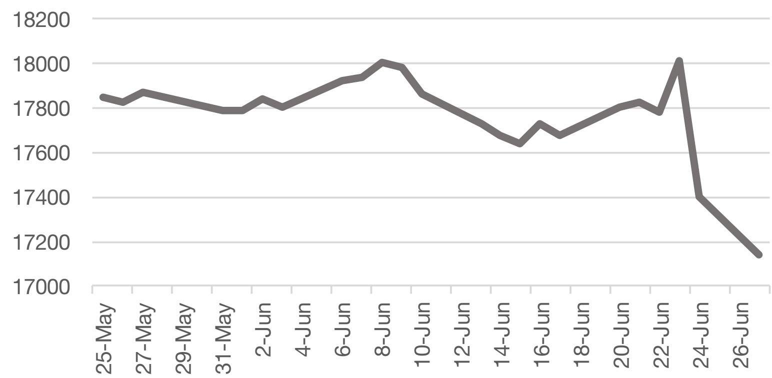
The real cost of borrowing has come down slightly for businesses. Overall, the prime business rate charged by Canada's major chartered banks remains unchanged at 2.7 per cent. However, deflationary pressures have eased, helping push the real interest rate down from about 3.7 per cent in Q3 2015 to about 2.5 per cent in early 2016.

Given the recent economic uncertainty in Canada and around the world, the outlook is for interest rates to remain steady through the medium term.

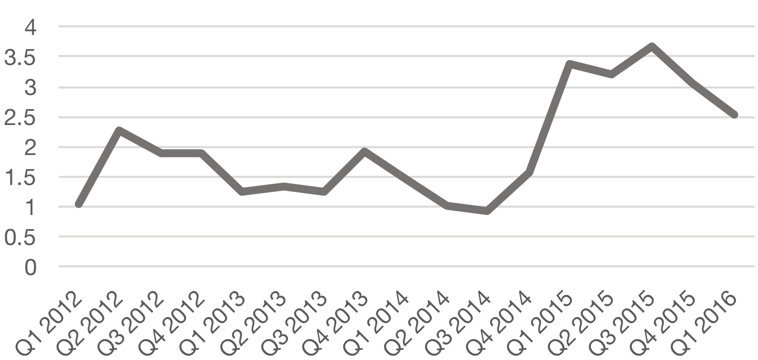
Canadian economy struggles in early 2016
(monthly growth in real GDP, in %)



Stock markets tumble on Brexit vote
(DJIA index)



Real interest rates fall as inflation stabilizes
(real prime business rate, in %)



About Canadian Manufacturers Coalition

The Canadian Manufacturing Coalition is comprised of more than 50 major industry groups, united by a common vision for a world-class manufacturing sector in Canada.

The Coalition speaks with one voice on priority issues affecting manufacturers, and what must be done to ensure all Canadians continue to enjoy economic growth, high-value outputs and high-paying jobs.

The Canadian Manufacturing Coalition's member organizations represent roughly 100,000 companies and 1.7 million workers, coast to coast.

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