

Rail blockades add to “transitory” disruptions

February 2020

Highlights

- Rail blockades could reduce Canadian GDP growth by 0.2 pts in Q1/20, potentially more if a resolution isn't found soon.
- The disruptions add to a growing list of transitory or one-off factors that have impacted Canada's economy in the past year.
- Economic activity should eventually rebound from temporary factors, but downside surprises are more likely than unexpectedly strong growth at this stage in the economic cycle.

Economic impact of rail blockades

It's been out of the frying pan into the fire for Canada's rail sector. Just three months after a week-long strike reduced rail transportation activity to a three-year low, the industry is facing new challenges with protests and blockades dramatically curtailing rail traffic. With service interruptions dragging on for two weeks now, both commercial and passenger operators have announced layoffs and complaints from the business community are growing louder.

November's rail strike caused a temporary slowdown in a number of industries—Statistics Canada noted primary metal manufacturers were among the many establishments impacted by rail disruptions. The overall economic impact was still relatively small, by our count the strike reduced (annualized) Q4 GDP growth by 0.1 percentage

points. The disruptions from the blockades have already been longer, and the negative impact will probably be larger. The impact of the current disruption will depend on how long the blockades last. But as of now, we estimate Q1/20 GDP growth will be reduced by about 0.2 percentage points (relative to our latest forecast of 1.4%). That impact will continue to grow the longer rail traffic remains constrained.

It's important to note that the impact of transportation disruptions is temporary. A count of idled train cars shows activity bounced back almost immediately after November's strike ended. Other affected industries also tend to see a quick rebound—primary metal manufacturing, for instance, bounced back sharply in December. Rail operators' layoffs should be temporary, and we don't expect other businesses will be eager to cut workers in today's tight labour markets. As such, we expect the negative impact of the current rail disruptions on Q1 economic growth will be reversed in Q2/20, though a good deal of this quarter's “lost” activity won't be made up for.

Canadian GDP: rail transportation

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Source: Statistics Canada, RBC Economics

Are negative surprises the new normal?

Still, February's rail disruptions aren't the only temporary factor that has impacted Canada's economy of late. From energy sector curtailments/shutdowns and labour disruptions last year to [COVID-19](#) early this year, the economy has been subject to a number of transitory shocks in recent quarters. Other one-off events, like the closure of GM's Oshawa plant, represent a more permanent hit to economic output. The appendix below presents a brief summary of some of the factors that have weighed on growth in the past year. By our count, Q1 2020 will be the fourth of the last 5 quarters Canada's economy has been subject to net-negative shocks. The frequency of these one-off hits eventually begs the question that if growth doesn't actually bounce back, can these disruptions still be called "transitory"?

To be clear, we do expect those earlier drags on the economy (aside from permanent auto closures) will be reversed and make a net positive contribution to top-line GDP growth in the coming quarters. But it's worth noting that in the late stages of the economic cycle, we're more likely to see downside rather than upside surprises in GDP growth. Notwithstanding slower activity in the second half of last year, labour markets remain tight in most provinces and job shortages continue to be a key concern for businesses. Against this backdrop, it's simply more difficult for the economy to grow at an above-trend rate—by extension, that limits the scope for stronger-than-expected growth.

Being at a mature point in the economic cycle isn't a bad thing. Policymakers, in Bank of Canada Governor Poloz's words, want to get the economy "home" to a point where unemployment is low and inflation is on target. As the economy bumps up against capacity limits, economic growth naturally slows. But wages also rise alongside tighter labour markets. Workers feel more secure in their jobs, and more confident that they will be able to find a new one if they quit. Against that backdrop, it's not surprising that Canadian consumer confidence has remained resilient despite the slew of negative headlines early this year. That said, the prevalence of negative growth surprises in Canada over the past year is a reminder that, at this point in the economic cycle, risks are tilted to the downside.

