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CANADA

Financial and energy activities push corporate profits down

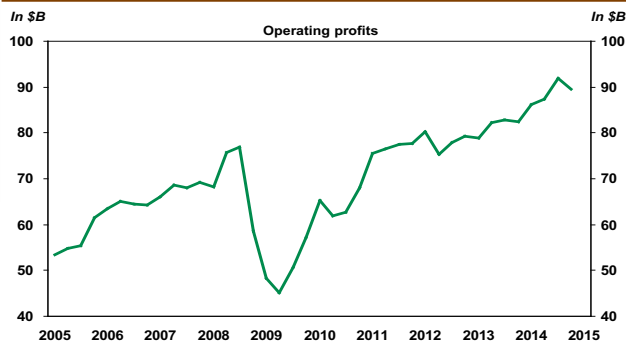
After three quarters of sustained growth, the operating profits of Canadian businesses fell by 2.8% in the fourth quarter of 2014. Year over year, the change is still in positive territory: a gain of 8.5%.

This slowdown is not really surprising. The plunge in oil prices that occurred in the autumn has led to lower operating revenues in the oil and gas extraction sector. Even though costs have also diminished slightly, that was not enough to prevent that industry's operating profits from declining by 16.7% in the fourth quarter.

Operating profits in the financial sector also tumbled last fall. The tribulations of the oil and gas extraction industry certainly had repercussions on the profitability of some financial firms. In addition, the flattening of the interest rate curve reduced the profitability of certain financial activities. That said, the profit margins of financial activities have reached very high levels in recent quarters, from a historical perspective. For example, the profit margin of depository credit intermediation has risen to approximately 30% in recent quarters, compared with a historical average of 19% for that sector. The spread is also quite significant compared with other sectors, given that the profit margin of all non-financial activities was just 8.1% in the fourth quarter. With such high profit margins, it is clearly difficult to maintain a steady pace of growth in the financial sector's operating profits.

If we exclude financial activities and oil and gas extraction, operating profit growth is quite good, with a 1.1% increase in the fourth quarter and year-over-year growth still above 10%. The only fly in the ointment is a 4.2% drop in the manufacturing sector's profits in the fourth quarter. However, that comes on the heels of a 10% gain in the previous quarter. Since the value of manufacturing sales rebounded in December after a two-month pullback, improvement in manufacturers' profitability is to be expected in early 2015. Moreover, the manufacturing

The operating profits of Canadian companies had some difficulties at the end of 2014



Sources: Statistics Canada and Desjardins, Economic Studies

sector's profit margin is still above its historical average. Thus conditions are still favourable for an acceleration in investment in this industry, especially since its capacity utilization rate is quite high.

Implications: All things considered, the fourth-quarter business profit numbers are rather mixed, underlining how sensitive the Canadian economy is to lower oil prices. It is just a matter of time before the deteriorating profitability of energy firms leads to slower wage growth in that industry, slowing employment and, ultimately, weaker economic growth, especially in the first half of 2015. Thus, the monetary authorities will probably order another preventive cut in key interest rates at their March meeting.

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