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Recent Developments in the Canadian Economy: Fall 2017

by Guy Gellatly and Elizabeth Richards

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Recent Developments in the Canadian Economy: Fall 2017

by Guy Gellatly and Elizabeth Richards, Analytical Studies Branch

This article in the *Economic Insights* series provides users with an integrated summary of recent changes in output, employment, household demand, international trade and prices. Organized as a statistical summary of major indicators, the report is designed to inform about recent developments in the Canadian economy, highlighting major changes in the economic data during the first two quarters of 2017 and into the summer months. Unless otherwise noted, the tabulations presented in this report are based on seasonally adjusted data available in CANSIM on October 6, 2017.

Overview

Economic activity continued to strengthen in the first half of 2017 as household spending, exports and business investment supported growth. Business outlays on non-residential structures, machinery and equipment, and intellectual property assets rose during the first two quarters of the year, following notable declines during 2015 and 2016.

Real gross domestic product (GDP) increased for eight consecutive months from November 2016 to June 2017 before stabilizing in July, with gains broadly based across industries. Mining, quarrying, and oil and gas extraction, manufacturing, and construction contributed to higher goods output during the first half of 2017, while wholesale trade, retail trade, and finance industries supported growth among services.

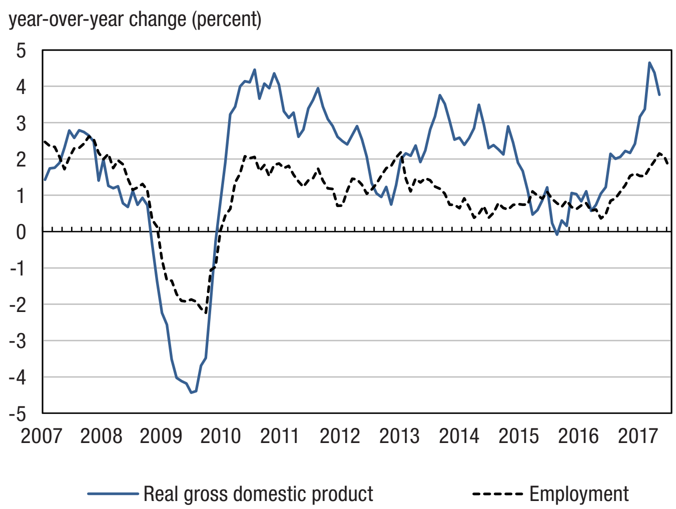
Employment also continued to strengthen in the first half of 2017 on gains in full-time work. Higher employment among core-age workers accounted for about two-thirds of overall employment growth from January to June. British Columbia led employment growth among the provinces. Employment continued to increase in the third quarter, albeit at a more measured pace.

Overall, real GDP growth, measured year-over-year, increased steadily during the winter and early spring, before rising above 4% in May and June. Annual employment growth strengthened to 1.9% year-over-year in June, before rising above 2% during the summer months. As a result, output growth at mid-year 2017 exceeded employment growth by the widest margin since mid-2014.

Despite the pace of economic growth, consumer price inflation decelerated during the first half of 2017, slowing from 2.1% in January to 1.0% in June.

Moreover, Canada posted a cumulative merchandise trade deficit of $7.8 billion over the first half of 2017, similar to the deficit over the last half of 2016. A larger net surplus for energy products in the first half of 2017 was offset by larger deficits for non-energy commodities.

Chart 1
Output and employment



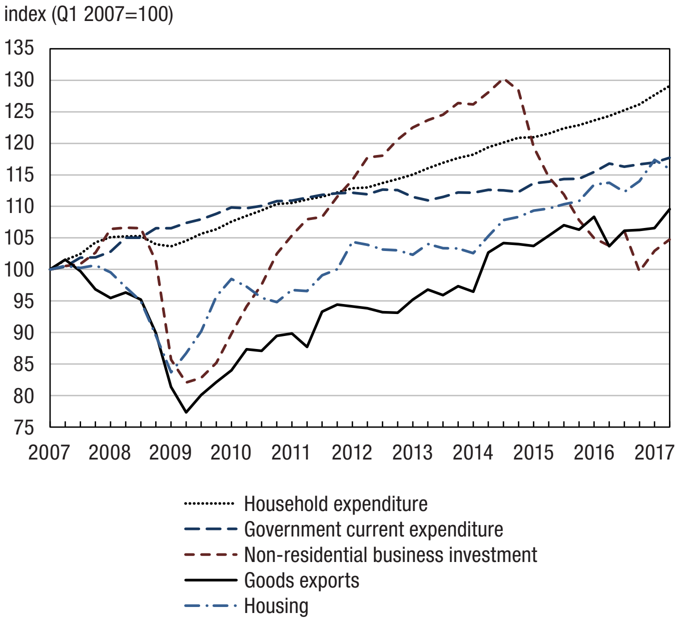
Sources: Statistics Canada, CANSIM tables 282-0087 and 379-0031.

Broad-based contributions to growth

The pace of economic growth strengthened during the first half of 2017, with the strongest cumulative growth over the first two quarters of the year since 2002. Gains during the first half were supported by household spending, exports and non-residential business investment. The economy has expanded for four consecutive quarters since wildfires in Northern Alberta weighed on growth during the second quarter of 2016.

Real GDP rose 1.1% in the second quarter, following a 0.9% gain in the first quarter. In the United States, real GDP grew 0.8% in the second quarter, up from 0.3% to start the year. Economic growth in Canada has outpaced growth in the United States over the last four quarters.

