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Canadian rail dispute: A temporary derailment for the economy

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This morning, some 9300 workers from Canada's two largest rail companies (CPKC and CN) were locked out as negotiations over new contracts failed. If it persists, the lockout would temporarily derail activity not just within that sector but within the economy more broadly, given how important the rail network is for exports and goods shipments. We estimate that a one week lockout would lower annualized Q3 GDP by around 0.4%-pts, with that impact more than doubling in the case of a two-week dispute as more sectors would be forced to curtail production the longer the lockout persists.

- Short-lived labour disputes in Canada's rail sector are not unprecedented, with CP workers having disputes in 2012, 2015, and even briefly in 2022. CN workers were off the job for nine days in late 2019. What makes this year's situation unique is that both CPKC and CN workers are locked out at the same time. Typically, Canada's two major rail companies are negotiating new contracts with employees a year apart, but in 2022 CN requested a year-long extension to the current deal, bringing the negotiation periods into line with each other.
- The direct impact on the economy is relatively small. Rail transportation accounts for just under 0.5% of GDP, so a one-week shutdown which takes activity in this segment to almost zero during that period, would shave only roughly 0.1% from monthly GDP, and 0.13%-points annualized from Q3 assuming rail transportation volumes rebound in September. But that's far from the full story.
- The indirect effect on the economy would likely be much larger, particularly if the labour dispute lasted longer than a week. In a short-lived shutdown, the composition of GDP would shift towards greater inventory accumulation and reduced final sales, and then swing back once the freight trains were moving again. But a longer disruption would see some goods production shutting down due to the lack of inputs or constraints on the ability to store outputs, and would also begin to impede retailers' ability to stock certain goods on their shelves. Because of that the indirect effects will be non-linear, as a labour dispute of four weeks would have far more than four times the negative impact relative to if it lasted just one week.
- The latest data from the Railway Association of Canada show that $380bn worth of goods are transported by rail each year (i.e. more than $1bn a day), with rail accounting for 70% of inter-city traffic and 50% of Canada's exports. Manufacturing, mining, wholesaling, retailing and agriculture would all be negatively impacted. Lacking historical precedent for a long rail strike, it's challenging to quantify what a strike that dragged on would do for the economy, but it would clearly become quite material, and have longer term impacts on Canada's reputation as a reliable source of supply.
- However, it is precisely because of these broadly-based negative indirect effects that rail disputes have typically been quite short-lived historically. As more sectors of the economy are impacted, the greater the pressure becomes on negotiators and the Federal government to end the dispute. The 2019 CN strike ended after eight days when an agreement was reached, while in 2012 the government passed legislation to end a CP dispute after nine days. Other strikes/lockouts seen during this period have spanned less than a week. A one-week lockout, including the indirect impacts, would shave nearly a half percent from annualized Q3 GDP, but extending this to a full month would put Q3 growth into negative territory.

- The Liberal government did intervene quickly in a recent labour dispute that would have shuttered one of Canada's two major airlines, but that was a first contract where the Minister can do so more readily. Prior to today, the Minister had refused a request by one of the parties to order mandatory arbitration, showing a reluctance to interfere with workers' bargaining rights prior to the deadline. The NDP, whose support has kept this minority government in power, has also spoken out against a forced settlement. We understand that the Liberals would have to recall parliament for a vote on the matter, so at this point they would need the support of the Conservatives, who haven't called for such a step. But political pressure will grow on all parties in the days ahead as we see disruptions hit politically sensitive industries (e.g. farming) or at some point, we see other unionized workers sent home from various facilities that are unable to sustain operations without rail shipments.
- The rail dispute will also likely put some upward pressure on some components within the CPI, with reports already that shipments of fresh and frozen foods were halted in the lead up to today's lockout. However, the effect on inflation would be much smaller than the negative impact on GDP, as unlike prior supply disruptions of recent years (port strike, bridge blockades) inventory-shipment ratios are starting from a position of being above their pre-pandemic norms rather than below, and some goods will be diverted to trucks. We would expect the Bank of Canada would look through any short term impacts on prices, leaving monetary policy still on course for rate cuts at the three remaining decision dates this year.

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