Canadian GDP Tees Up Federal Budget Stimulus

Canada, GDP, q/q % SAAR Q4, m/m % December:
Actual: 0.4 / -0.1
Scotia: 1.0 / 0.1
Consensus: 1.0 / 0.0
Prior: Unrevised from 2.0 / -0.1

- Canada's economy stumbled in Q4 but likely for transitory reasons. Growth of 0.4% at an annualized rate disappointed our analysis and forecasts as well as consensus expectations. It was the weakest growth report since 2016Q2 when the economy contracted before ripping higher the next quarter. After removing an undesired jump in inventories, the economy contracted by approximately 1% at an annualized rate which further reinforces the headline softness. CAD has depreciated by about a full cent to the USD since about 8am and began to move before the 8:30amET release due to a botched advance flash on the perennially troubled StatsCan web site. The Canadian two year yield is outperforming the US front-end with a present change to the 2s differential of over 4bps this morning.

- Before turning to drivers of weakness and the math behind them, I offer two points for consideration. For one, **expect this kind of reading to provide cover for the Federal Government to add stimulus in the March 19th budget.** I wouldn't be surprised to see the emphasis upon **quick shots** that get stimulus immediately out the door, like more cash infusions for households as one option. It might also raise pressure on Finance and the provinces to **ease restrictions on housing demand** which Finance Minister Morneau has already hinted will be a focus in the upcoming budget. It is, after all, an election year with polls shedding weak results. There are perils to providing such stimulus, but that debate among economists will play second fiddle to the political expediency. **Second, don't panic. I still believe that Q4 softness was transitory and a rebound will be in the cards.** Q4 weakness was likely driven by a combination of a) the plunge in domestic oil prices that has since reversed, b) lingering negative NAFTA uncertainty effects on investment with a deal struck awaiting ratification, c) the aftermath of B20 and provincial housing measures that crimped housing demand but this should stabilize against the backdrop of very strong job gains as housing measures are likely to be eased.

- Regardless, this will be a **downside disappointment to the BoC's forecast** for 1.3% annualized GDP growth. In fairness, however, that forecast dated back to the January MPR and it's unclear what the BoC's fresher tracking might have been before Governor Poloz spoke on February 21st about the need to return the policy rate to neutral. It's likely that the magnitude of the disappointment to the BoC is considerably less than 0.9% (ie: 1.3 minus 0.4) but by how much we won't ever know. The BoC publishes fresh forecasts in the April 24th MPR. **Generally speaking, the report definitely adds to pause pressure in H1 but I don't see it materially impacting expectations for a return to hiking in H2 unless an expected rebound fails to materialize.** The BoC is likely to continue to count on a combination of oil's rebound, dissipating NAFTA effects, a decently performing US economy, stabilizing B20 and provincial housing policy effects, strong job growth, accelerated write-off incentives for business investment and fiscal stimulus to return GDP growth to a much more favourable picture going forward.

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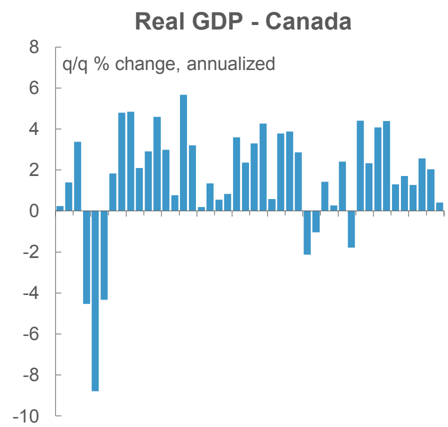
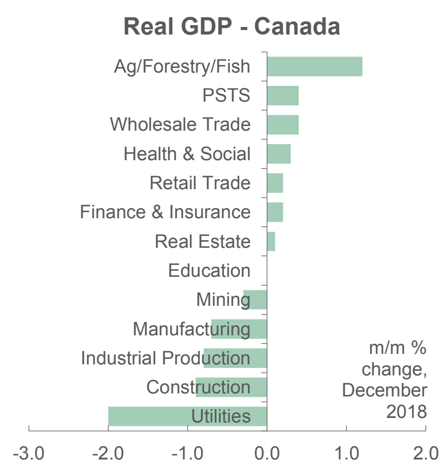


Sources: Scotiabank Economics, Statistics Canada.



Sources: Scotiabank Economics, Statistics Canada.

- A plunge in cap-ex across housing and business investment was a major catalyst to the softening. Housing investment fell 14.7% q/q at an annualized rate. Business investment in structures and equipment fell by 10.9%. **In weighted contribution terms, housing knocked about 1% off GDP, plant investment subtracted 0.8% and investment in machinery and equipment removed 0.2% from broad growth.**
- Inventories were up C$8 billion versus a prior quarter decline of $10 billion. **This means inventories added about 1½% to GDP growth in the fourth quarter.** It was likely an undesired inventory accumulation that further dents the quality of the reading. Removing the inventory contribution leaves GDP ex-inventories down about 1% at an annualized q/q pace.
- Exports were down 0.2% q/q and imports fell by more (-1.1%) such that **net trade perversely added marginally to GDP growth.**
- **Government spending was up 2% at an annualized rate and added 0.4% to annualized GDP growth**.
- **Consumer spending was up 0.7% at an annualized rate. That only added 0.4 points to GDP growth** in weighted terms.
- **The economy shrank by 0.1% m/m for the month of December.** Thirteen of 20 industries expanded so breadth was not bad. The dip in overall GDP was driven by contractions in utilities output (-2% m/m), construction (-0.9%), manufacturing (-0.7%) and mining/quarrying/oil/gas (-0.3%).

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