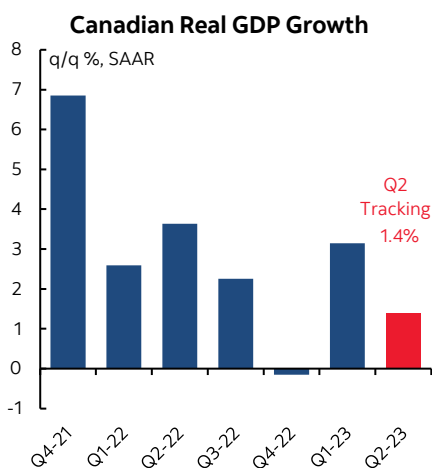


#### Contributors

##### Derek Holt

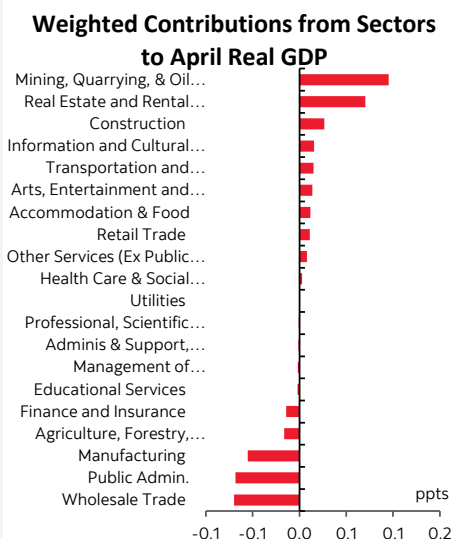
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Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

## GDP, BoC Surveys Likely Offer Enough Reason to Hike

- With jobs and wages pending, the BoC has a case to hike in July
- The economy is tracking 1½% GDP growth in Q2...
- ...which may be slightly exceeding BoC forecasts even with distortions...
- ...on a mish mash of monthly revisions, misses and beats
- BoC surveys continue to indicate unmoored inflation expectations...
- ...and rising house price expectations
- US data spilled over into Canadian market effects

### Canadian GDP m/m % change, April:

Actual: 0.0

Scotia: 0.3

Consensus: 0.2

Prior: 0.1 revised up from 0.0

May GDP 'flash' estimate: 0.4%

### BANK OF CANADA IMPLICATIONS

A suite of readings indicates that GDP growth is modestly exceeding the Bank of Canada's Q2 forecast while its surveys of businesses and consumers point to unmoored inflation expectations and rising expectations for gains in house prices in a case of here-we-go-again. On net, these developments bolster—not cement—the case for a BoC hike on July 12th and probably carry the day over the recent CPI figures. An economy that is not yet making strides toward opening up disinflationary slack approaching two years after bond market tightening began and with no one believing they'll hit their 2% inflation target requires another disciplinary jolt of monetary tightening in a race against the clock to contain inflation risk. The narrative for how inflation risk has pivoted higher remains intact. The last piece of information may be next Friday's jobs and wages that I think will set a constructive tone.

The case against a hike in July is nevertheless not to be fully discounted even if not a base case by a slim margin. The BoC has skipped making rate changes along trend tightening or easing paths in past fine-tuning stages as it assesses a sweep of data and the recently softer than expected inflation print could provide some cover to take the summer to evaluate and come back recharged in September. Some, like me, might be left wondering what was the point if the only incremental tightening turns out to be a quarter-point and question the BoC's resolve to crush inflation risk in slow footed fashion.

### GDP DETAILS

March GDP was revised up a tick from flat to a 0.1% gain. April GDP landed flat compared to initial flash guidance that the economy grew by 0.2% with some of that miss explained by the upward revision to the prior month which was the only month that got revised. The truly new information came through May GDP with the initial estimate pointing toward a strong 0.4% m/m gain, until that possibly gets revised either up or down.

This combination of a positive revision, a miss, and then a strong flash reading combined to net out to tracking growth that is still in the 1½% q/q annualized range for Q2 using the monthly GDP accounts (chart 1).

There are three reasons not to get too fussed by a slowdown in growth:

- Growth in Q2 may be slightly exceeding the BoC's forecast for 1% q/q SAAR growth. Whether using the monthly production-side GDP accounts or our 'nowcast' for

quarterly GDP growth using expenditure accounts, we think that growth is tracking around a half percentage point faster than the BoC anticipated. That's not a big deal, but it means that instead of mildly lower than potential GDP growth we have growth roughly matching potential GDP growth and hence the economy is still not opening up disinflationary slack.

- A significant caveat around the data is the uncertain net effect of transitory shocks such as ongoing wildfires that have disrupted some activity relative to what might have occurred while boosting spending to fight the fires. It's also unclear whether the full indirect effects of the Federal civil service strike were shaken off even in the May GDP estimate.
- Some growth may have been pulled forward into Q1 from Q2 and so we need to look at the combination through the whole first half. Some growth in Q2 may be punted into Q3.
- After the economy expanded by 3.1% in Q1 and then shifted to rising at around the supply side's ability to expand, the economy is still not making material traction toward opening up disinflationary slack.

