

## Falling factory sales point to a growth moderation in Q3

### Manufacturing sales for July:

**Latest: -2.6% (actual), -1.9% (expected)**

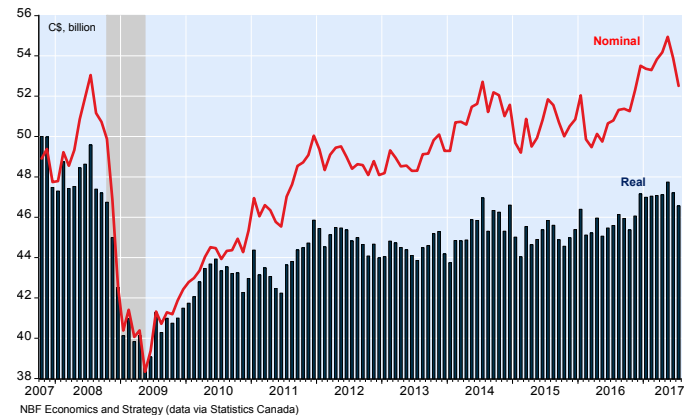
**Previous: -1.9% (revised down from -1.8%)**

**FACTS:** Manufacturing shipments fell 2.6% month on month in July, the biggest drop in 17 months. This result was significantly below consensus, which was looking for a -1.9% print. Sales declined in only 9 of the 21 industries surveyed, but a sharp downturn in the transportation category (-13.8%), the steepest retreat since May 2009, caused by weakening sales of motor vehicles (-19.9%) and parts (-11.3%), sapped the overall figure. Sales of food products (-0.9%) and machinery (-1.4%) also faded in the month. Alternatively, decent upswings were observed in the wood (+2.3%), primary metals (+1.9%) and non-metallic mineral (+4.4%) categories. Nationally, manufacturing sales contracted in seven of the ten Canadian provinces with Ontario being hit especially hard (-6.1%) on account of its exposure to the automotive industry. Quebec, on the other hand, fared much better with shipments up 4.3% in July. If the effect of price changes are removed, total factory sales decreased 1.4% on a monthly basis. Meanwhile real inventories rose 0.7%, leading the real inventory-to-sales ratio to climb from 1.39 in June to 1.42 in July, its highest level in a year.

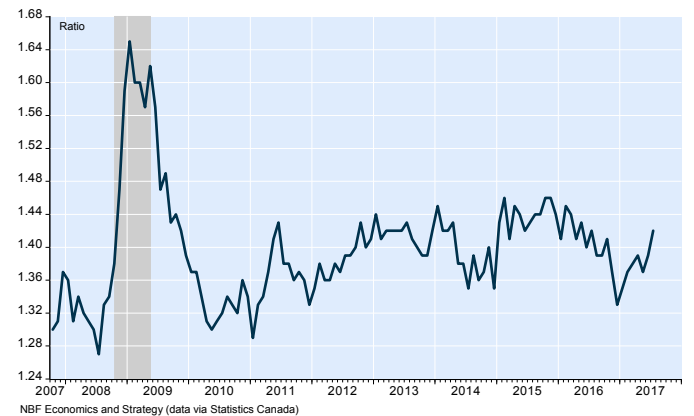
**OPINION:** Factory shipments in July came in well below expectations for the second month in a row. In fact, since reaching an all-time high in May, nominal shipments have dropped no less than 4.4%, the worst two-month performance in a year and a half (top chart). True, the latest monthly results were hampered by a sale slump in the transportation sector which resulted in part from weak exports to the U.S. and a longer than usual summer shut-down period in vehicle assembly plants (for maintenance). Not accounting for transportation, manufacturing sales actually increased by 0.4%. But of concern is the slow but steady increase of the real inventory-to-shipments ratio, which hit a 12-month high in July (middle chart). Stagnating sales in Ontario, Canada's economic powerhouse, were another weak point in the report. Indeed, July's monthly downturn in sales there translated into a 2.4% year-on-year decline for manufacturing shipments, the worst figure in more than four years. Looking at Q3, the picture does not look so good at this point. With a relatively low starting point (on account of soft sales in June) and a dreary first month of data, real manufacturing shipments are on pace to fall 6.6% annualized in the quarter (bottom chart). This is consistent with our view that Canadian economic growth is set to soften in the third quarter after a blistering first half of 2017.

Jocelyn Paquet

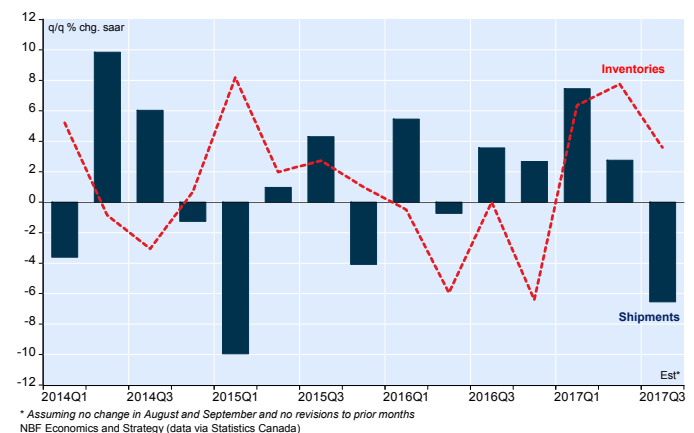
**Canada: Nominal factory sales dropped for second month in a row**  
Nominal vs. real factory sales



**Canada: Real inventory-to-shipments ratio at a 12-month high**  
Real inventory-to-shipments ratio



**Canada: Factory output may act as a drag on growth in Q3**  
Real manufacturing shipments and inventories



\* Assuming no change in August and September and no revisions to prior months  
NBF Economics and Strategy (data via Statistics Canada)

## Economics and Strategy

### Montreal Office

514-879-2529

#### Stéfane Marion

*Chief Economist and Strategist*  
stefane.marion@nbc.ca

#### Paul-André Pinsonnault

*Senior Fixed Income Economist*  
paulandre.pinsonnault@nbc.ca

#### Krishen Rangasamy

*Senior Economist*  
krishen.rangasamy@nbc.ca

#### Marc Pinsonneault

*Senior Economist*  
marc.pinsonneault@nbc.ca

#### Matthieu Arseneau

*Senior Economist*  
matthieu.arseneau@nbc.ca

#### Angelo Katsoras

*Geopolitical Analyst*  
angelo.katsoras@nbc.ca

#### Kyle Dahms

*Economist*  
kyle.dahms@nbc.ca

#### Jocelyn Paquet

*Economist*  
jocelyn.paquet@nbc.ca

### Toronto Office

416-869-8598

#### Warren Lovely

*MD, Public Sector Research and Strategy*  
warren.lovely@nbc.ca

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