

## Canada's Economy Has Stalled, Case For Rate Cuts Grows

- The evidence that the economy is rapidly weakening is broadening
- Retailers have had no volume growth in two years...
- ...with Q4 tracking the biggest decline since 2008
- GDP growth has stalled out in the final quarter of 2019
- There is a strong case to look through a backward inflation overshoot...
- ...as slack widens with disappointing data...
- ...and creating a case for rate cuts in 2020H1 to stay on the inflation target
- The BoC will be pressured to revise its forecasts next month

### Retail sales, total / ex-autos, m/m % change, October:

Actual: -1.2 / -0.5

Scotia: 0.5 / 0.2

Consensus: 0.5 / 0.2

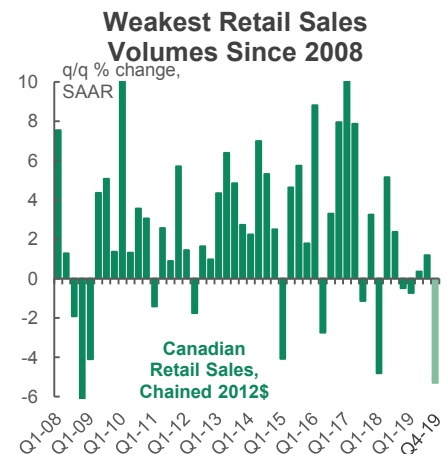
Prior: -0.1 / 0.2

Yet another economic indicator turned up a pile of rotten poinsettias. Economic weakness in Canada is about much more than just one single jobs report and this morning's release is just the latest evidence. The dollar value of sales unexpectedly fell by 1.2% m/m and weakness was widespread. Retail sales volumes are putting in the worst performance since 2008 and broad economic growth appears to have entirely stalled out by more than the Bank of Canada anticipated. This is by no means 2008 on so many counts, but the point is to emphasize how unusually weak recent spending has been. The two year GoC bond yield fell by 5bps post-release and the C\$ depreciated by only a quarter cent to the USD.

The Bank of Canada is facing somewhat of a dilemma with disappointing activity readings and above-target inflation, but I think the solution is to look through the mild rise in backward looking 'core' inflation to 2.2% y/y and place increased emphasis upon whether such inflation readings will prove to be durable. If the acceleration in core inflation is being driven by an unusual array of transitory idiosyncratic factors as argued [here](#) while the economy is stalling out and slack is widening, then ensuring the BoC stays on its inflation target presents the need to take out insurance rate cuts in keeping with our forecast for two cuts over 2020H1. We've had episodes like this previously. The average of the three 'core' measures of inflation was above target right up to July 2009 yet the BoC had the foresight to begin easing in late 2007 with an eye on the risks facing its target in lagging fashion to the unfolding deterioration. All that's missing now is a clear bias shift from the BoC that is unclear but that may be presented in BoC forecast revisions next month. An about face would hardly be unprecedented but a complicating factor is that the BoC is in transition.

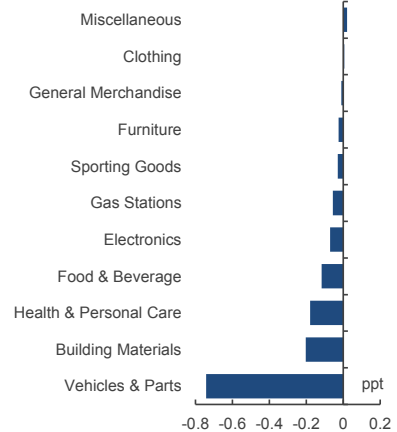
### CONTACTS

Derek Holt, VP & Head of Capital Markets Economics  
416.863.7707  
Scotiabank Economics  
[derek.holt@scotiabank.com](mailto:derek.holt@scotiabank.com)



Sources: Scotiabank Economics, Statistics Canada.

### Weighted Contributions to October Volume Retail Sales



Sources: Scotiabank Economics, Statistics

On a quarterly annualized basis, retail sales volumes are tracking a decline of just over 5% in seasonally adjusted and annualized terms. The last time we saw a reading that weak was a decline of over double that magnitude in the final quarter of 2008 (chart 1).

Yes there is more data to come in Q4 as this is just an October reading. But, this kind of retrenchment should be shaking everyone out apathy toward the domestic economy. It's not as if a weak consumer is a new development or 'just one report'. As chart 1 shows, retail sales volumes have been weak for five consecutive quarters. You could stretch that even further back to the start of 2018 as the strong gain in the second quarter of that year was just a reversal of the prior quarter's similar drop. Retail sales volumes are only 0.6% higher now versus the end of 2017.

The softness in total consumption has also been evident for some time. Real consumer spending advanced by just 0.5% q/q SAAR in Q2 and 1.6% in Q3. A renewed deceleration in Q4 is signalled by the retail figures.

All of the monthly decline came through lower volumes (-1.4% m/m) as prices edged a bit higher.

Eight out of 11 sectors saw lower sales. Chart 2 shows the drivers on a weight contribution to overall volume growth basis to showcase the main drivers. Note that almost all categories pulled sales lower. At the top (or bottom...) of the list is that sales at new motor vehicle dealers unexpectedly plunged by 2.8% m/m based on registrations whereas our data is based upon self-disclosed sales data from dealers. This may have been a GM strike issue but if so, it showed up very inconsistently in the two sources. An alternative is that sales of things other than vehicles plunged at new car dealers (parts, service, ancillary sales) and that auto prices were weak (we track sales volumes).

The weakness in autos nevertheless went much further. Used car dealers saw a 2.8% sales slide and that had zip to do with the GM strike. 'Other' motor vehicle dealers saw a 1.8% decline (ATVs etc). Parts and accessories stores saw a 4.2% sales slide.

Besides, to repeat, sales weakness was widespread. Sales fell at furniture and home furnishings stores (-0.8%), electronics and appliance stores (-2.5%), building material and equipment stores (-3.4%), food and beverage stores (-0.6%), health and personal cares (-2%), gasoline stations (-0.5%) and sporting goods and hobby stores (-1.4%). The only mild bright spots were clothing and accessories stores (+0.1%) and cannabis sales (+5.4%). Clothes and pot, as great foundation for resilience.

Six out of 10 provinces saw lower sales. Ontario was hammered (-2.0% m/m), Quebec was down 1.7% m/m and BC fell by 0.9% while Alberta edged out a 0.4% rise. That kind of plays against any notion this is a weak spending tally because of resource sector challenges. Ontario and Quebec typically benefit from lower commodity prices on balance, yet consumers retrenched the most in those two provinces.

October GDP is tracking a decline of -0.1% m/m. Q4 GDP tracking lies at only about ¼% at a seasonally adjusted and annualized rate. The BoC had forecast Q4 GDP growth of 1.3% and so at this tentative stage we are tracking a full percentage point softer than anticipated but with a considerable amount of data left in the quarter.

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