The Good, The Bad, and The Huh?
A Look Back at the Canadian Economy in 2019

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Highlights

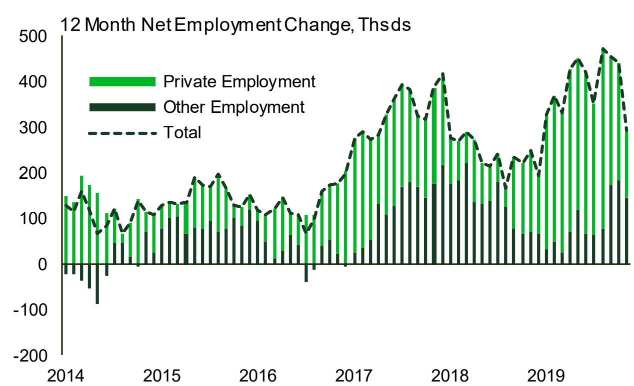
- Starting points matter when it comes to economic performance. Last year delivered a mixed bag, with several key themes emerging.
- On the plus side, labour markets performed well over 2019 as a whole, and housing markets have gotten back on track. However, the trend in both these areas cooled markedly as winter approached.
- The negatives include effectively zero productivity growth and a household spending trend that continued to soften. Stretched household balance sheets became evident not only in spending, but in insolvencies as well.
- Business investment was revised higher on surprising strength in oil and gas spending. That said, the sector remains challenged, with spending well below historic highs in the wake of heightened uncertainty.
- Whether good or bad, these key themes all point to the same starting point: a modest economic growth outlook punctuated by cautious consumers and ongoing external headwinds to investment.

With a new year and a new decade come new beginnings, but when it comes to economics, where you're starting from can be just as important as where you're hoping to go. In this spirit, this report takes a brief look back at some of the key themes that defined 2019 and what they mean for the year to come. Last year brought a mixed bag when it came to the Canadian economy. The positives included a healthy labour market and a convincing recovery in housing activity. But stresses emerged as well – towards the end of the year, labour market dynamics took a soft turn, and beneath a decent enough headline performance was almost non-existent per-capita economic growth as productivity flatlined. The story was worse for consumer spending, which has failed to even keep up with population growth. This was just one manifestation of household financial stress that has resulted in rising insolvencies. Last year also delivered at least one head-scratcher as Statistics Canada revised the investment figures up on apparently strength in the oil and gas sector in the midst of one of the most challenging adjustment periods the industry has ever faced. As this report highlights, each of these themes is not only interesting in its own right but can also tell us something about the outlook for 2020. Unsurprisingly, the common theme is one of caution, consistent with a modest deceleration of economic growth and Bank of Canada easing.

The Good: Job markets and wages performed well through the year, housing back on track

Let's start with the positives. Top of the list is labour markets. Even with the significant retrenchment in November, the Canadian labour market continued to crank out jobs – over the twelve months to November 2019, a net 293k new jobs were generated, down from highs earlier in the year, but an impressive pace nevertheless (Chart 1). Healthy job gains have helped absorb significant numbers of new Canadians into labour markets – population growth hit its

Chart 1: The Canadian Economy Churned Out Jobs Last Year



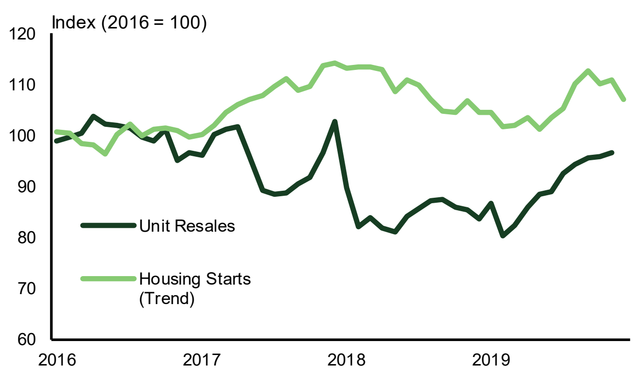
Source: Statistics Canada, TD Economics.

highest pace in nearly three decades last year, well ahead of our advanced economy peers, and as will be discussed later, a key source of growth. The solid labour market performance was also seen in wages – the latter half of the year saw a robust 4.3% y/y pace of growth. That pace was flattered somewhat by a bit of softness in late 2018 that made last year look even stronger by comparison, but other measures have also ticked up. The payrolls-based measure has also accelerated, reaching 4% y/y for salaried employees in October (the latest data available).

The trend in labour markets for last year overall was clearly a healthy one, but it would be a disservice to ignore some troubling signs that began to emerge late in the year. Taking a tighter time horizon, the six-month trend in hiring has come off the boil, averaging just 5.9k per month (vs the 24.4k per month beneath the 293k yearly pace). Perhaps most concerning is that the six-month trend for private sector employment went negative in November (-4.3k). This means that it was down to public sector hiring to keep things in positive territory. A normal expectation for hiring in this sector is for a pace consistent with overall population/GDP growth that holds the sector's share roughly constant; seeing it carrying the entire burden is hardly an encouraging signal.

