CANADA

Corporate earnings growth accelerates

Canadian corporate operating profits grew 7.4% (quarterly annualized) in the first quarter of 2014, pushing the annual change up from 4.0% to 12.3%. This quarterly gain is explained by rather modest growth in operating expenses (0.5%) while operating income growth (1.1%) held true to its historical average.

With rising energy prices in recent months, the oil and gas extraction sector stands out, adding 66.4% to quarterly operating profits. Remember that this sector had a 28.8% backslide in the fourth quarter. The very harsh winter also impacted utilities, leading to a 14.1% first quarter increase. Manufacturing also had good financial results, posting a gain of 24.3% in operating profits.

The advance in earnings reflects growth in corporate operating profit margins, which reached their highest level in the first quarter of 2014 since this time series began in 1988. This robustness is fairly widespread, with most sectors posting margins that are sharply above their historical averages.

The high level of profit margins is good news for the outlook on business investment. Combined with exceptionally low interest rates, the financial conditions are very promising for Canadian businesses. This highlights the extent to which movement in investments currently depends on business confidence, which is not at its best given the uncertainties that still plague growth in domestic and foreign demand. Yet, everything suggests that an acceleration in non-residential investment could materialize as soon as there are significant strides in demand, particularly from abroad.

Implications: Growth in corporate earnings is good news for the Canadian economy. Non-residential investment should heat up eventually, and the labour market should also benefit. In addition, the strong financial position of companies is clearly reflected in the outstanding performance of the Canadian stock market in recent months.