

CANADA'S MANUFACTURING, WHOLESALE AND TRANSPORTATION SECTOR

October 2016

Stronger, albeit uneven performance in the first half of 2016

- Growth in the manufacturing, wholesale trade and transportation & warehousing (MWT) industries has accelerated modestly in Canada in the first half of 2016. Real GDP grew by 2.1% collectively in these industries in the first seven months of 2016, following a lackluster gain of 1.2% in 2015.
- Despite increasing since the lows recorded at the start of this year, persistent low oil prices continue to impose difficult conditions for supply chains tied to the energy sector in oil-producing regions of the country.
- Among MWT's three main pillars, transportation & warehousing shows the fastest growth led by a strong advance in the air transportation industry segment.
- Overall employment in Canada's MWT industries continues to trend lower, furthering a downward trajectory that began in mid-2014. Weakness is concentrated in the manufacturing and wholesales trade sectors.
- The volume of goods carried by railway is down significantly, falling by 4.7% compared to the same period in 2015.
- Regionally, BC boasts gains in all three MWT industries, while Newfoundland & Labrador and Alberta continue to experience sharp declines.
- The nominal value of Canadian merchandise exports are down after showing resilience in the face of declining energy prices in 2015. A sharp decline in energy exports caused by lower oil prices and the temporary effect of the Alberta wildfires in May accounts for most of the weakness.
- After recovering from its mid-January tumble, the Canadian dollar has recently settled into a tight range against its US counterpart. RBC expects the loonie to remain around 75 cents US through the end of 2017.
- RBC expects the recovery in oil prices that began in mid-February to continue as supply and demand are moving closer to balance. However price gains will be gradual as the market works through the record level of stored product. RBC forecasts WTI to average US \$44/barrel in 2016 and US \$56/barrel in 2017.
- The overall macroeconomic backdrop has been soft in the first half of 2016 for Canadian MWT industries; however RBC Economics expects the economy to rebound in the second half of the year and sustain a stronger pace in 2017.

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

	2008	2009	2010	2011	2012	2013	2014	2015	2016 ytd*
Manufacturing	-5.5	-14.0	4.6	3.5	1.6	-0.2	3.1	0.4	1.3
Wholesale trade	-0.9	-6.7	7.5	7.6	3.2	1.7	4.2	1.0	2.2
Transportation and warehousing	0.3	-4.1	6.7	4.9	2.6	1.5	5.1	4.5	4.8
Total supply chains industries	-3.6	-10.7	5.7	4.9	2.2	0.6	3.8	1.2	2.1