Appendix: Temporary and one-off factors in the past year

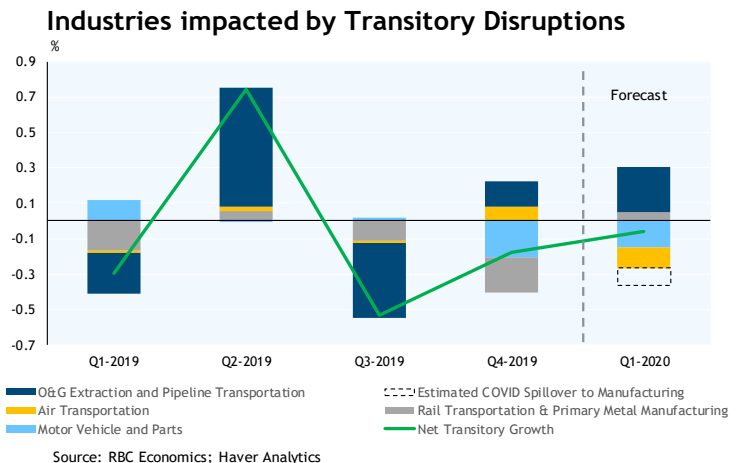
Alberta's production curtailments: Non-conventional oil and gas extraction fell by 5% in Q1/19 when the Alberta government's mandatory curtailments took effect. The impact eased over the course of the year as the government gradually increased production caps, though maintenance shutdowns in the summer also temporarily reduced activity.

Early-2019 rail disruptions: Wintry weather, which can force operators to shorten trains, and a derailment in BC contributed to an 11% decline in rail transportation in February 2019. Activity rebounded over the following months.

Oil shutdowns on the East Coast: Maintenance issues shut down some of Newfoundland and Labrador's offshore oil production in July, contributing to a 4% drop in conventional oil and gas extraction. Production didn't rebound until October.

Early winter on the Prairies: Statistics Canada said a significant amount of snowfall in early-fall brought the harvest to a halt, impacting farm wholesalers and rail transport in September. The impact was likely felt at the local level, and destroyed crops represent a permanent loss of output, but the negative impact on Canada-wide GDP was likely modest.

Keystone pipeline shutdown: A leak forced the pipeline to be shut down in early November and crude oil pipeline trans-



portation GDP fell 6% in the month. But with the sector representing just 1/4% of Canadian GDP, the impact on overall growth was likely modest. Transportation issues also caused a brief widening of the WCS-WTI oil differential, though the temporary, negative impact on producers' profits won't have been felt at the macro level.

US auto strike: Labour disruptions south of the border resulted in production cutbacks in Canada, contributing to 3% declines in motor vehicle and parts output in both September and October. While the shutdowns were largely reversed in November, they still weighed on Q4/19 GDP growth.

CN rail strike: As noted above, a week-long strike in November cut rail transportation GDP to a three-year low, and associated supply chain disruptions negatively impacted a number of other industries. Rail transportation rebounded in December after labour disruptions were resolved, but on balance we think the strike and other rail-specific factors trimmed Q4/19 GDP growth by about 0.1 ppt.

GM Oshawa closure: The GM Oshawa plant accounted for nearly 7% of light vehicle production in 2019. Its permanent shutdown at the end of last year will weigh on motor vehicle output at the start of the year, though the plant was already winding down in late-2019 (December's production was about 1/3 lower than a year earlier). The closure will have spillover effects on parts suppliers and the Durham region as a whole. Our early estimate is that reduced motor vehicle output will shave 0.1-0.2 percentage points off annualized GDP growth in Q1/20, with no rebound in the following quarters.

COVID-19: The novel coronavirus outbreak in early-2020 drew comparisons to 2003's SARS outbreak, which the Bank of Canada estimated trimmed 0.6 percentage points off Q2/03 GDP growth. While the impact of COVID-19 is ongoing (and right now we have limited data covering the affected period) our [early estimate](#) is that reduced travel and tourism and supply chain disruptions will reduce Canadian GDP growth by 0.2-0.3 percentage points in Q1/20.