November 30, 2018

Canadian GDP: The Best And The Worst

Canada, GDP, q/q % SAAR Q3, m/m % September:
Actual: 2.0 / -0.1
Scotia: 1.8 / 0.1
Consensus: 2.0 / 0.1
Prior: Unrevised from 2.9 / 0.1

- The best and the worst of worlds were delivered in this report, but it all nets out to an ok showing all things considered. CAD and short rates were little affected in the immediate aftermath but the dollar is depreciating and short rates are slipping alongside a post-GDP decline in oil prices. Regardless, bigger risks lay ahead than a backward looking and at least partly distorted growth print into the BoC statement, Poloz's speech the next day, the G20 and OPEC meetings, and both jobs and trade updates next week. All things considered and in light of tales of doom and gloom, this is still an economy that has managed to achieve growth of 2.0% in Q3, 2.9% in Q2 and 1.7% in Q1. That's less than the super charged US growth due to transitory influences from the TCJA, but it steers well clear of the concern that 2019 would be derailed by housing and consumer worries. Chalk up another year of postponed doom!
- GDP growth of 2.0% slightly exceeded the BoC's estimate of 1.8% in the October MPR although clearly that was somewhat dated in relation to new tracking information that has arrived since then. From a headline fundamentals perspective, broad growth keeps the BoC on track. 2.0% Q3 GDP growth also slightly exceeded Scotiabank Economics' forecast based upon modelling and nowcasts that had suggested 1.8% growth.
- The details, however, were somewhat mixed from a quality standpoint. The weakness in investment is disappointing and contrasts to the strength in the BoC's Business Outlook Survey and its investment intentions metric. The BoC may be inclined to cautiously look through some of this weakness given a) tightening capacity, b) the USMCA agreement that lessens some uncertainty, and c) the investment incentives that were introduced in the Federal mini-budget (reminder here); and d) it's possible that we're still just coming off the investment strengths in 2017Q4 and 2018Q1 and should look to the trends. Indeed, for several of these reasons, one might expect an investment acceleration going forward. At the margin, however, soft investment tightens capacity pressures and may marginally raise inflation risk.
- September GDP fell 0.1% m/m after unchanged growth readings of 0.1% in August and 0.2% in July. I had incorrectly gambled—and so had probably a few others in consensus—that enough areas of weakness during the prior month could bounce back and that many of them fell outside of the ability to track through higher frequency readings like retail, wholesale, manufacturing reports etc. Absent tracking for many of those sectors, a large component of the month's growth was not something that could be adequately relied upon in my monthly GDP model. That was a wrong assumption. The weakness remained fairly broadly based as 10 of 21 industries fell and we didn't see much of a pick-up in prior areas of softness.
- The way Q3 ended is unfavourable to extremely preliminary tracking of how Q4 may shape up. With the huge caveats that we have little Q4 data so far

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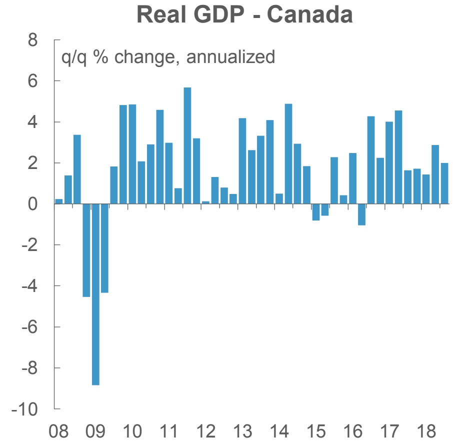

Sources: Scotiabank Economics, Statistics Canada.

and monthly GDP doesn't necessarily bolt onto quarterly GDP due to different concepts, the September hand-off to Q4 implies no growth in the economy during Q4. That could well improve—and we expect it to—but at present the tracking information is fairly scant, save for a rise in hours worked during October ahead of the November figures next Friday along with next week's trade figures for October.

- On a weighted contributions to growth basis during Q3, consumption added about 0.7 points to the 2.0% headline. There was particular softness in big ticket durables spending. I still think the consumer picture is adjusting in transitory fashion to B20 and other cooling initiatives applied to housing but that the picture is and will continue to gradually stabilize.
- Inventories subtracted a large 1.3 percentage points from GDP growth in Q3 which is usually taken as positive for quality. Imports, however, added 2.8 points to GDP growth through less of an import leakage effect, some of which may be transitory given StatsCan is flagging a substitution effect from accelerating domestic oil production that has crowded out oil imports. This is interesting because it plays to the leakage argument on how lower oil prices are affecting Canada; some of the concern applied to lower oil prices for GDP growth would be mitigated by substitution toward depressed Canadian oil from dearer imported oil as the benefits get captured by domestic users.