*January to July period

Source: Statistics Canada, RBC Economics Research

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	173,417	10.6	1,465	9.3	27,706	19,332	3,126	279
Food	22,649	1.4	224	1.4	2,613	2,443	543	44
Beverage and tobacco	6,205	0.4	34	0.2	559	408	48	8
Textile, clothing and leather	2,494	0.2	7	0.0	1,706	741	92	4
Wood	9,390	0.6	92	0.6	1,685	1,410	265	7
Paper	7,442	0.5	56	0.4	148	262	154	10
Printing and related support activities	4,246	0.3	50	0.3	2,655	946	89	8
Petroleum and coal	6,451	0.4	19	0.1	164	143	31	4
Chemical	14,323	0.9	89	0.6	936	892	151	21
Plastics and rubber	9,392	0.6	97	0.6	758	1,105	259	13
Non-metallic mineral	5,436	0.3	52	0.3	984	1,147	98	2
Primary metal	12,880	0.8	57	0.4	222	238	104	23
Fabricated metal	12,656	0.8	155	1.0	4,014	3,305	287	15
Machinery	13,787	0.8	133	0.8	2,440	1,985	291	20
Computer and electronic	6,071	0.4	56	0.4	886	661	120	13
Electrical equipment, appliance and component	3,612	0.2	34	0.2	600	422	90	4
Transportation equipment	27,272	1.7	191	1.2	899	692	283	75
Furniture and related	4,580	0.3	64	0.4	2,400	1,263	142	7
Miscellaneous	4,531	0.3	57	0.4	4,037	1,269	79	1
Wholesale trade	94,074	5.7	783	5.0	38,770	19,766	1,064	58
Farm product	1,554	0.1	14	0.1	705	404	13	0
Petroleum product	4,340	0.3	16	0.1	642	377	8	0
Food, beverage and tobacco	10,841	0.7	111	0.7	4,587	2,300	278	10
Personal and household goods	12,939	0.8	105	0.7	5,108	1,999	180	20
Motor vehicle and parts	8,375	0.5	65	0.4	2,327	1,680	80	2
Building material and supplies	15,473	0.9	128	0.8	5,905	4,090	130	4
Machinery, equipment and supplies	26,163	1.6	216	1.4	9,587	5,702	233	15
Miscellaneous	11,706	0.7	93	0.6	6,141	2,517	99	5
Electronic markets, and agents and brokers	2,683	0.2	33	0.2	3,768	697	43	2
Transportation and warehousing	71,474	4.4	638	4.0	53,794	10,502	1,039	136
Air	8,083	0.5	75	0.5	644	368	73	14
Rail	6,891	0.4	43	0.3	84	59	43	12
Water	1,472	0.1	n/a	n/a	166	119	20	5
Truck	20,081	1.2	196	1.2	39,595	4,688	257	10
Transit, ground passenger, scenic and sightseeing	7,543	0.5	122	0.8	3,037	1,202	184	30
Pipeline	5,959	0.4	0	0.0	139	31	13	5
Support activities	12,784	0.8	111	0.7	6,007	2,349	190	19
Postal service and couriers and messengers	6,488	0.4	47	0.3	2,556	678	124	32
Warehousing and storage	2,173	0.1	44	0.3	1,566	1,008	135	9
Total supply chains industries	338,965	20.7	2,886	18.3	120,270	49,600	5,229	473

* Excludes firms with no employees. June 2016.

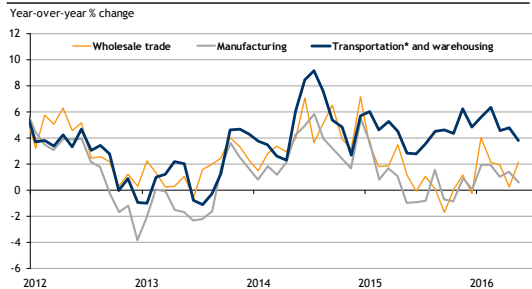
** In 2015, millions of 2007 dollars.

*** In 2015.

Source: Statistics Canada, RBC Economics Research

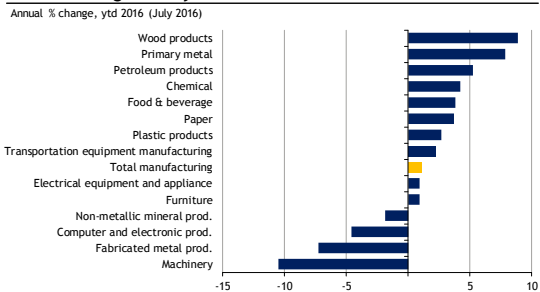
Industry trends

MWT real GDP: Canada



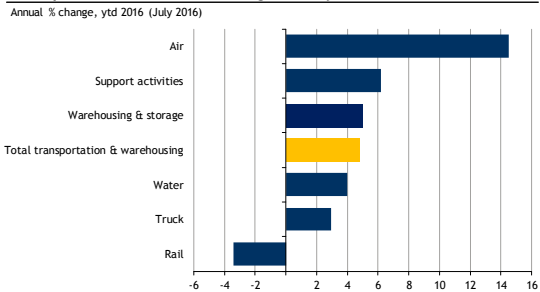
* Transportation consists of air, rail, water, trucking and support activities. Source: Statistics Canada, RBC Economics Research

Manufacturing industry real GDP: Canada



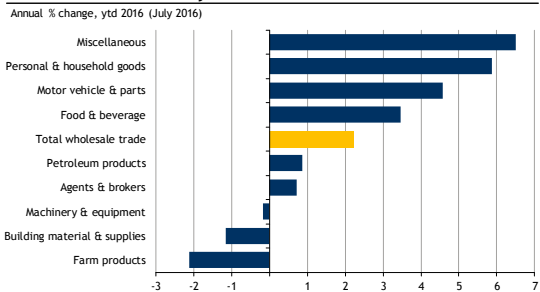
Source: Statistics Canada, RBC Economics Research