Chart 2
Real gross domestic product, selected aggregates



Note: Q1=first quarter.
Source: Statistics Canada, CANSIM table 380-0064.

The pace of consumer spending in Canada accelerated in the first half of 2017, as household expenditures rose by 1.2% and 1.1% in the first and second quarters, respectively. This compares to 0.7% growth during the third and the fourth quarters of 2016. Spending on durables contributed to the growth during the first half, advancing by 2.3% in the second quarter following a 3.2% gain in the first. Expenditures on durables have increased notably over the last three quarters, supported by auto sales. Higher outlays on clothing and footwear and housing-related expenditures also contributed to growth.

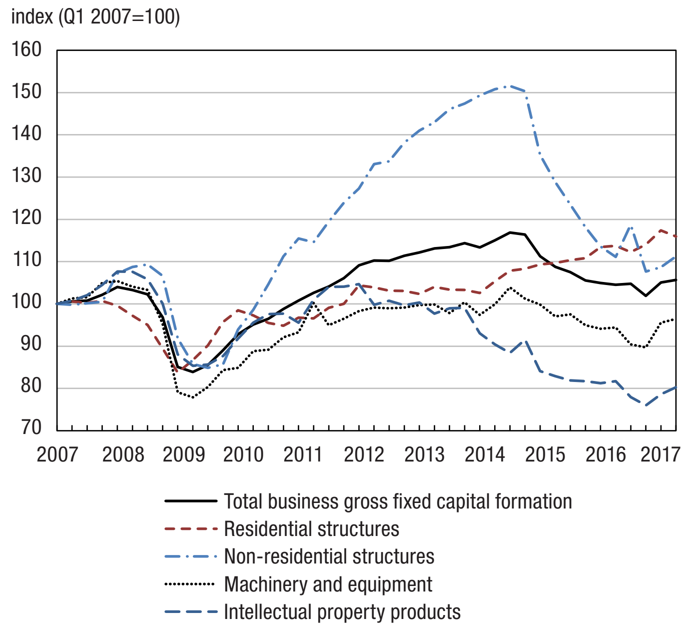
Exports of goods rose 2.8% in the second quarter, after edging up 0.3% in the first. Energy exports rose 9.2% in the second quarter on higher volumes of crude oil and crude bitumen, natural gas, and refined petroleum products. This followed a 0.7% decline in energy exports in the first quarter. Higher volumes of industrial machinery, equipment and parts, aircraft and other transportation equipment and parts, and motor vehicles and parts also contributed to higher exports in the second quarter.

Import volumes strengthened during the first half of 2017. Goods imports rose 4.0% in the first quarter and 2.5% in the second. Imports of motor vehicles and parts, industrial machinery and equipment, electronic and electrical equipment supported import volumes early in the year. Energy imports contributed to growth in both quarters, increasing 8.4% in the second.

Business investment increased

Non-residential business outlays on structures and machinery and equipment (M&E) supported growth during the first half of 2017, increasing 3.3% in the first quarter and 1.7% in the second. The two consecutive quarterly gains in early 2017 mark the first back-to-back increases in non-residential business investment since 2014. Nevertheless, combined business outlays on non-residential structures and machinery and equipment remain 18% below levels in mid-2014 prior to declines in crude oil prices.

Chart 3
Business gross fixed capital formation



Note: Q1=first quarter.
Source: Statistics Canada, CANSIM table 380-0068.

Business outlays on non-residential structures rose 2.4% in the second quarter of 2017, following a 1.0% gain in the first. Higher spending on engineering structures supported the increase in both quarters. Business outlays on machinery and equipment rose 6.6% in the first quarter of the year, the largest quarterly increase in over five years. Investments in aircraft, industrial machinery, autos and communications equipment contributed to higher M&E outlays in early 2017. Spending on M&E moderated in the second quarter, increasing 0.9%.

Business investment in intellectual property products rose during the first half of 2017, advancing 2.1% in the second quarter following a 3.5% increase in the first. Spending on mineral exploration and evaluation rose in both quarters, following eight consecutive quarterly declines.

After a notable gain the first quarter (+2.9%), business outlays on residential structures declined in the second (-1.2%). The first-quarter gain was the largest quarterly increase in residential structures in five years. Lower spending in the second quarter reflected a 6.7% decline in ownership transfer costs due to lower activity in resale markets.

Following 1.3% growth in the first quarter, business sector labour productivity edged down (-0.1%) in the second as gains in hours worked (+1.4%) outpaced the growth in output. The quarterly increase in hours worked, supported by broad-based increases among services, was the largest since late 2003. Productivity in mining and oil and gas extraction declined during the first half of the year, reflecting sizable increases in hours worked in both quarters. After increasing in the first quarter, manufacturing productivity declined in the second as the pace of output growth slowed.

