CM&E

CANADIAN
MANUFACTURERS
& EXPORTERS

2018 YEAR IN REVIEW
2019 ECONOMIC OUTLOOK

MIKE HOLDEN
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WHO WE ARE

ABOUT OUR CHIEF ECONOMIST

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Chief Economist
Canadian Manufacturers & Exporters

Mike Holden leads the organization's economic analysis and forecasting functions, and directs CME's major research projects. He has written on a wide range of issues important to manufacturers, including tax competitiveness, market access, and capital investment. He also directs CME's biannual Management Issues Survey, and was a key architect of CME's Industrie 2030 initiative.

Mike has a BA in honours economics from the University of Alberta and an MA in economics from Queen's University.

ABOUT CANADIAN MANUFACTURERS & EXPORTERS

Since 1871, we have made a difference for Canada's manufacturing and exporting communities. Fighting for their future. Saving them money. Helping manufacturers grow.

The association directly represents more than 2,500 leading companies nationwide. More than 85 per cent of CME's members are small and medium-sized enterprises. As Canada's leading business network, CME, through various initiatives including the establishment of the Canadian Manufacturing Coalition, touches more than 100,000 companies from coast to coast, engaged in manufacturing, global business, and service-related industries.

CME's membership network accounts for an estimated 82 per cent of total manufacturing production and 90 per cent of Canada's exports.

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HIGHLIGHTS

AT A GLANCE 2018 | 2019

2018 YEAR IN REVIEW

- Economic news dominated headlines in 2018, but at the end of the day, the Canadian economy performed about exactly as expected. GDP growth across the country slowed from 3.0 per cent in 2017 to an estimated 2.0 per cent last year.
- Consumer and housing market activity slowed in 2018 as higher interest rates and the new mortgage stress test put a dent in purchases of homes and other big-ticket items.
- Government spending and exports picked up some of the slack in 2018. Higher crude oil prices drove export gains for the year as a whole, but exports dropped off towards the end of the year when energy price declined.
- Business investment also picked up in the first half of the year, but is still a long ways from returning to 2015 levels.
- Job growth slowed in 2018, but labour markets remain extremely tight. The unemployment rate fell to an all-time low of 5.6 per cent and a growing number of businesses are reporting labour shortages.
- Thanks to a strong first six months, 2018 was another good year for Canadian manufacturing. Sales grew by an estimated 6.2 per cent and reached a new all-time high of about $690 billion.
- Manufacturing gains were widespread, led by a price-driven increase in the value of petroleum output; motor vehicles and parts production was the one weak spot in Canadian manufacturing last year.

2019 ECONOMIC OUTLOOK

- The Canadian economy will continue to decelerate in 2019. Lower oil prices, slower growth in the US and global economies, softer housing markets and weaker household spending will all be a drag on GDP growth. Expectations are for economic growth in the range of 1.6 per cent in 2019.
- Higher borrowing costs, equity market volatility, geopolitical uncertainty and ongoing trade tensions will all dampen global economic growth this year. This is contributing to softer commodity markets and could impact exports.
- Tax cuts boosted consumer spending and business investment in the US last year. Those impacts will fade as 2019 wears on, contributing to slower growth south of the border. However, the US economy will still out pace Canada this year.
- Tight labour markets in Canada should drive wages higher in 2019. Job vacancies are up and as competition for available talent intensifies, the cost of hiring is likely to rise. However, higher wages will help counter increased borrowing costs and prevent consumer spending from dropping too far.
- Low oil prices and production cuts in Alberta will be a significant drag on the Canadian economy in early 2019. These will negatively impact business investment and exports, and will keep the Canadian dollar from rising.
- Most economists expect the Bank of Canada to raise interest rates 2-3 times in 2019. Our view is that economic conditions do not warrant such action. We expect, at most, 1-2 rate increases this year.

SUMMARY

FIVE THINGS TO WATCH IN 2019

Economic projections are based on historic patterns, emerging trends and an understanding of a deep and complex series of cause-and-effect relationships. However, those aren't the only things that affect how an economy performs. Government policy announcements, large-scale business investment decisions, geopolitical instability and a host of other factors are inherently unpredictable and can have a major impact on an economy's performance.

With that in mind, CME's economics team gazes into its crystal ball every year to highlight five things to watch out for in the coming year. These are some of our "known unknowns" – factors that we know will impact the economy, whether for good or for ill, but whose effect is far from clear.

1. WHAT IMPACT WILL THE CANNABIS INDUSTRY HAVE ON THE CANADIAN ECONOMY?

Businesses are pouring billions of dollars into Canada's burgeoning cannabis industry. But the industry is still in its infancy. There will be mergers and acquisitions as it matures and consolidates. There will be gut-wrenching stock volatility. But cannabis production is creating new economic activity and boosting demand for manufactured goods. If this plays out right, Canadian businesses could leverage their first-mover advantage and become world leaders in the industry.

2. CAN ANYTHING BE BUILT IN CANADA?

The Trans Mountain pipeline is the poster child for Canada's growing reputation as a place where nothing can ever be built – especially in the energy sector. Capital spending in energy has fallen off a cliff; investors are abandoning projects; new federal project approval rules could further chill development; and no one knows for sure what the term "meaningful consultation" means. With several key investment and approval decisions coming this year, 2019 will be an important test for the future of the country's resources sector.

3. IS A RECESSION LURKING AROUND THE CORNER?

Economists have a well-deserved reputation for too-enthusiastically predicting when the next recession will hit. However, the current economic expansion in the US is decidedly long in the tooth and whatever goes up must come down – eventually. There are early warning signs – equity market volatility, a declining yield curve, and growing business pessimism – that could signal an economic downturn in the US within the next 12-24 months. If that happens, Canada is sure to follow suit.

4. WILL GOVERNMENT ACTIONS SUPPORT OR IMPEDE BUSINESS INVESTMENT?

New federal tax changes that allow businesses to immediately expense machinery, equipment and technology purchases should provide a shot in the arm for capital investment in Canada. The problem is that for every step forward, it seems like there's at least one step back. New carbon pricing rules, higher CPP payments and a host of other cost increases will diminish the effectiveness of this government incentive program – to say nothing of the dim outlook for resource investment. How will these influences net out?

5. WHAT WILL THE US PRESIDENT DO?

The glib answer to that question is that no one knows for sure – possibly not even the man himself. However, the US President has the power and influence to singlehandedly shape the future of the global economy and he has not proved shy in his willingness to act as he sees fit. This has prompted Ottawa to try to diversify the country's export markets. But this is not an overnight process. In the meantime, we're all along for the ride; and we have no idea where it's going.