Transportation and warehousing industry real GDP: Canada



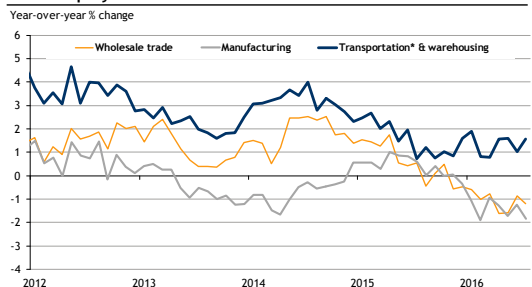
Source: Statistics Canada, RBC Economics Research

Wholesale trade industry real GDP: Canada



Source: Statistics Canada, RBC Economics Research

MWT employment: Canada



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

Growth in Canada's MWT industries picked up slightly during the first half of 2016. Real GDP for the manufacturing, wholesale trade and transportation & warehousing industries has grown by 2.0% collectively in the first seven months of 2016, following a lackluster gain of 1.2% in 2015. After experiencing slow growth in 2015, growth in wholesale trade and manufacturing has picked up their pace this year, while transportation and warehousing maintained a solid pace, of 4.8% on average to date.

Growth in manufacturing in the first seven months of 2016 has been led by strong gains in wood products, petroleum products, and most notably a sharp turn-around for primary metal production (a 7.9% gain after a decline of nearly 5% in 2015). Partially offsetting these gains were declines of more than 4.5% in machinery, fabricated metal, and computer and electronic production.

In the first seven months of 2016, air transportation has grown at a rate of 14.5% – surpassing the already robust gains made in 2015 and more than doubling the rate of all other industries within transportation and warehousing. Warehousing & storage has rebounded strongly after posting negative growth in 2015. Rail transportation is the lone industry losing ground in the first half of 2016, thereby further extending the negative growth exhibited in 2015. Carloadings of grain, coal, primary metal products, and petroleum products all fell.

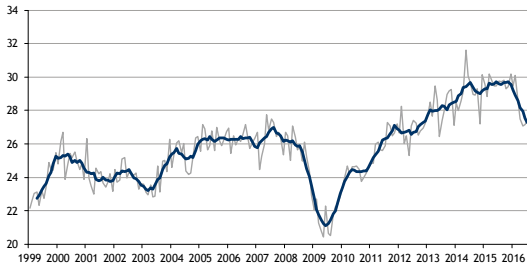
As was the case in 2015, the 'miscellaneous' category (which includes paper, minerals, and chemicals) has led all industry segments within wholesale trade, growing at 6.5% in the first half of 2016. The personal & household goods, motor vehicle & parts, and food & beverage segments also helped support a strong first half of the year for the industry overall. After declining in 2015, petroleum product wholesale has rebounded mildly by 0.9%, while farm products have slumped, falling 2.1% in the first seven months of 2016, after experiencing a gain of 2.6% in 2015.

Overall employment in Canada's MWT industries has declined so far in 2016, furthering a downward trend that began in mid-2014. However, transportation and warehousing has bucked the trend with small gains. Both wholesale trade and manufacturing have posted declines in excess of 1%.

Industry trends

Railway carloadings: Canada

Traffic carried, million tonnes, SA

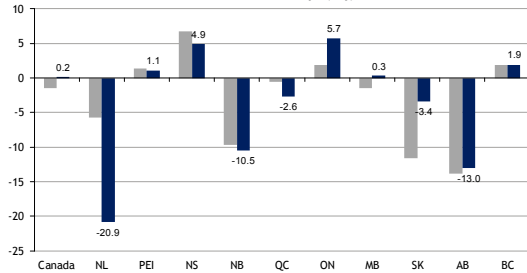


Source: Statistics Canada, RBC Economics Research

The volume of goods carried by railway dropped off significantly by 4.7% in the first half of 2016. Carloadings of grain, coal, primary metal products, and petroleum products all fell by more than 13%; however, this was partly offset by increases in traffic of food products (9.2%) and lumber & wood products (10.4%).