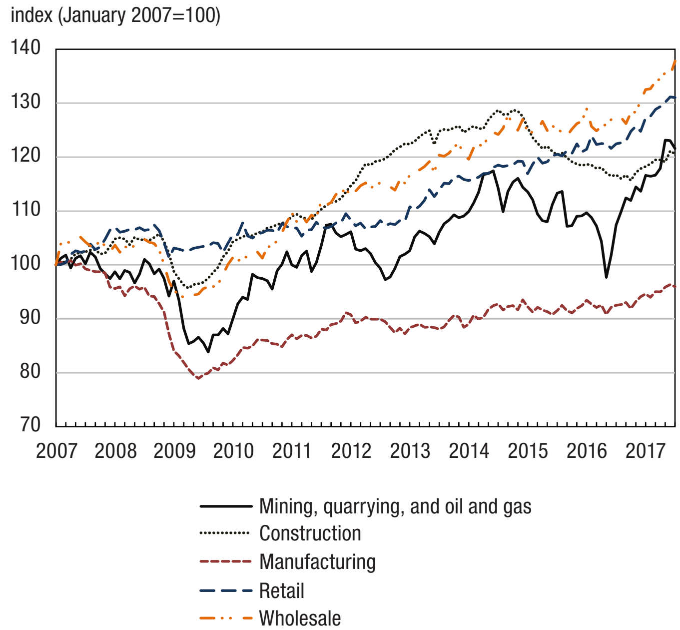
Industrial capacity utilization rose to 85% in the second quarter, the highest level since the third quarter of 2007. After little change over the previous three quarters, capacity utilization in oil and gas extraction rose 3.3 percentage points to 84% in the second quarter. Capacity utilization in manufacturing also increased, rising to 84.2% in the second quarter.

The terms of trade deteriorated in the second quarter, weighing on real income growth for the first time since early 2016. Import prices rose 2.7% in the second quarter while export prices edged up 0.5%. Improvements in the terms of trade had made substantial contributions to the growth in real domestic income over the previous three quarters. Following a 1.9% increase to start the year, nominal GDP rose 0.7% in the second quarter as corporate earnings edged lower.

Widespread gains across industrial sectors

The output of the goods sector advanced steadily in first half of 2017 with gains in five of the first six months. Mining, quarrying and oil and gas extraction supported growth in both quarters, as did manufacturing and construction. Manufacturing output increased in four of the first six months of the year. Output in June was 2.4% higher than levels at year-end 2016, as machinery manufacturing, petroleum refineries and primary metal manufacturing increased output during the first half of 2017.[1]

Chart 4
Real gross domestic product, selected industries



Source: Statistics Canada, CANSIM table 379-0031.

Construction output advanced steadily from January to March, and then rose 1.7% in June as non-residential, residential and engineering construction all advanced. The notable gain in June followed lower non-residential construction activity in May due in part to the strike by unionized construction workers in Quebec. Non-residential output in June rebounded to 2016 year-end levels.

After gains from January to March, residential construction edged lower in April and May before strengthening in June. Residential construction at mid-year was 3% higher than at year-end 2016.

Following sharp declines as oil prices fell in 2015 and 2016, engineering construction posted gains in four of the first six months of 2017. As of June, output in this sector remained 22% below mid-2014 levels.

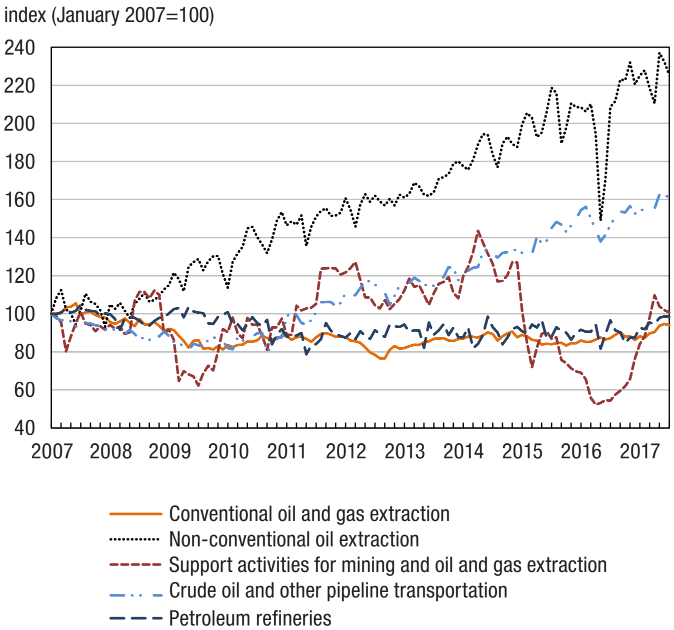
The pace of growth in the service sector accelerated during the first half of 2017, supported by gains in wholesale, retail, transportation and warehousing, finance and insurance, and professional, scientific and technical services. Wholesale trade contributed significantly to higher services output in the first quarter, while finance and insurance industries supported growth in the second. The output of real estate agents and brokers was down in the second quarter as resale housing activity declined in the Greater Toronto Area.

1. For a recent analysis of long-term changes in manufacturing output, see Clarke and Couture (2017).

Conventional oil and gas extraction expanded output

Conventional oil and gas extraction rose during five of the first six months of 2017. The output of conventional producers in June was 10% higher than levels at year-end 2016. Non-conventional oil extraction rose 5% from December to June, as production disruptions in the oil sands weighed on non-conventional output in March and April, prior to the return to higher levels in May. Non-conventional oil extraction in June was up 36% year-over-year following recent lows in the spring of 2016 due to wildfires in Northern Alberta.

Chart 5
Real gross domestic product, selected industries



Source: Statistics Canada, CANSIM table 379-0031.