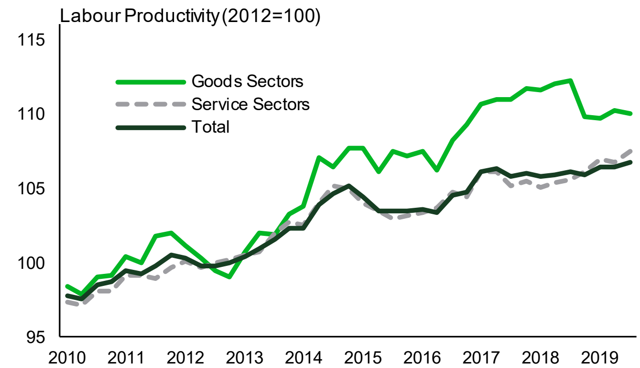
Flipping back to the positive side of the scorecard, the other major stand-out performer was housing. After a number of policy measures intended to cool markets took their toll on activity throughout 2018, the resale market began a steady climb higher early last year, and while gains have trailed off a bit of late, the level of activity is roughly in line with 2016/2017 levels (i.e. before the impact of B-20 and other policy measures). At the same time, new housing construction, as measured by housing starts, remained solid on a trend basis (Chart 2). The recovery in activity was enough to break the contractionary streak for the residential investment component of GDP: after five quarters of declines, resale activity, construction, and renovations were, all together, positive contributors to growth in both 2019Q2 and Q3.

Chart 2: Resale Activity Came Back to Life While Starts Accelerated



Source: CREA, CMHC, TD Economics.

Chart 3: Labour Productivity Has Been Flat for Two Years



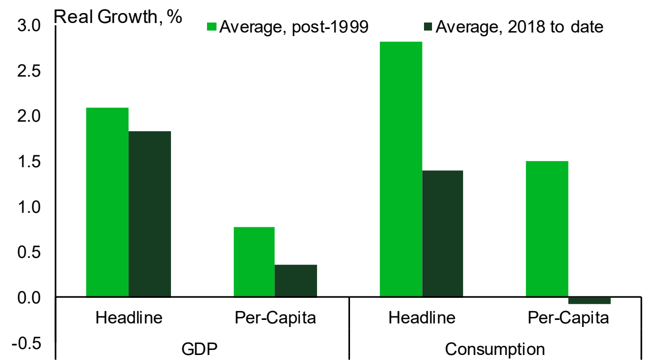
Source: Statistics Canada, TD Economics.

As with labour markets, a closer look at the most recent dynamics is warranted. For resale housing, the upside to activity is likely to remain limited by supply issues. November saw just 4.2 months' supply available, consistent with other tightness measures such as sales-to-listings ratios that have moved solidly into seller's territory. A lack of supply will help support prices but does little for longstanding affordability concerns (or associated financial stability risks of ever larger mortgages). From a growth perspective, what matters most is activity, suggesting that only a subdued performance from the sector should be expected.

The Bad: Zero productivity, softening spending, rising insolvencies

Strong job creation and ho-hum GDP growth is a recipe for disappointing productivity figures, and that's exactly the case for Canada of late. Since late 2017 labour productivity has gone nowhere (Chart 3). Part of the story has been a fall-off in the goods sector, attributable to mining, oil and gas extraction, as well as utilities, but the service sector has hardly been a strong performer. Part of this may be down to measurement issues – as Bank of Canada officials have suggested on several occasions, it is possible that new ways of doing business, such as cloud computing, are not being fully captured. There may be a compositional effect at play as well – a decent chunk of recent job gains have come in areas such as health care and educational services where

Chart 4: Stripping Away Population Growth Reveals a Lacklustre Performance



Source: Statistics Canada, TD Economics. 15+ population used in per-capita calculation.

productivity growth can sometimes be limited by regulations such as student to educator ratios. There are of course good reasons for these regulations; this is only to note that to the extent that demographic forces point to continued growth in these types of jobs they will continue to exert a drag on productivity.

Weak productivity means that almost all the recent economic growth has come from rising employment. Overall growth of late has been broadly comparable with the experience over the last two decades, but on a per-person basis, the pace of growth has been less than half of that benchmark (Chart 4). Last fall, we looked at some of the drivers of lacklustre consumer spending (See report). That report noted a marked slowing of per-capita spending, and it has only gotten worse since. As illustrated in Chart 4, growth in consumption fell below population growth over the last two years – the last time this happened was during the Great Recession.