Manufacturing sales by province

Annual % change

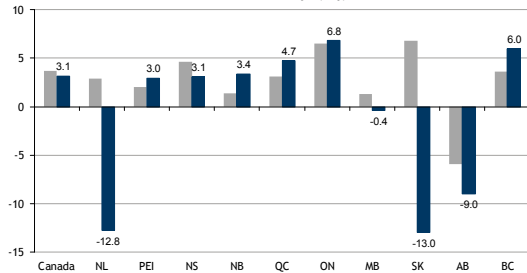


Source: Statistics Canada, RBC Economics Research

Manufacturing sales (unadjusted for price changes) remained weak overall in the first seven months of 2016. Nondurable goods industries – led by petroleum and coal products – fell by 3.1%, while durable goods industries rose by a near-equal rate. Regionally, sales continued to erode in Canada’s oil-producing provinces (i.e. Alberta, Saskatchewan and Newfoundland & Labrador), and in New Brunswick and Quebec. Both Ontario and Nova Scotia saw strong gains, while BC continued to achieve modest growth.

Wholesale sales by province

Annual % change

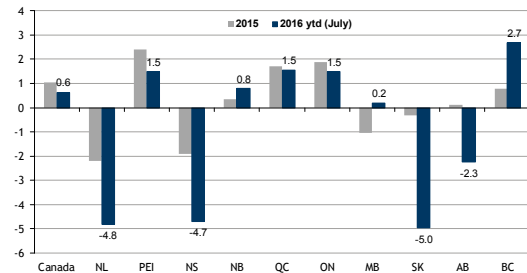


Source: Statistics Canada, RBC Economics Research

Wholesale sales (unadjusted for price changes) in Canada have slowed down relative to the 6.7% gain in 2014 and 3.9% gain in 2015; yet they remain in steady growth mode at 3.1% so far this year. Most industry segments have seen increases in early 2016 but the headline figure was held back by declines in sales of wholesalers of farm products, machinery equipment and supplies. Ontario wholesalers enjoyed the strongest sales increase in Canada followed closely by those in BC. Wholesalers in Saskatchewan, Alberta, and Newfoundland & Labrador all experienced sharp declines in the first half of 2016.

Transportation and warehousing employment by province

Annual % change



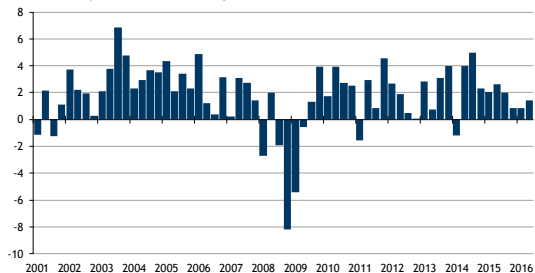
Source: Statistics Canada, RBC Economics Research

Payrolls in Canada’s transportation and warehousing industry expanded slightly in the first seven months of 2016, growing by just 0.6% nationally. Regionally, employment fell in Newfoundland & Labrador, Saskatchewan, and Alberta with these provinces negatively impacted by lower oil prices – along with Nova Scotia. BC payrolls in this industry have grown the most among the provinces this year – up 2.7% year-to-date – while payrolls in Ontario, Quebec, and PEI have all grown modestly by 1.5%.

Macroeconomic context

U.S. real GDP

Quarter-over-quarter, annualized % change



Source: Bureau of Economic Analysis, RBC Economics Research

US real GDP growth averaged just 1.1% in the first half of 2016, a disappointing result largely due to weakness in business fixed investment and inventories. However, a firming in labour market conditions has resulted in strong consumer spending, which is expected to continue through Q3. RBC Economics expects US growth to rebound to 2.9% in Q3 and 2.8% in Q4 such that GDP growth for 2016 as a whole would be 1.6%, down from 2.6% in 2015.

Industrial production: U.S.