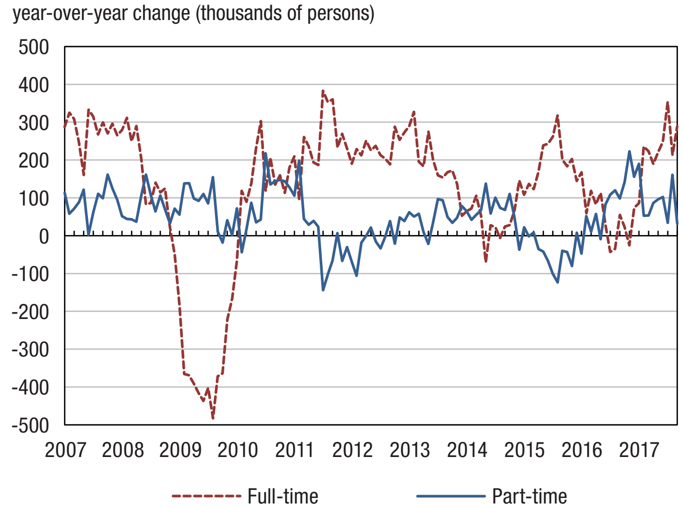
Businesses that provide support activities for mining and oil and gas extraction, including rigging and drilling services, continued to increase output in the first half of 2017, as production rose from January to April, prior to declines into mid-year. These activities have strengthened considerably over the last year, following steep declines during 2015 and early 2016 as oil prices trended lower. In June, the output of businesses that provide support activities for resource extraction was 33% higher than at year-end 2016, and 86% higher than in mid-2016.

More recently, real GDP was unchanged in July as gains in wholesale, utilities and public sector industries were offset by declines in mining, quarrying, and oil and gas extraction manufacturing, construction, and finance.

Employment continued to strengthen

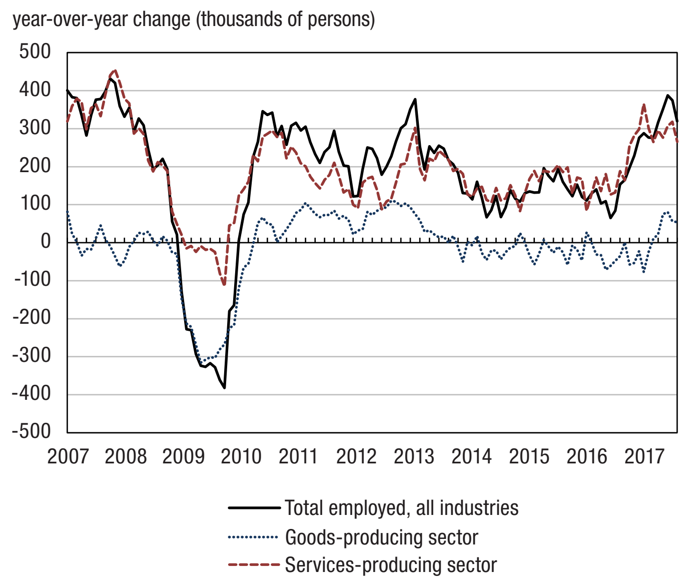
Total employment rose by 186,000 (+1.0%) in the first six months of 2017, led by gains in full-time work and among core-age individuals (aged 25 to 54). Gains among private sector employees accounted for about one-half of the total increase. Higher employment in services, supported by gains in professional, scientific and technical services and in health care and social assistance, accounted for over two-thirds of the overall increase.

Chart 6
Type of employment



Source: Statistics Canada, CANSIM table 282-0087.

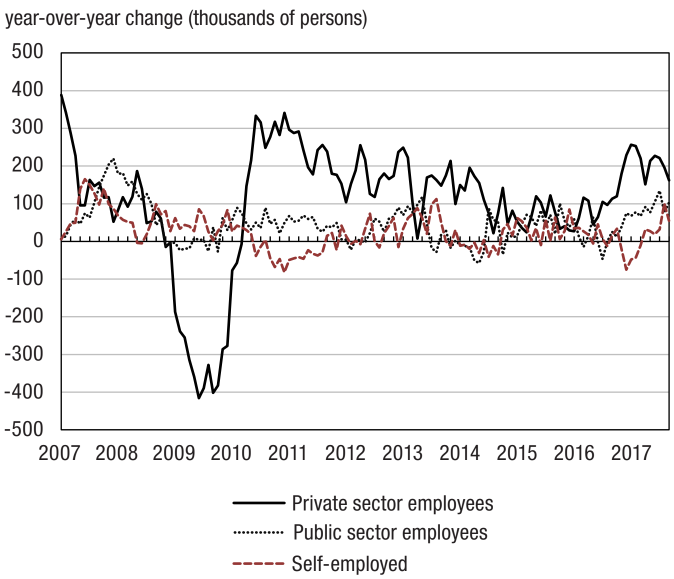
Chart 7
Employment, by sector



Source: Statistics Canada, CANSIM table 282-0088.

Employment in the goods sector rose by 56,000 in the first half of 2017, led by gains in manufacturing. British Columbia had the strongest employment increase among the provinces. Overall employment in British Columbia rose by 78,000 during the first six months of the year, about twice the net increase reported in both Quebec and Ontario. The growth in British Columbia was all in full-time work, and supported by gains among core-age individuals and private sector employees.

Chart 8
Employment, by class of worker



Source: Statistics Canada, CANSIM table 282-0089.

