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GLOBAL ECONOMICS

SCOTIA FLASH

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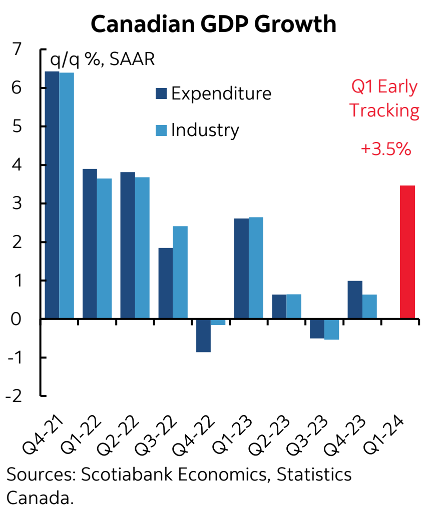
Contributors

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

Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Canadian GDP Spells Reeeebound — And No Pressing Need for Rate Cuts!

- **Canada's economy is strongly rebounding in Q1**
- **The BoC will have to sharply upgrade its forecasts…**
- **…and not just for Q1 as governments ramp up spending**
- **The BoC should be under no pressure to cut rates any time soon**
- **Has real GDP per capita bottomed?**

Canadian GDP, m/m %, January, SA:
Actual: 0.6
Scotia: 0.4
Consensus: 0.4
Prior: -0.1 (revised from 0%)
'Flash' February guidance: +0.4

What a glorious day. It's opening day for the Blue Jays, a long weekend beckons, and the Canadian economy is on fire. Good times.

This is the rebound I've been talking about. I've generally been more upbeat about what's going on under the hood in Canada's economy and the prospects for a rebound, and by corollary more rate bearish than consensus for a long time. What we just learned validates this bias and with more to come as I'll explain.

STRONG Q1 GROWTH

Canada's economy is rebounding at the fastest pace since 2022Q2 (chart 1). First quarter economic activity is tracking a rise of 3.5% q/q at a seasonally adjusted and annualized pace. 3.5%. Did I mention 3.5%? I like the number so much I'll say it again: 3.5 bigguns!

This estimate is based upon Statistics Canada's estimates for January and February GDP that were even stronger than the rebound that I thought we'd see. January GDP grew by 0.6% m/m SA for the strongest gain since January of last year which is two-tenths faster than their initial guidance. The preliminary estimate for February GDP indicates a further expansion of 0.4% m/m based upon partial data available to date which is two-tenths faster than my regression estimate based upon much less data than Statcan has.

Taking those numbers and revisions that included a slight downgrade to December (-0.1% m/m instead of flat) while assuming March comes in flat simply to focus the effects upon known data results in 3.5% q/q SAAR growth tracking in Q1. In case I forgot to mention, it's 3.5%!

BOC HAS TO REVISE GROWTH FORECASTS HIGHER

How does that compare to what the BoC was expecting? They're looking way too pessimistic. It's tricky in that they—and us—forecast GDP on an expenditure basis whereas the numbers we got this morning are on a production-side basis. In plain language, we still need to keep an eye on inventory and net import contributions to growth that are captured in expenditure-based GDP. Still, the BoC's January MPR expected only 0.5% q/q SAAR growth in GDP on an expenditure basis and it seems likely that we're tracking something that is multiples higher than that.

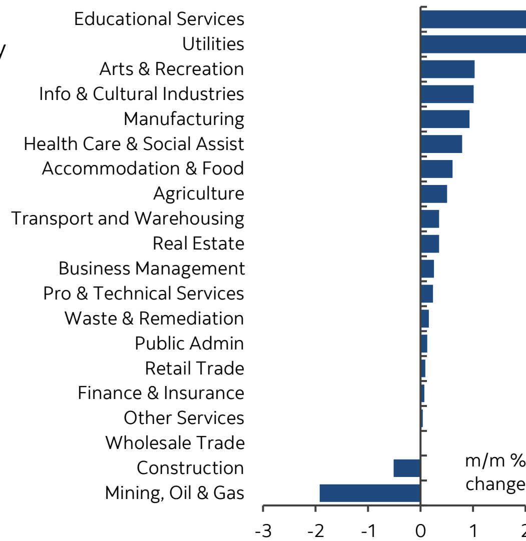
So what? Well, the BoC guesstimates that potential GDP can grow by 2% per year over its forecast horizon albeit with wide brackets. To grow by 3.5% is a material jump over the economy's noninflationary "potential" speed limit. It means that the slight progress

toward creating disinflationary slack in Q4 took a significant step back in Q1. The BoC may no longer be able to claim that the Canadian economy is moving toward creating excess supply or will at least have to temper this assessment in its April statement and MPR.