Index 2012 = 100, seasonally adjusted

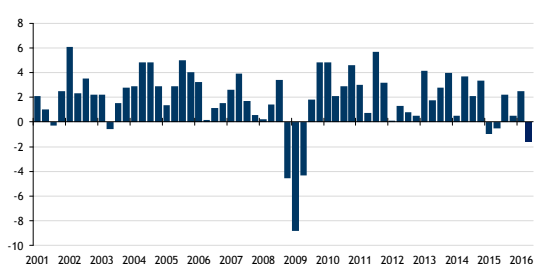


Source: Federal Reserve Board, RBC Economics Research

U.S. industrial production fell by 1.2% in the first seven months of 2016. Manufacturing, normally a source of growth for U.S. industrial production, grew by just 0.2%. Mining was largely responsible for the overall decline in the headline number, falling by an outsized 10.5% weighed down by weakening commodity prices, while utilities also fell by 2.1%.

Canada's real GDP

Quarter-over-quarter % change, annualized rate



Source: Statistics Canada, RBC Economics Research

The Canadian economy hit another pothole in the second quarter of 2016 as the impact of the wildfires in Alberta reverberated through the economy. The sharp, but temporary, pullback in oil sands production in the wake of wildfires in Alberta in May was the key factor underpinning the 1.6% annualized decline in real GDP in the second quarter. While the unfortunate event interrupted the economy's momentum after a solid first quarter, the recovery is forecast to spur a very sharp rebound of 3.7% in real GDP in Q3. RBC Economics expects overall growth to be 1.3% in 2016.

Real merchandise trade: Canada

Billion constant 2007 \$

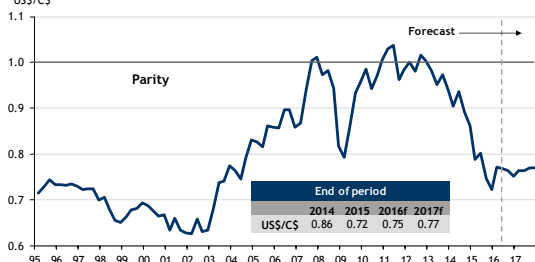


Source: Statistics Canada, RBC Economics Research

Canadian merchandise exports fell sharply in the first half of 2016 after showing resilience in the face of declining energy prices in 2015. The drop in exports can be traced at least in part to the pullback in energy sales caused by the Alberta wildfires. RBC economics expects a snapback in exports in the second half of 2016 and further modest strengthening in 2017 when exports are projected to rise by 2.4% backed by an anticipated pickup in U.S. industrial production, a weak Canadian dollar and a continuation of modest global trade growth.

Canadian dollar forecast

US\$/C\$

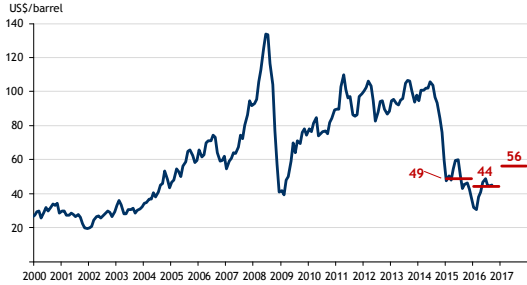


Source: Bank of Canada, RBC Economics Research Forecasts

After recovering from its mid-January tumble, the Canadian dollar settled into a tight range against its US counterpart this summer weathering gyrations in oil prices and ebb and flow of expectations about a near-term Fed rate hike. Looking forward, RBC expects the currency to maintain a largely flat trend with monetary policy divergences between Canada and the US, and gradually rising oil prices exerting offsetting forces on the loonie against the greenback.

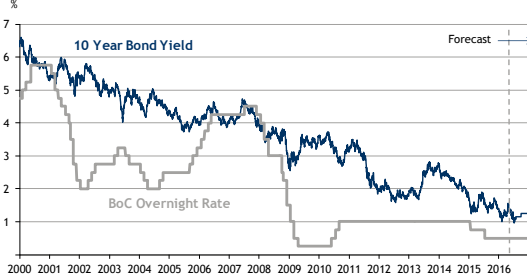
Macroeconomic context

Crude oil prices WTI



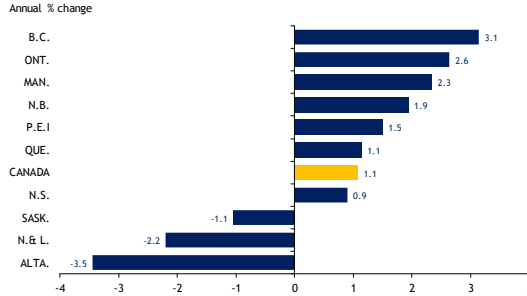
Source: Wall Street Journal, Haver Analytics, RBC Economics Research