The national unemployment rate edged lower during the first half of 2017, declining from 6.8% at the start of the year to 6.5% in June. The unemployment rate in Alberta declined from 8.8% in January to 7.4% in June, as employment in the province edged higher in the first half (+31,000). The unemployment rate in British Columbia averaged 5.4% during the first six months of the year, compared to 6.3% in Ontario and Quebec.

More recently, employment growth moderated in the third quarter (+43,000), supported by increases in self-employment and in full-time work. Employment in Ontario strengthened during the third quarter. The national unemployment rate fell to 6.2% in August, the lowest level since October 2008, and remained at 6.2% in September.

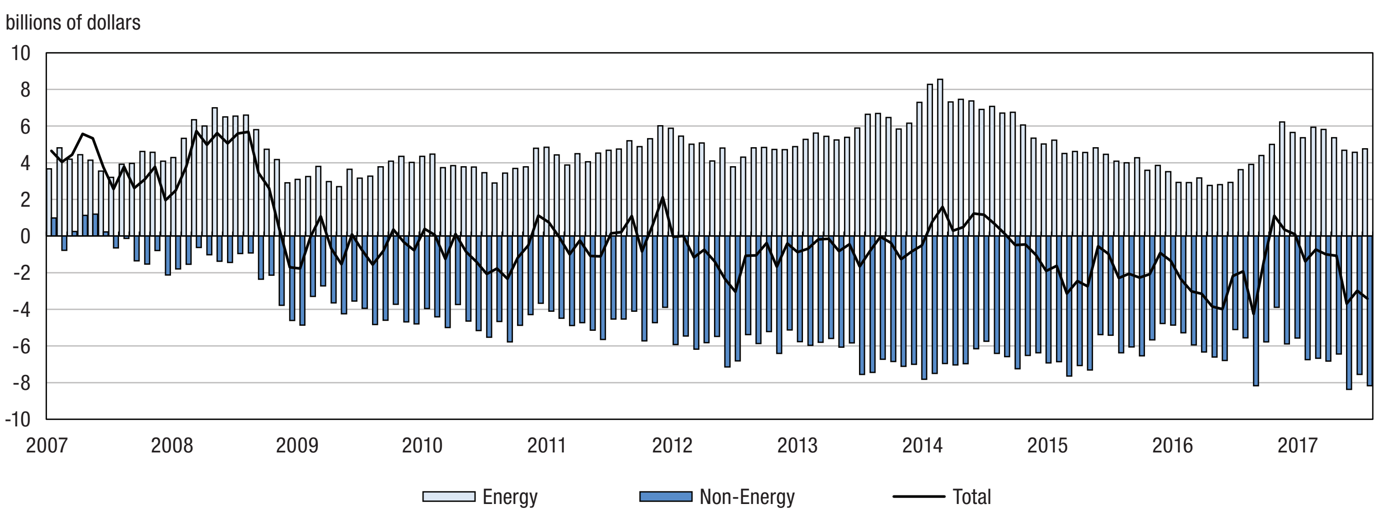
Trade deficits widened in mid-2017

Canada posted a cumulative merchandise trade deficit of $7.8 billion over the first half of 2017, similar to the cumulative deficit ($8.3 billion) during the last half of 2016. A larger net surplus for energy products in the first half was offset by larger deficits for non-energy products including consumer goods, aircraft and other transportation equipment and parts, electronic and electrical equipment, and motor vehicles and parts. After posting modest trade deficits from February to May, the monthly trade deficit rose to $3.7 billion in June on a lower surplus for energy products.

Energy exports during the first six months of 2017 totalled $49.1 billion, an increase of 20% from combined energy exports during the second half of last year. Exports of non-energy products rose 2.8% in the first half of 2017, reflecting widespread gains across commodities. Higher exports of metals and non-metallic mineral products, motor vehicles, and industrial machinery, equipment and parts supported the increase in non-energy exports, while exports of consumer goods and aircraft product and parts declined.

Non-energy imports strengthened during the first half of the year. Total non-energy imports during the first six months of 2017 were 5% higher than in the second half of last year. Imports of motor vehicles and parts contributed to the gain

Chart 9
Merchandise trade balance, energy and non-energy commodities



Source: Statistics Canada, CANSIM table 228-0059.

supported by higher shipments of tires, motor vehicle engines and parts. Imports of consumer products also strengthened on higher shipments of pharmaceuticals and clothing. Imports of aircraft and other transportation equipment and parts were 29% higher in the first half of the year, as ships, locomotives, railway rolling stock, and rapid transit equipment posted notable gains.

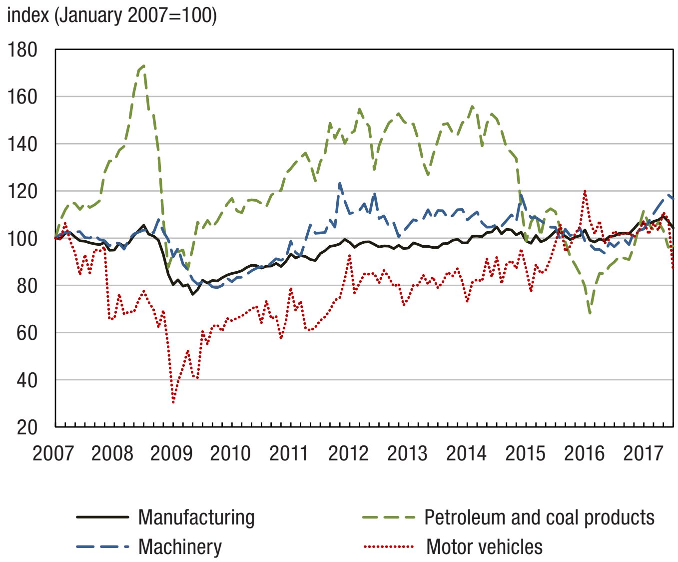
More recently, the trade deficit narrowed to $3.0 billion in July as exports and imports fell on broad-based declines across commodities. Both energy and non-energy trade declined for the second consecutive month. The trade deficit widened to $3.4 billion in August as non-energy exports declined for the third consecutive month.