Chart 2 shows the weighted contributions to April's flat GDP print by sector. Bright spots were in resources, real estate services and construction, and travel/tourism activities. Downsides came through wholesale trade, manufacturing and public administration.

April was stronger than it appeared and May was weaker than it appeared because of the direct effects of the Federal civil servants' strike. The federal civil servants' strike shaved about 0.1% m/m off of April GDP in terms of direct effects and while we only have verbal guidance for May's rebound in public administration, it's likely that a similar weighted *positive* contribution to May GDP took place. What we cannot tell is the multiplier effect of the strike on other sectors such as agriculture but a ballpark guesstimate could reasonably mean another 0.1% or so of growth was robbed in April through the strike's indirect effects. As an aside, the public administration sector offers a case of many more employed bodies producing less person employed (chart 3).

We don't get numbers behind the flash estimate for May GDP and instead get this loose verbal guidance from Statcan:

"Advance information indicates that real GDP increased 0.4% in May. Growth was led by the manufacturing and wholesale trade sectors, as well as by offices of real estate agents and brokers. There was also a rebound in federal government public administration (except defence). These increases were partially offset by decreases in the mining, quarrying, and oil and gas extraction sector, as well as the utilities sector."

## BANK OF CANADA SURVEYS — UNMOORED EXPECTATIONS

The release of the Bank of Canada's twin consumer ([here](#) and [here](#)) and business surveys ([here](#) and [here](#)) is likely going to concern the central bank. Signs of progress toward lower inflation included fewer reported labour shortages that are still high, and weaker expected growth that is likely necessary to achieve lower inflation.

What dominates, however, is ongoing evidence that inflation is expected to remain well above the BoC's target for an extended period of time. Unmoored expectations are a

Chart 3

### Employees Are Exceeding Output in the Public Administration Sector

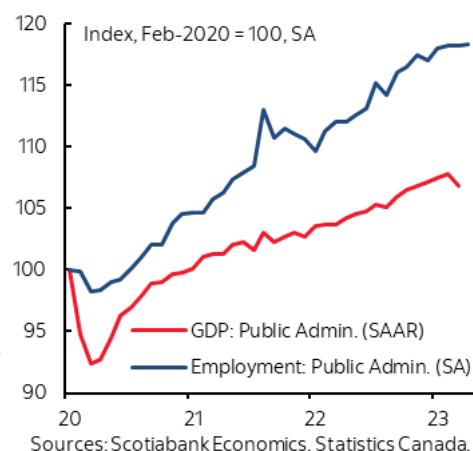
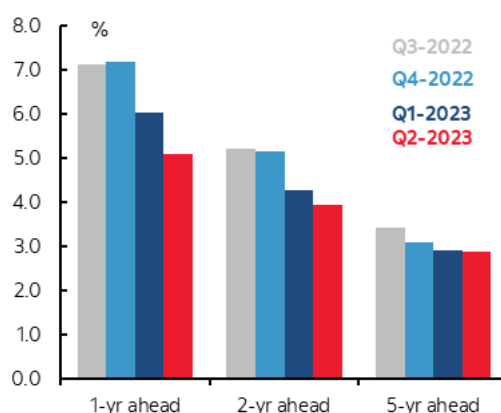


Chart 4

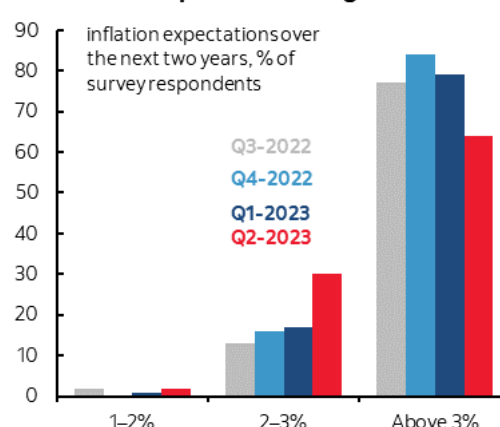
### Canadian Consumers Inflation Expectations



Sources: Scotiabank Economics, Bank of Canada.

Chart 5

### Canadian Businesses Expect Inflation to Surpass BoC's Target



Sources: Scotiabank Economics, Bank of Canada.

June 30, 2023

challenge to the BoC's 2% target because when higher inflation becomes expected in demands and contracts it can become a self-fulfilling prophecy that is difficult to control.

There were some improvements such as in consumers' 1-year and 2-year ahead inflation expectations but they are still high, and consumers still expect above 2% inflation 5-years out from now (chart 4). Businesses' inflation expectations shifted a little from the above-3% to the 2-3% category, but basically businesses think inflation will be above the 2% target throughout the 2023-24 period (chart 5).

What may also concern the BoC is evidence that households are raising their house price growth expectations as shown in their chart 2 in the second link provided for the consumer survey.

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