

Canada's Economy Stumbles Into Q3

- No growth was recorded in July
- Transitory factors may have played a role...
- ...but energy sector disruptions may be a long-lived fact of life
- Q3 growth is tracking below the BoC's stale estimate with data thus far

Canadian GDP, m/m % change SA, July:

Actual: 0.0

Scotia: 0.0

Consensus: 0.1

Prior: 0.2

Canada's economy stumbled, but perhaps largely due to another temporary setback in the energy sector. No growth was recorded during July, in keeping with Scotia's estimate and a tick beneath consensus. There was little market reaction as CAD depreciated very slightly and the two-year Canada bond richened by a small amount. That's likely because the miss wasn't large, market participants were probably largely positioned for softer Q3 growth, and the underlying details were mixed.

Chart 1 shows the industry breakdown of monthly GDP in unweighted terms and chart 2 shows the weighted contribution to GDP growth by sector.

A large 4.7% drop in oil and gas production excluding the oilsands knocked just under two-tenths off of GDP growth. Some of that was due to maintenance issues at east coast energy projects. Some of it was due to the high jumping off point represented by the sizeable 2.3% m/m gain the prior month. Controlling for this sector's issues would have yielded 0.2% m/m GDP growth in July if we just ignore what was a likely correction from the prior month and see through the maintenance issues in July.

Having said that, the trap one risks falling into involves repeatedly dismissing the perennial production interruptions at Canadian energy projects that perhaps are a recurring fact of life rather than anything that should be simply cleansed from the data. That point is highlighted by the following remark from StatsCan regarding another oscillating month for oilsands production that has had a high of 11% m/m back in April and a low of -6% m/m in May and that fell by another 1% in July. Control against these distortions at one's own risk.

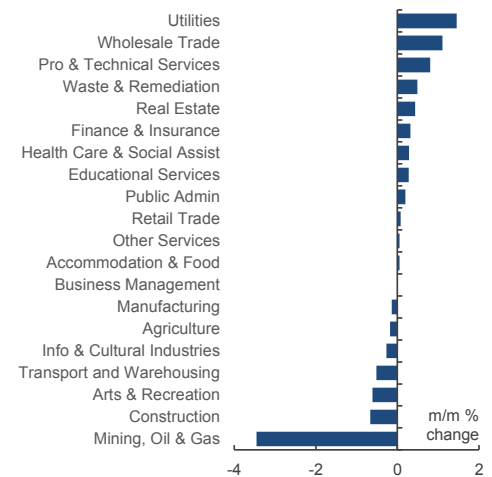
"A major factor in the decline was the shutdown of some of Newfoundland and Labrador's offshore production facilities for a large part of the month as a result of maintenance issues. Oil sands extraction was down 1.0%, as it continued the sequence of expansions and contractions observed over the course of the last four months."

Q3 GDP is tracking 0.8% q/q SAAR growth. That is purely allowing what is known data so far to speak without inferring anything about the remainder of the quarter. In order to exceed the BoC's Q3 growth forecast of 1.5% way back in the July MPR, average monthly growth of 0.2% would be needed in August and September and minimal difference in tracking GDP concepts.

CONTACTS

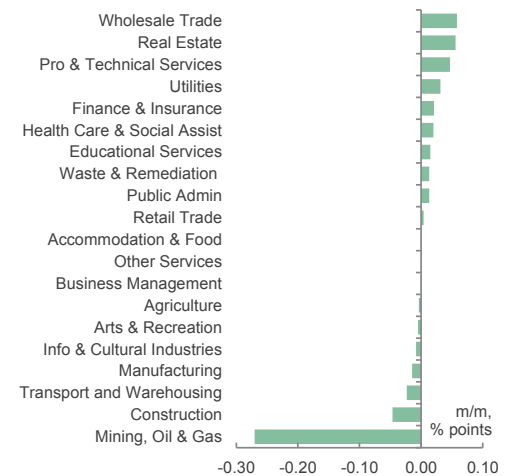
Derek Holt, VP & Head of Capital Markets Economics
416.863.7707
Scotiabank Economics
derek.holt@scotiabank.com

Monthly Real GDP Growth by Sector in July



Sources: Scotiabank Economics, Statistics Canada.

Weighted Contributions From Sectors to July Real GDP Growth



Sources: Scotiabank Economics, Statistics Canada.

On this latter point, monthly and quarterly GDP concepts are somewhat about comparing apples to oranges in that 3.7% was derived from expenditure based GDP versus the Q3 tracking that is based upon production side GDP. The difference in quarterly annualized tracking between the concepts is often within +/-0.5%. But the main conceptual differences between the two concepts include how they treat inventories and imports. Expenditure-based GDP takes account of how higher production was achieved. Production/income-based GDP doesn't and so whether higher or lower output came from inventories or imports is something that directly factors into the expenditure based concepts

What does it mean to the BoC? Nothing before the federal election of course, as they've only communicated when they've absolutely had to since July and only around the September statement. At the margin, however, the narrative that toward year-end the BoC could very well look back at just one single quarter of decent growth in Q2 and little to nothing over 2018Q4, 2019Q1 and 2019Q3 is intact. Below-potential GDP growth risks pressuring the output gap framework and the resilience of 2% core inflation while taking into account external risks. Fiscal stimulus—if it gets implemented and depending upon the form—would only begin to hit the economy around next summer and the effects would likely be in the low tenths of percentage points. That makes other risks more dominant.

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