Petroleum, autos and machinery bolstered manufacturing sales

Total manufacturing sales were 4.2% higher in the first half of 2017 following a 2.9% increase in the second half of 2016. Higher sales of petroleum and coal products accounted for almost one quarter of the increase, as sales rose 10.9% on higher prices and volumes. Sales of machinery products rose 12.0% in the first half, advancing steadily from January to June. Sales in this industry have been influenced by economic conditions related to oil and gas extraction, and have trended higher since mid-2016 as support and investment activities related to resource extraction began to recover from lows in 2015 and 2016. Shipments of motor vehicles also contributed to the strength in manufacturing sales during the first half of 2017, advancing 4.1% on higher volumes. Sales of motor vehicle manufacturers were $6.1 billion in May, their highest monthly level since January 2016.

Higher sales in Ontario, Quebec and Alberta were mainly responsible for the growth in manufacturing shipments during the first half of 2017. Sales in Ontario rose 2.8% on higher shipments of motor vehicles, which accounted for almost 30% of the gain. Sales of food, petroleum and coal products, and machinery also supported the increase in Ontario. Sales in Quebec rose 4.4% in the first half on widespread gains, led by aerospace products and parts. Manufacturing sales in Alberta rose by 9.2% led by gains in machinery products, petroleum and coal, and chemical products.

Chart 10
Manufacturing sales, selected industries



Source: Statistics Canada, CANSIM table 304-0014.

More recently, manufacturing sales declined 2.6% in July on lower sales of motor vehicles and motor vehicle parts. Longer shutdowns than usual for motor vehicle manufacturers led to a 20% decline in that month.[2]

Retail spending strengthened

Total retail sales were 4.6% higher in the first half of 2017, more than double the 2.1% rate of increase in the second half of 2016. Higher sales among motor vehicle and parts dealers (+6.5%) accounted for over one-third of the total increase in retail spending from January to June. Sales at gasoline stations, general merchandise stores, and building material and garden equipment dealers also contributed to the growth. Excluding sales at gas stations, retail spending rose 4.5% during the first half of the year, up from 1.3% in the second half of 2016.

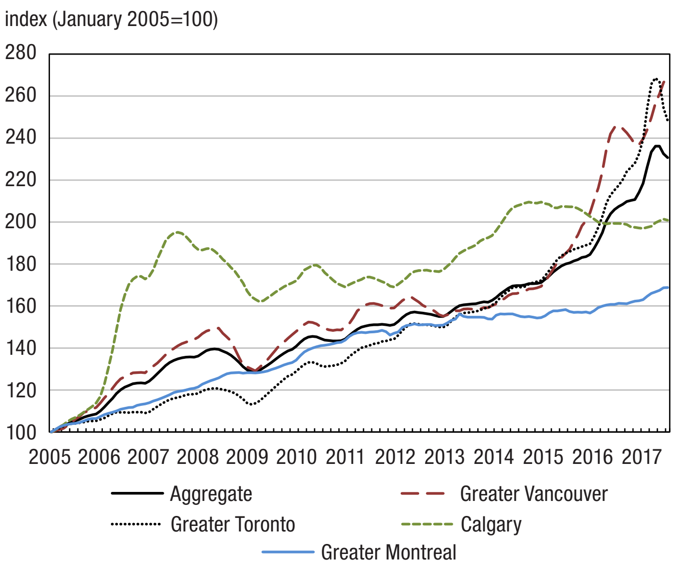
Higher sales in Ontario and Quebec accounted for nearly 50% of the national increase during the first half of the year. Retail sales in Alberta rose sharply during the first half of 2017, as spending continued to rebound from recent lows in early 2016. Sales in British Columbia also accelerated in the first half of the year, building on strong gains during 2015 and 2016.

2. For analyses of economic trends in the Canadian automotive sector, see Richards (2017a) and (2017b).

Home prices in Toronto moderated into mid-year

Home prices, measured year-over-year, continued to accelerate in early 2017. Based on estimates from the MLS Home Price Index, home prices rose 19.7% in the twelve months to April 2017, led by a 31.3% increase in the Greater Toronto Area.[3] More recently, the pace of price growth in the GTA slowed, decelerating to 14.3% year-over-year in August 2017. The Government of Ontario introduced the Fair Housing Plan in April 2017, a set of 16 measures to improve housing affordability for homebuyers and renters, which included a 15% Non-Resident Speculation Tax for the Greater Golden Horseshoe region, along with other affordability measures.

Chart 11
Multiple listing service home price index, selected cities



Source: The Canadian Real Estate Association.

Home prices in the Greater Vancouver area increased in the first half, up 7.9% year-over-year in June 2017. Home prices in Greater Vancouver had decelerated in the second half of 2016, following the introduction of an additional property transfer tax rate of 15% for foreign nationals. More recently, the pace of price growth in Greater Vancouver edged higher in the summer months, reaching 9.4% year-over-year in August.

