Let Me Serve You:

The stalwart growth of the Canadian service sector

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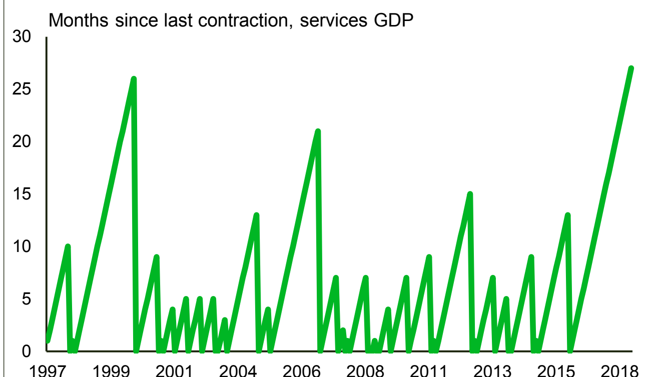
- Last Thursday's quarterly GDP report showed that the Canadian economy shook off the slow start to the year as growth recovered to 2.9% (quarter-on-quarter, annualized) in Q2.
- The GDP report also delivered an interesting detail. As mentioned in our commentary, June marked the 27th straight monthly expansion of the service sector. This now stands as the longest expansion in the current record (Chart 1).[1]
- We take this new milestone as an opportunity to dive a little deeper into this important aspect of the Canadian economy, which now accounts for roughly 70% of economic activity.

Just what does 'Services' mean?

- Ask a dozen people what they think of when they hear the term 'service sector', and you might get a dozen answers: the accountant that helps with their taxes, the ride-sharing service they used the other day, their insurance broker, or maybe the kind person who helps an elderly member of their family a few days a week. The answer is of course that it includes all these and more – the service economy touches nearly all aspects of Canadians' day to day lives (Table 1).

Chart 1: June 2018 marked a new length record for services output



Source: Statistics Canada, TD Economics. Last Data Point: June 2018.

Service sector now accounts for 70% of GDP

- The importance of services continues to grow. Already accounting for about 2/3rds of economic output 20 years ago, the sector today accounts for roughly 70 cents of every dollar of economic output, in real (volume) terms.[2]
- Matching its economic performance, the service sector has been an important driver of job gains. Of the roughly 650k jobs added in the 27 months to June, about 2/3rds have been generated by service industries.
- This is the result of a broad shift in the Canadian economy. In the years leading up to the global financial crisis, the manufacturing sector saw its share of output gradually decline, from a high of about 16%, to roughly 10.5% by 2009. Post-crisis, manufacturing (and most major industry groupings), has performed roughly in line with the economy as a whole, holding its output share largely constant, as has the construction industry (after strong gains in 2012 and 2013 gave way to a more modest performance thereafter).
- Unsurprisingly, the mining, quarrying and oil and gas industries outperformed the overall economy over this period, driven by gains in both conventional and unconventional oil and gas extraction.

Stalwart means less noise

- We've often referred to the service sector as a 'stalwart' part of the Canadian economy, largely due to its reliable nature. Not only does the service sector tend to grow more quickly than the goods-producing sector, it does so in a much less 'noisy' way. The standard deviation of monthly services GDP growth is less than one third that of the goods producing sector.
- To put this differently, the typical 'run' of uninterrupted service growth is about 7 months. The comparable length for goods production in 3 months, likely a reflection of the larger impact of idiosyncratic factors such as unplanned facility maintenance.

A different mix

- The Canadian economy continues to evolve, and this is perhaps best seen in the different drivers of the current run of service sector expansion. Comparing with the previous record expansion of 26 months, set between 1997 and 2000, several differences are observed (Chart 2).

