Hopes for factory-led recovery dashed by bleak manufacturing outlook

By David Parkinson
May 11, 2016 – *The Globe and Mail*

Belt-tightening Canadian manufacturers look poised to follow the battered energy sector in cutting their spending budgets in 2016, deepening the country's business investment woes, a new Statistics Canada survey indicated.

Statscan's annual Capital and Repair Expenditures Survey – which gauges private- and public-sector spending intentions on facility construction, machinery and equipment, and repairs – found that overall spending is expected to decline 4.4 per cent this year, to $242-billion. Private-sector businesses, which account for roughly two-thirds of the country's capital investment, expect to cut their spending by 9.3 per cent, while public-sector organizations plan to increase spending by 6.5 per cent.

The drop in this year's investment intentions compounds last year's spending decline of nearly $20-billion, or 7.2 per cent, which reflected a 35-per-cent plunge in the capital-intensive oil and gas extraction sector, the single biggest source for business investment in the country. The survey indicated that oil and gas will again lead the investment declines, with another 26 per cent of cuts planned.

But unlike last year, when spending in the manufacturing sector was the bright light on the dark investment landscape, with spending up nearly 7 per cent, manufacturers are poised to deepen the country's investment hole in 2016. The survey found that investment intentions in the sector are down 11 per cent this year.

"Profits are under pressure. That's the key factor that's linked to business investment," said economist Jayson Myers, president and CEO of Canadian Manufacturers & Exporters, an industry group. "It's really worrying."

Economists said that after two years of strong spending growth in manufacturing, aided by a weakening Canadian dollar that helped fuel growth in non-resource goods exports and sparked facility upgrades, the sector looks to have turned more cautious amid an uncertain global economy and uneven demand in both domestic and export markets.

"Whatever the location advantages might be from the lower Canadian dollar, they are being swamped by the lack of any need for capacity expansions amidst lacklustre global growth," said Avery Shenfeld, chief economist at Canadian Imperial Bank of Commerce, in a research note.

Last year's drop in business investment was the biggest weight around the neck of the Canadian economy, subtracting more than one full percentage point from Canada's 2015 real growth domestic product growth, according to recent Bank of Canada estimates. Another year of weak investment will again restrain the country's growth prospects, economists said, although the damage isn't expected to be as severe as last year.

But the weakness in manufacturing investment is worrisome, as economists at the Bank of Canada and elsewhere have been expecting growth in non-resource manufacturing exports, fuelled by a cheap dollar, to be the key catalyst in fuelling economic expansion and reviving investment growth. The weak results of the survey raises questions about whether the sector will step up as much as some experts have been hoping.

"The holy grail for an economic recovery powered by a cheaper currency is nowhere in sight," Mr. Shenfeld said.

But Toronto-Dominion Bank economist Warren Kirkland said a large part of the decline in manufacturing spending comes from the automotive sector, where several car plants went through major retoolings in the past couple of years. He said that in general, his expectation for improved manufacturing investment in many provinces, outside of Ontario's auto industry, "was largely corroborated."

Marc Pinsonneault, senior economist at National Bank of Canada, argued that actual spending might prove stronger than the survey of intentions, in part because the Canadian dollar has strengthened markedly since the survey, conducted between October and January, was completed. The stronger currency will make imported machinery and equipment less expensive for Canadian businesses, making investments more attractive.

Mr. Myers noted that the survey period was also a volatile time for financial markets and economic data. "The volatility may have made a lot of manufacturers cautious about their investment intentions," he said.

Regardless, the struggling oil and gas sector remains the biggest worry for Canada's investment outlook for a second straight year. Statscan's 26-per-cent drop in spending expectations in oil and gas extraction is more optimistic than the 32 per cent that the Bank of Canada projected for the oil and gas sector in its most recent quarterly economic forecast, released last month. If the intentions hold true, the sector is on track for its lowest investment since the 2009 recession, and it will have slashed spending by 52 per cent over a two-year span.

Mr. Kirkland cautioned that the destruction from the severe Alberta wildfires this month has injected new uncertainty into spending plans in the energy sector, and in Alberta in general.

"We expect there will be large declines in non-residential activity in Alberta as a significant amount of resources are and will be devoted to fighting the wildfires, [and] providing support to those that have lost their home. This should be followed by a ramp-up in construction activity as non-residential structure reconstruction begins in earnest," he predicted in a research note.