Interest rates: Canada



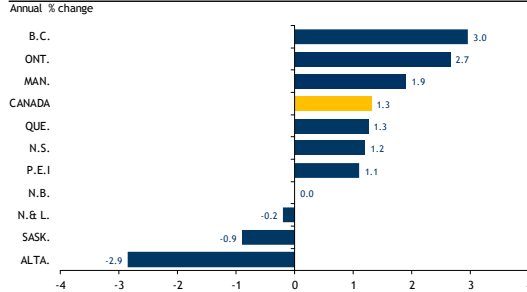
Source: Bank of Canada, RBC Economics

Provincial real GDP growth in 2015



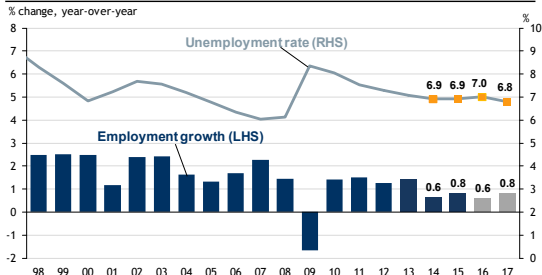
Sources: Statistics Canada, RBC Economics Research

Provincial real GDP growth in 2016



Sources: Statistics Canada, RBC Economics Research

Job market in Canada



Source: Statistics Canada, RBC Economics Research

RBC expects the recovery in oil prices that began in mid-February to continue in the period ahead as supply and demand move closer to balance. That being said, price gains will be gradual as the market works through the record petroleum inventories. RBC forecasts WTI to average US\$44/bbl in 2016, down slightly from US\$49/bbl average in 2015. Further moderate appreciation (to US\$56/bbl) is projected for 2017.

After a quiet summer, Bank of Canada policymakers were out in force in September with speeches featuring a central theme: lower-for-longer. The Bank has marked down its growth forecast in its October *Monetary Policy Report*, with the economy now expected to reach full capacity by mid-2018, later than previously assumed. RBC Economics sees the Governing Council holding interest rates steady through the remainder of 2016 and all of 2017, thereby maintaining a stimulative stance while other policy levers (fiscal stimulus, and particularly infrastructure investment) get activated to shore up growth.

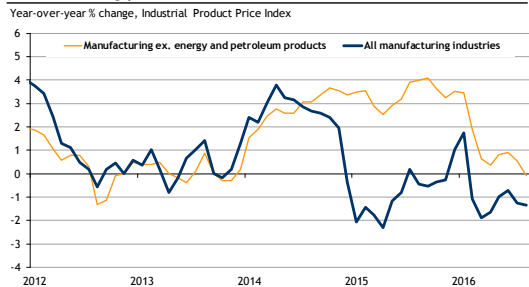
The oil price shock triggered a significant shift in provincial economic performance in 2015. After consistently driving economic growth in Canada since 2010, Alberta was hit hard by plummeting capital expenditures in its energy sector. BC grew by 3.1% with impressive strength in the labour market, consumer spending, exports, and non-residential construction also helped support that province's expansion. However, the strong economy and low interest rates have contributed to an overheated housing market.

Developments in 2016 can best be described as a mixed bag for provincial economies. There was some encouraging news including further impressive employment gains in British Columbia and, to a lesser extent, Ontario, as well as indications that consumers kept the wallets open in several provinces; however, the news remained predominantly grim in oil-producing parts of the country struggling with low oil prices.

The pace of employment gains has moderated in the year to September in Canada with job cuts in oil-producing provinces being partly responsible. However, demographic factors are restraining growth in the working-age population and commensurately lowering the number of positions that need to be created to absorb unemployed workers. Therefore, despite the modest job creation in Canada, the unemployment rate is expected to hold around 7.0% in 2016 and fall to 6.8% in 2017.