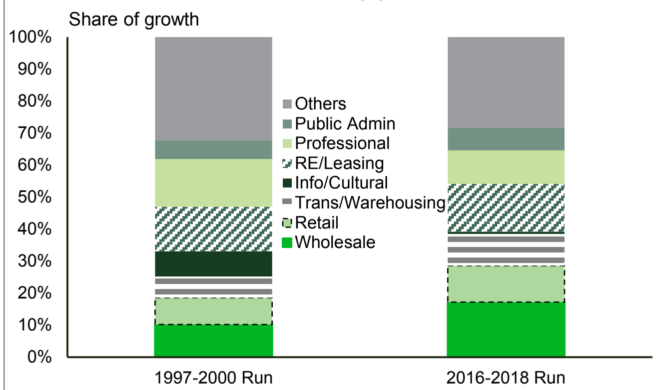
Table 1: Services a growing share of the economy that covers many aspects of our daily lives

Component	Examples	Share of Total GDP: 1998	Share: 2018 YTD
Services Total		***65.0***	***70.0***
Wholesale Trade	Farm product distributors, motor vehicle distributors, food distributors	4.7	5.9
Retail Trade	Auto dealers, furniture stores, gas stations, sports stores	4.6	5.5
Transportation and Warehousing	Airlines, trucking companies, taxis, oil pipelines, package delivery	4.3	4.5
Information and Cultural Industries	Publishers, radio stations, TV stations, phone companies, web hosting	2.7	3.0
Finance and Insurance	Banks, credit unions, brokers, insurance agents, investment funds	6.2	7.0
Real Estate and Rental and Leasing	Real estate agents, care rental/leasing, landlords	11.1	12.8
Professional, Scientific and Technical Services	Lawyers, advertising agencies, software firms, architects	4.4	5.6
Management of Companies and Enterprises		--	0.6
Administration & Support, Waste Mgmt & Remediation	Employment agencies, security services, travel agents, trash collection	2.2	2.4
Education	Universities, Colleges	5.6	5.2
Health Care and Social Assistance	Hospitals, ambulances, residential care facilities	7.0	6.6
Arts, Entertainment and Recreation	Concerts, casinos, amusement parks, professional sports	0.8	0.8
Accommodation and Food Services	Hotels, restaurants, bars	2.3	2.2
Other Services (Ex Public Administration)	Repair services, professional associations	1.8	1.9
Public Administration	Municipal government, military	6.7	6.2

Shares are relative to overall GDP, including goods producing sectors. See footnote 1. Management of companies was not reported before 2007.
Source: Statistics Canada, TD Economics

- Consumer spending has been a much more significant driver of growth in the current expansion, reflected not just in a rising share of retail trade, but also wholesale, and perhaps most significantly, transportation and warehousing. Zooming in on the first half of 2018 reveals a similar mix, but with professional services picking up the slack for real estate and leasing, where output was hit by mortgage underwriting rules that took effect in January (See our earlier discussion).
- It is likely that this latter category is where the "Amazon effect" can be seen most clearly. As a seemingly ever-increasing number of retailers offer online ordering and home delivery, their needs for warehousing, delivery services, and other aspects of direct fulfilment have increased, and is likely an important driver of the expansion of this sector.

Chart 2: Retail and wholesale trade took a bigger role in driving growth



Source: Statistics Canada, TD Economics

- Underscoring this impact, overall employment across retail and wholesale trade remained effectively flat during this expansion, but the transportation and warehousing sector added 85k jobs. This was sufficient to keep the average pace of hiring in this area above 4% year-on-year, well ahead of the overall pace of job gains.

Everything ends eventually

- So, where and when will this run of uninterrupted growth end? That we've seen a new record is particularly impressive in light of sizeable declines in some industries early in 2018. For instance, activity in the real estate sector pulled back dramatically over the winter months as government regulations took a bite out of resale housing activity.
- The simple fact is that unlike larger, quarterly movements in economic output, the variability of output from month to month means that it likely won't take a huge shock to end this streak. The 1997 streak came to an end with 7 of 14 service industries pulling back – hardly the definition of a systemic upset. Indeed, that 26 month expansion streak was followed by 9 more months of expansion.
- It is this resilience that makes the service economy stalwart. Bumps on the road may bring the current streak to an end, but it takes more than monthly gyrations to hold back the service economy.

Endnotes

1. This record is calculated using the current definition of the series, which begins in 1997.

2. These data are presented in chained volume terms, making the calculation of exact shares conceptually difficult. As such, these figures should be considered approximations.