DETAILS SHOWCASE BROADLY BASED GAINS

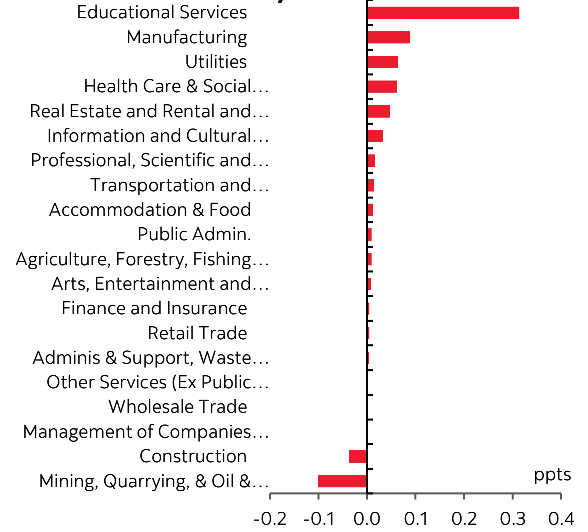
Chart 2 shows the breakdown of growth by sector during January. Chart 3 shows the weighted contributions to GDP growth by sector in January. The education sector led the way because of the end to Quebec's public sector strike. That strike didn't have the same effect on the health sector because of mandatory service requirements. Still, there were enough other sectors that made positive contributions to January GDP to support breadth.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

What's more impressive is the guidance from Statcan on February GDP. They don't break down the numbers behind the preliminary estimate, but the verbal guidance indicates "Broad-based increases, with main contributions from mining, quarrying, and oil and gas extraction, manufacturing, and finance and insurance that were partially offset by decreases in utilities." Utilities are a weather report and so the overall guidance on February is looking very positive in terms of sustained momentum.

Now what about forward-looking prospects?

FISCAL EASING NEGATES MONETARY EASING

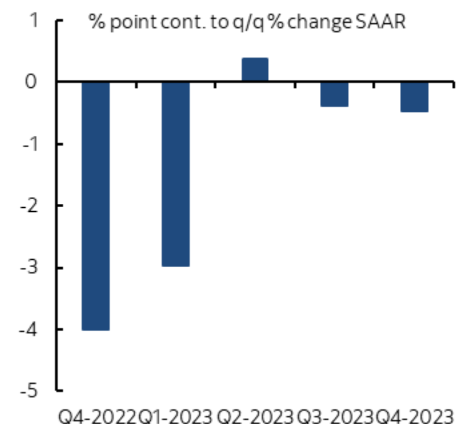
Enter fiscal policy. Not only does the BoC have to revise up Q1 GDP growth by probably a lot, it also has to revise up GDP growth arguably throughout its whole projection period. Blame or credit governments, you pick.

The BoC had already estimated that government spending would add about 0.5–0.6 ppts to GDP growth in each of 2024 and 2025 in its January MPR forecasts before the current Budget season began to unfold. As previously written, that's looking more like 1%+ just based on the incremental spending by the biggest provinces. That estimate will likely move higher upon full incorporation of the effects of spending changes by all provinces and in the upcoming Federal Budget on April 16th. All the signs from the Feds point to more spending on housing, whatever they cost out for pharmacare, and on 'fair' stuff which usually means redistributing money while assaulting businesses and anyone who's done reasonably well.

In plain language, this means that while governments feel they have a case for increased spending on myriad things (they always do...), this comes at the expense of higher borrowing costs for longer. Adding to growth slows any progress toward creating disinflationary slack which in turn makes the BoC less comfortable to ease monetary policy.

