Scotiabank Nowcast: Unbelievably Strong Jump in Exports Boosts Q2-2019 to 2.80%

This note is part of a series that will be published after important data releases, documenting mechanical updates of the nowcast for Canadian GDP coming from the Scotiabank nowcasting model. The evolution of this nowcast will inform Scotiabank Economics' official macroeconomic outlook.

The model is described in a related note here. Changes to the model this quarter are detailed in the box on the next page.

- **Canadian merchandise trade had an unbelievably strong month in May, with real exports expanding by a whopping 4.0% m/m. While most of the growth was driven by exports of motor vehicles (+12.1% m/m in real terms), aircraft (+32.2% m/m in real terms) and energy (+4.1% m/m in real terms), other sectors expanded as well.**
- **Some of the exports strength was explained by a reversal of factors holding exports back temporarily in prior months: auto production resumption in May following plant shutdowns in April, and a ramp-up of Canadian crude exports following a decline in April and, more generally, a resumption of production following Alberta's mandated production cuts.**
- **While some of the exports rebound might be temporary, and in terms of its impact on GDP might be offset by running down inventories which are at historically high levels, the release boosts our Q2-2019 nowcast to 2.80% Q/Q SAAR, with industry-level GDP at 0.18% m/m in May.**

Table 1: Canadian GDP Nowcast, Q2-2019

	Nowcast Date	Q2-2019 GDP Growth, %	GDP by industry, %m/m Apr actual	May	Jun
Previous nowcast	*28-Jun-19*	2.30	0.26	-0.00	0.16
Revisions		-0.01			
Business outlook survey, Canada		0.04			
Merchandise exports, Canada		0.41			
Merchandise imports, Canada		0.06			
Current Nowcast	*03-Jul-19*	2.80	0.26	0.18	0.27

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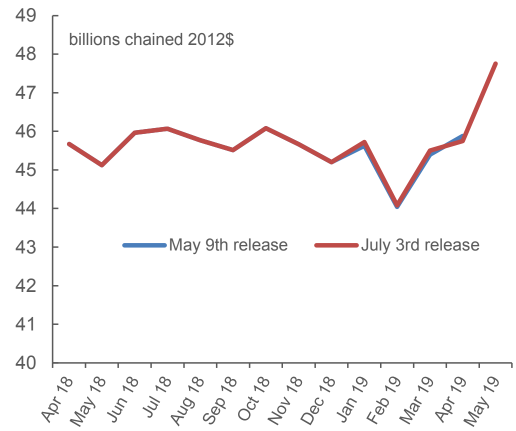
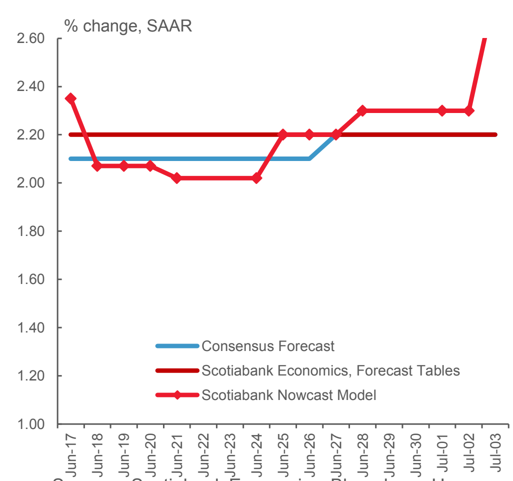
Chart 1: Merchandise exports, Canada



Sources: Scotiabank Economics, Haver Analytics, Statistics Canada

Chart 2: The Evolution of the Scotiabank Economics Q2-2019 Nowcast



Sources: Scotiabank Economics, Bloomberg, Haver Analytics.

Box 1. Changes to the Nowcasting Model

Starting in Q2-2019 we made the following tweaks to the model used for the Canadian GDP nowcast. A recent paper from the Bank of Canada points out that revisions to monthly GDP for the first month of the quarter are very significant, construction industry being one of the most heavily-revised (see Rizetto, P., 2018. GDP by industry in real time: are revisions well-behaved? Staff analytical note 2018-40, Bank of Canada). Given that in Q1-2019 the main reason for the forecast miss was data revisions and construction industry in particular, we made the following modifications to capture these aspects of the Canadian data:

1) Within a given quarter we treat observed monthly GDP as more uncertain than later vintages. This implies that first releases of monthly GDP are compared against all other available data and the model is used to back-cast monthly GDP in real-time. Technically this is accomplished by increasing the variance in the observation equation related to monthly GDP.

2) In order to cover real estate and construction in more detail we add average seasonally adjusted house price in Canada, as reported by CREA. This is also in line with evidence that house prices have leading information for Canadian GDP (see Lalonde, Perevalov, 2019, A New Approach to Forecasting Economic Downturns).

Other data we included are i) a measure of equity prices (S&P TSX index), and ii) Canadian employment from the Labour Force Survey.