Following twenty-two months of consecutive year-over-year declines, home prices in Calgary edged higher on a year-over-year basis from May to August.

Housing starts increased on multi-family dwellings

Monthly housing starts averaged 215,000 units (seasonally adjusted at annual rates) in the first half of 2017, up from 198,100 units in the second half of 2016. Higher multi-family starts supported the gains, as Quebec and Ontario posted increases. Total starts continued to rise in July and August.

Investment in new housing construction, measured year-over-year, also strengthened during the first half of 2017. Capital spending on single units rose 11.7% year-over-year in June 2017, and has trended upward since early 2016. Outlays on double units increased, while spending on apartments moderated, down 0.2% year-over-year in June for the second consecutive decline. Residential building permits edged up to $5.1 billion in mid-2017.

Headline inflation slowed

Consumer price inflation, measured year-over-year, slowed during the first half of 2017, decelerating from 2.1% in January to 1.0% in June. During this period, lower prices for food, clothing and footwear were offset by price movements in transportation and shelter.

Measured on a year-over-year basis, food prices declined during the first five months of the year, while prices for clothing and footwear fell from March to July. The energy index accelerated early in 2017 as gasoline prices were 23.1% higher year-over-year in February. The growth in energy prices decelerated from February to June as gasoline prices moderated.

Shelter prices were 2.4% higher year-over-year to start 2017, and have moderated in recent months, slowing to 1.3% in July. Electricity prices declined on a year-over-year basis during the first half of the year, with prices more than 5% lower in May and June led by declines in Ontario. Increases in the homeowner's replacement cost index, which reflects changes in new housing prices, averaged 4.1% during the first half of the year.

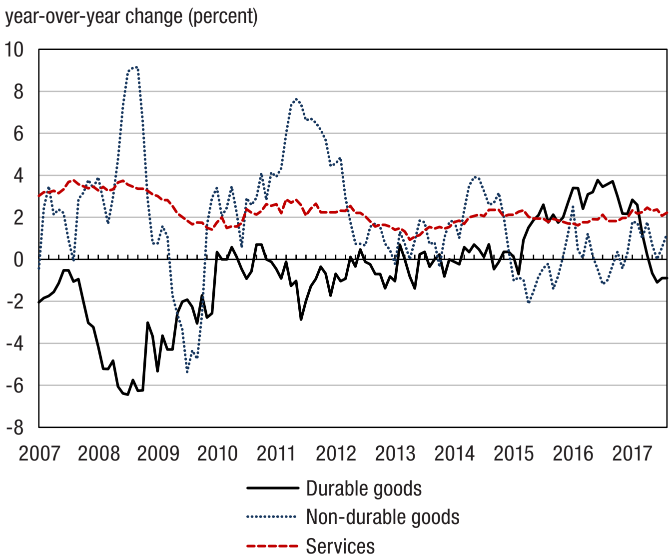
Excluding food and energy, consumer price inflation slowed during the first five months of the year, from 2.2% in January to 1.4% in May. Inflation excluding food and energy remained at 1.4% in June, before edging up to 1.5% in July.

After accelerating to 2.8% to start the year, the durable goods price index slowed to 0.2% in April, before declining year-over-year from May to July. Price inflation among non-durables also slowed in late spring. Price increases for services, measured year-over-year, remained above 2% throughout the first half of 2017, averaging 2.3% during this period.

3. The Multiple Listing Service Home Price Index (MLS HPI) is published by the Canadian Real Estate Association. The index controls for differences in mix of sales activity over time. The aggregate composite MLS HPI aggregates transactional data across 11 major markets, and includes data on one and two-storey homes, row and townhouse units, and apartments. For background, see *MLS, Home Price Index Methodology*, version 2.1, July 6, The Canadian Real Estate Association.

The Bank of Canada's preferred measures of core inflation were all below 2% during the first half of 2017. In June, the three year-over-year measures (CPI-trim, CPI-common, and CPI-median) ranged from 1.2% to 1.5%.[4] Two of these measures, CPI-trim and CPI-median, edged lower during the first half of 2017.

Chart 12
Consumer price index, selected aggregates



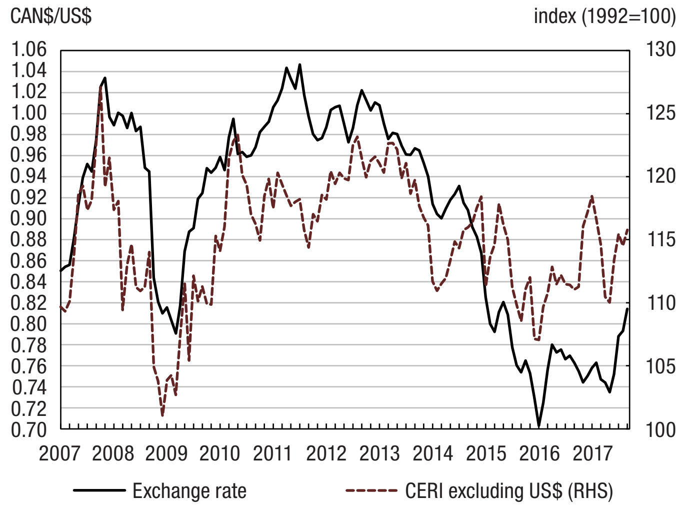
Source: Statistics Canada, CANSIM table 326-0020.