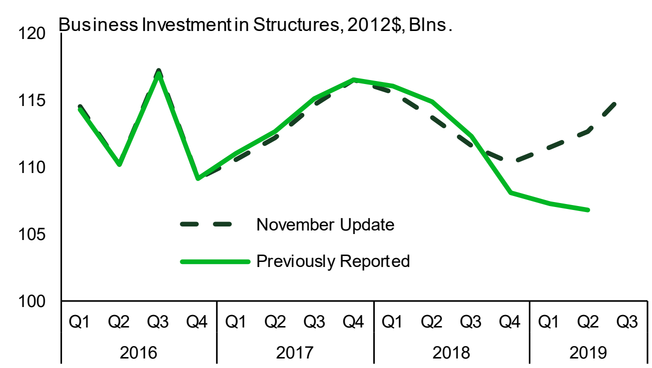
The reasons for this have been discussed at length by TD Economics and other commentators, with the common theme of these analyses being the increase in borrowing costs following the Bank of Canada's 1.25 percentage point increase in its overnight rate over 2017 and 2018. This sent household debt service ratios sharply higher (to all-time highs, in fact) and has helped drive rising insolvencies. Rising insolvencies without a deterioration of labour markets may seem odd at first glance but is consistent with the types of stresses observed. Rather than a generalized rise of arrears and related stress indicators, much of the 'pain' has been concentrated in products such as lines of credit, where borrowing costs tend to move immediately with the prime rate. When it comes to secured borrowing, such as mortgages, the 5-year change in 5-year bond yields (a decent proxy of changes in actual mortgage costs) ended 2019 back in positive territory. This creates the risk that pain spreads to the much larger mortgage market – a risk the Bank of Canada will be monitoring closely.

The Huh: Business Investment

Private business investment has been challenged of late, to say the least. Trade tensions and related economic uncertainty have kept activity muted, even in the face of positive developments such as tax changes (accelerated depreciation) and positive movement on CUSMA (the 'new NAFTA' trade deal). What positives we did see tended to be in the 'lumpier' categories such as aircraft and vehicle fleets, where large outlays are often followed by a pull-back in spending. As disappointing as Canadian business investment has been, there is a logical consistency between that behaviour and global developments.

The 'huh' moment for business investment came with Statistics Canada's 'benchmark revisions'. Once a year the agency provides what can often be a significant update of its GDP estimates, incorporating more robust but lagged data such as tax returns to refine its figures. Last year's revisions brought a bit of a head-scratcher, changing the pattern of business investment in non-residential structures significantly (Chart 5). Several quarters previously reported as contractions are now expansions, and the level of activity at mid-year was marked up more than five percent. The drivers? First, updated data on the progress at the Kitimat LNG facility, where prep work has been moving quickly. Second, and the 'huh', is new data on spending in the oil and gas sector, with Statistics Canada analysts indicating that this was the bigger driver of the revisions.

Chart 5: Suddenly Business Investment Didn't Look Quite So Bad



Source: Statistics Canada, TD Economics.

There is no reason to doubt Statistics Canada's figures, but it is nevertheless surprising that this source of (relative) strength has come during one of the most challenging periods for the Canadian energy sector in recent memory. Issues around takeaway capacity led to production curtailments, which have helped improve pricing at the expense of volumes and ongoing uncertainty around longer-term ability to get product to market efficiently are marked headwinds. Smaller producers, who have some exemptions from curtailment, may explain the result, but given these headwinds, it still came as a surprise to see the sector driving positive revisions.

What do these changes mean for the 2020 and beyond outlook? Not too much. The past few years have shown the importance of the global uncertainty channel in limiting business spending, and we have seen little progress on that front. Moreover, even the new figures hardly paint a robust picture. The positive dynamics in non-residential structure spending still leaves the pace roughly in line with 2017, nearly 25% below its 2014 peak. Similarly, spending on machinery and equipment is about 9% below its earlier peak, with roughly the same difference in spending on intellectual property products. And these are merely comparisons with historical peaks – relative to fundamental trends such as robust population/employment growth the picture is even more disheartening.

The takeaway is that despite a surprisingly better picture of investment of late, the sector clearly remains challenged when placed in the broader macroeconomic context, let alone historical comparisons. Many of the fundamentals for the sector remain positive, but so long as the headwind of uncertainty remains in place, only a modest performance is likely going forward. As with the other trends discussed in this report, the signal here is one of caution.

Bottom Line: Still Looking For A Spark To 2020 Growth

None of the major trends of 2019 suggest impending economic doom, but nor do they point to much in terms of upside. In all cases, a 'ho hum' economic performance appears to be the best we can hope for. Indeed, this is the story of TD Economics' latest Quarterly Economic Forecast, which sees sub-trend Canadian growth this year. Some help will come in the form of a Bank of Canada policy interest rate cut, but we expect that easing to be motivated more by shifting financial conditions back to 2019 levels, rather than initiating major stimulus. Without a major catalyst in the form of a markedly improved external backdrop, the Canadian economy appears set to turn in an echo of last year's growth performance.