As for risks, there are plenty. The US economy has been highly resilient and had Canada's back and so hopefully that continues as I think it will. Canada's housing market faces a strong outlook with supply shortfalls that pre-existed the surge in immigration that adds to the shortfall alongside the effects of over half a million jobs created since the end of 2022 and rising wage pressures best captured by wage settlements.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.

IT'S BEAR HUNTING SEASON

In all, the bearishness toward Canada's economy is overdone. It has been for quite a while now. I stand by prior assessments that say GDP understated resilience in the Canadian economy from the end of 2022 throughout all of 2023.

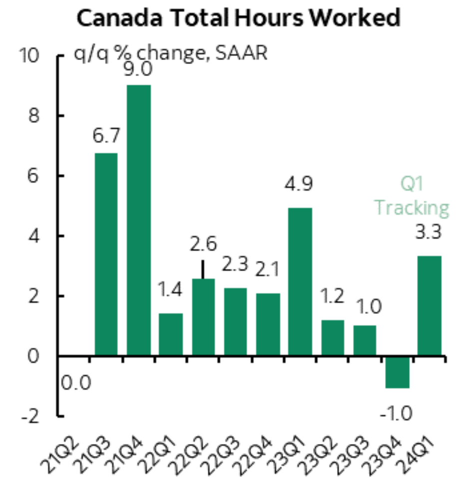
One reason I've argued that is because inventories were shaving a lot off growth in several of those quarters including about 4 percentage points of drag on growth from inventories in 2022Q4, another 3 ppts in 2023Q1, and then smaller effects thereafter (chart 4). Amid the uncertainty and the cost of financing and storing inventories, this reflected prudent actions by companies, not something to view negatively. Another reason included the large disruptive role of strikes that shaved a lot off of hours worked especially into the end of the year (chart 5). Further, wildfires, unplanned maintenance at petrochemicals facilities and mines, and the myriad of indirect effects of strikes across multiple sectors all weighed on growth.

In short, the Bank of Canada has been too aggressive in taking credit for weak growth over the past year due to its rate hikes and too dismissive toward rebound potential in its forecasts. They told us 2024H1 would be bad and so far it's a very strong start of the year. Some cry out for rate cuts. But if the economy is more resilient under the hood and rebounding, then the BoC should feel totally comfortable to continue leaning against any pressure to cut rates any time soon regardless of what the politicians who've mismanaged their finances and debt issuance would prefer to see.

As for the per capita perspective, the decline in real GDP per capita is arguably coming to a halt in Q1 (chart 6). Whether that's temporary or not only time will tell. Concrete short-term action to curtail temps will help this year, but successfully delivering upon targets to lower temps in coming years will be required. Still, I maintain the bias that the decline in GDP per capita last year was a) partly distorted by the above arguments on how GDP temporarily overstated softness in the economy, and b) GDP is getting a lift now, and c) it depends upon future immigration policy that is likely to drop population growth back down to 1% or less per year and d) depends upon the debate over whether the first round effects of a population shock can be very different from subsequent rounds as new arrivals gradually ramp up contributions to the economy with lagging effects.

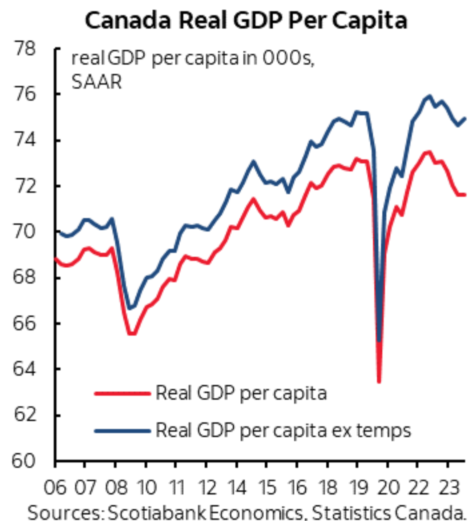
I have long maintained that immigration was excessive relative to the lack of preparedness in terms of available housing, infrastructure, and other supports. It's welcome to see some relief. But I have also been much less pessimistic in the debate over what has driven falling real per capita GDP and how sustained this may be.

Chart 5



Sources: Scotiabank Economics, Statistics Canada.

Chart 6



Sources: Scotiabank Economics, Statistics Canada.

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