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TD Economics

Data Release: Canadian corporate profits slip in Q1

- Corporate operating profits fell 7.4% in the first three months of 2017, relative to the final quarter of 2016. On a year-on-year basis, profits were up a healthy 19.1%, reflecting last year's more challenging operating environment.
- Despite 10 of 17 major non-financial industries seeing a gain in profits, overall profits were slightly down (-0.4%). Leading the aggregate lower were declines in manufacturing (-3.9%), as well as wholesale trade (-5.4%) and utilities (-13.1%). Profits were up modestly in the oil and gas extraction industry (+7%), marking the fourth straight quarterly gain.
- Canadian financial industries also saw profits fall as whole, down 18.4% relative to Q4. This was largely due to the life insurance industry, where an adjustment to actuarial liabilities drove declines. Excluding life insurance, financial industries would have recorded a fourth straight gain in operating profits.
- Lending moderated somewhat in the first quarter. Residential mortgage loans rose 0.7% in the first quarter, while consumer lending was effectively flat (+0.3%). Lending to businesses rose for a third straight quarter (+2.7%). At the same time, leverage within the financial industries continued to decline. Breaking recent trends, leverage among non-financial corporations also fell slightly in the first quarter as equity rose faster than debt.

Key Implications

- On its face, it can be hard to square the fall in corporate operating profits with the healthy economic growth figures that have so far characterized 2017. Digging into the data, it is clear that as is often the case, one-off shocks are distorting the picture. Excluding insurance carriers and related industries (where an actuarial adjustment had a significant impact), operating profits were up slightly in first quarter (approximately +0.5%). Beyond profits, it was also encouraging to see a moderation in residential and consumer lending given risks around elevated household debt and real estate markets.
- The first quarter may not have seen a dynamite performance, but current indications suggest that the economic backdrop should remain supportive of corporate proftability. Indeed, current softness in inflation suggests that slack remains in the Canadian economy, leaving space for above-trend grwoth. As a result, the growth outlook for the coming few quarters should be broadly supportive of Canadian corporate profits.
- Taking a longer-term view, the expected 'normalization' of economic activity – both in terms of the pace and sources of growth – is likely to weigh on profit growth. Rising long-term rates should be broadly supportive of the financial sector, although a normalization of housing activity is likely to act as a headwind to this and a number of other sectors. High household indebtedness is likely to weigh on consumer spending, and thus the outlook for the retail sector (as well as other consumption-focused industries). As such, while corporate profit growth is likely to remain positive over the longer-term, a modest pace of growth is expected to prevail.

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