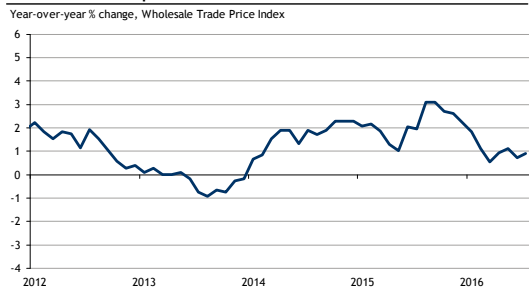
Industry prices and costs

Manufacturing prices: Canada



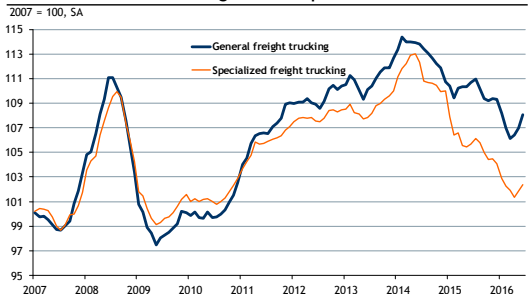
Source: Statistics Canada, RBC Economics Research

Wholesale trade prices: Canada



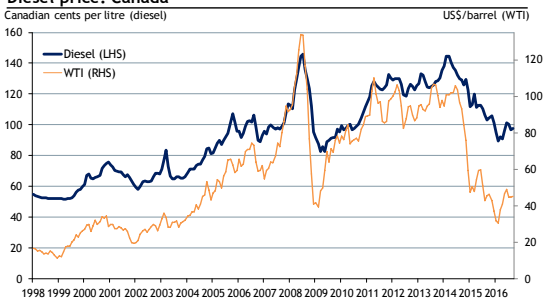
Source: Statistics Canada, RBC Economics Research

For-hire motor carrier freight service price index: Canada



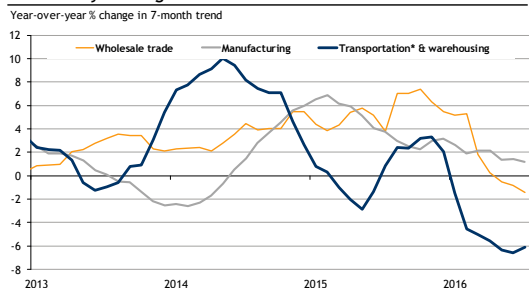
Source: Statistics Canada, RBC Economics Research

Diesel price: Canada



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

MWT hourly earnings: Canada



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

Excluding energy and petroleum product prices, manufacturing output prices (measured in Canadian dollars) have increased much more slowly in the first half of 2016 (up 1.2%), compared to 2014 (2.8%) and 2015 (3.4%). The slow-down this year was due in part to sharp declines in prices for chemicals and chemical products, primary metals products, and meat, fish & dairy products. Including energy and petroleum products, manufacturing prices have continued to fall by 0.8%, matching the rate of decline in 2015.

Prices received by Canadian wholesalers have risen by 1.0% in the first seven months of 2016, thereby representing a moderation from 2.2% in 2015, which is consistent with a continued weaker growth in wholesale sales volume this year in Canada.

Prices charged by Canadian for-hire motor carrier freight services continue to fall from their peak in early 2014, reflecting trends in fuel costs. Prices for specialized freight trucking fell by 3.9% in the first half of 2016, while prices for general freight trucking prices fell by a lesser rate of 2.8%. Strong competition and low fuel costs continue to drive the decline in both segments of the industry.

Diesel prices fell by 15% in the 12 months ending September 2016. While this represented a moderation from the 20% rate of decline posted a year earlier, it provided further relief for one of the biggest cost items faced by motor carriers. Crude oil prices fell by 27% over the same time period, nearly doubling the rate of decline in diesel.

Labour costs in the MWT sector have been under noticeable downward pressure in the first half of 2016, with transportation and warehousing employees experiencing outright declines in wages among workers paid by the hour (down 5.6% y/y). Wholesale trade wages have risen by 0.1% so far in 2016; however, the trend has slipped into negative growth territory in recent months. Manufacturing wages have averaged 2.1% y/y gains in 2016, which is well below the 4% increase the industry posted in 2015.

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