Equities edged lower as energy stocks declined

After increasing during late 2016 and early 2017, the Standard and Poor/Toronto Stock Exchange (S&P/TSX) composite edged lower towards mid-year, closing at 15,182 in June, down 0.7% from year-end 2016. Equities advanced from January to April, as industrials, information technology, and the consumer indices supported gains. Following notable increases in the second half of 2016, energy weighed on equities during the first half of 2017. The energy index declined in five of the first six months of the year, and in June was down 22% from year-end 2016. Financials also moderated in the first half, following notable strength in late 2016. After declines from March to May, the financial index at mid-year was little changed (+0.7%) from levels at year-end.

The Canadian dollar also edged lower against the U.S dollar into the spring, trading at a recent low of 72.8 cents U.S. in early May. However, the dollar appreciated markedly in June and July, trading at 78.5 cents U.S. shortly after the Bank of Canada's decision to raise the target for the overnight rate by 25 basis points on July 12th. The dollar continued to appreciate during late summer, trading at a recent high of 82.3 cents U.S. following the Bank of Canada's decision on September 6th to raise the target for the overnight rate by an additional 25 basis points. Measured on a trade-weighted basis, the Canadian dollar also appreciated against major non-U.S. currencies in recent months, advancing against the euro and the U.K. pound sterling in July.

Chart 13
Exchange rates



Notes: CERI: Canadian-dollar effective exchange rate index. Data on CAN$/US$ exchange rates for the period January 2007 to December 2016 are Bank of Canada legacy estimates based on the average noon spot rate; starting with the monthly estimate for January 2017, CAN$/US$ exchange rate data reflect recent changes to the Bank of Canada's estimation methodology. Estimates of the CERI excluding US$ are based on rates at month end. RHS=right hand scale.
Sources: Statistics Canada, CANSIM tables 176-0064 and 176-0081; and Bank of Canada.

After little change from January to May, yields on benchmark Government of Canada short-term bonds rose in June and July. Yields on five-year bonds were at 1.58% in July, up from 1.17% at the start of the year, and from 0.65% in July 2016. Yields on ten-year bonds were at 1.96% in July, up 89 basis points from a year earlier. Chartered bank conventional five-year mortgage rates also rose in July, as the major chartered banks increased their prime lending rates by 25 basis points following the increase in the overnight rate. Mortgage lending rates also rose following the Bank of Canada's interest rate increase in September, while five-year benchmark bond yields rose to 1.8%, the highest level since December 2013.

Lower energy prices offset higher prices for non-energy commodities

After gains in late 2016, overall commodity prices in mid-2017 were little changed from year-end levels, as lower energy prices were offset by higher prices for metals and minerals, agricultural and forestry products. Energy prices in June were down 8.4% from prices at year-end 2016. Excluding energy, commodity prices rose 9.8% during the first six months of the year.

4. For more information on these measures, see Bank of Canada's Preferred Measures of Core Inflation General Information Document.

Overall commodity prices rose from July to September, supported by higher prices for energy and metals and minerals.

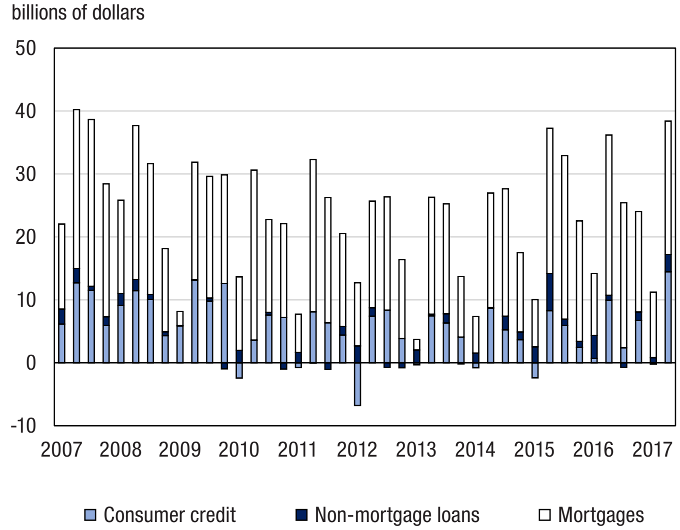
Consumer credit increase highest since late 2009

The net worth of households was little changed in the second quarter (-0.1%), as lower housing prices and resale activity, coupled with weaker equity prices, weighed on the growth of household assets. Total household assets in the second quarter were valued at $12.6 trillion, while total financial liabilities amounted to $2.1 trillion.

Household credit market debt rose 1.9% in the second quarter following a 0.5% increase in the first. The accumulation of debt liabilities in the quarter reflected increases in mortgages, non-mortgage loans, and consumer credit. After remaining unchanged in the first quarter, consumer credit, which includes home-equity lines of credit, rose 2.4% in the second, the highest quarterly increase since late 2009. Mortgage debt rose 1.6% in the second quarter, following a 0.8% gain in the first.

The ratio of household credit market debt to disposable income rose to 167.8% in the second quarter, while the household debt service ratio, which includes obligations on principal and interest owing, was unchanged at 14.2%. The ratio of household debt to household assets edged up to 16.7% in the quarter, but has generally trended lower since the 2008-2009 recession.

Chart 14
Change in household credit market debt



Note: Data are not seasonally adjusted.
Source: Statistics Canada, CANSIM table 378-0121.

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