Scotiabank

GLOBAL ECONOMICS

SCOTIA FLASH

September 26, 2025

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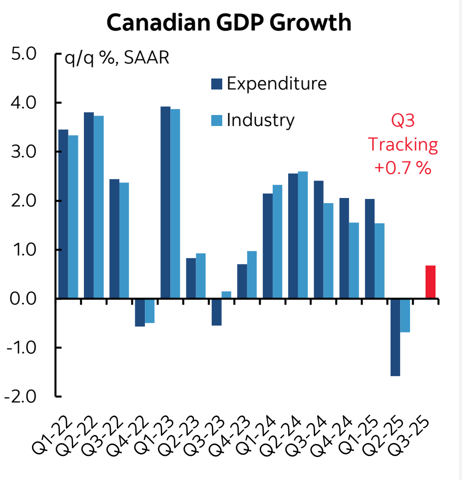
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Canadian GDP Not Surprising the BoC; US Core Inflation Is Not Light as Americans Spend Beyond Incomes

- **Canada's economy is tracking very soft Q3 growth**
- **Implications for the BoC**
- **US core PCE inflation is not light, and is still driven by services**
- **Americans are financing spending by saving less…**
- **…thereby questioning the sustainability**

Canada GDP July, m/m %, SA:
Actual: 0.24
Scotia: 0.1
Consensus: 0.1
Prior: -0.1
August 'flash': "essentially unchanged"

Canada's economy is tracking very soft growth in Q3. While not a recession, it's still an economy that's bumbling along. I'll go over BoC implications after recapping the figures.

July GDP grew by 0.24% m/m SA. That slightly beat Statcan's preliminary 'flash' guidance from a month ago that said they were tracking half that rate of growth. The estimate also beat consensus.

Statcan's first stab at providing advance guidance for August GDP was "essentially unchanged." If that's zero, say zero!

The combined effect leaves us tracking growth of only about 0.7% q/q at a seasonally adjusted and annualized rate (SAAR) in Q3. That's hardly much of any rebound from Q2 (chart 1). This tracking takes the information we got this morning for July and August, assumes September comes in flat simply to focus the math on what's known to date, and what we know about Q2.

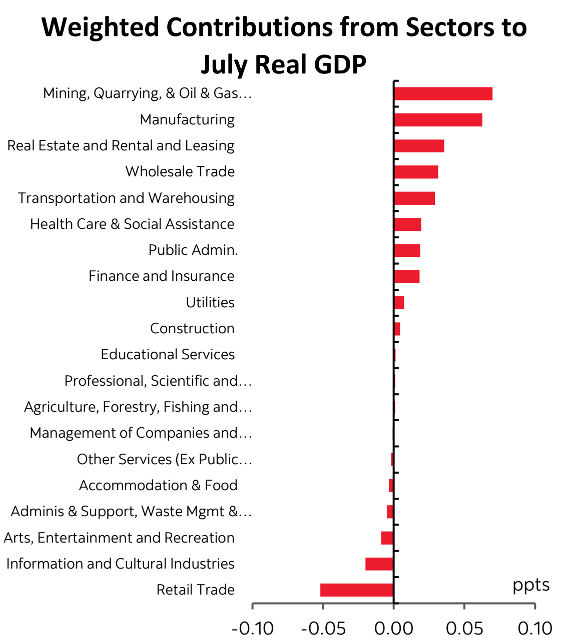
Chart 2 shows the weighted contributions to July GDP growth on a sector basis. There was significant breadth to the growth.

BOC IMPLICATIONS

The BoC is coming close to nailing it with their GDP forecasts of late. The July MPR was the last time they provided projections in their 'current tariff scenario' until they update them again toward the end of October.

Back then, the BoC had forecast Q2 GDP at –1.5% and we got –1.6%. They had predicted Q3 GDP at 1.0% q/q SAAR and we can't say we are meaningfully tracking something different at this point.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

The BoC and street forecast GDP on a quarterly expenditure basis. The numbers we got this morning are monthly income-based numbers. The inventory and net trade effects can be among the considerations that can drive a wedge between the two sets of accounts. With data available to date, we can't say that the BoC's expectations are being meaningfully surprised.

Therefore, all else equal, they'd be of the view that a touch more slack vindicates the September cut and still keeps them focused upon other data dependencies like the next batch of data before the October meeting. Unless we get some nasty surprises, I'd lean toward a skip at that meeting but tentatively and based on it being just days before Carney delayed the promised October budget to November 4th and hence after the BoC has updated all of its forecasts and is unable to do a thorough accounting of the effects of the fiscal measures that are introduced.

Such a cut-hold-cut possible path would be consistent with other fine-tuning stages when Canada has been hit by a terms of trade shock that the BoC has felt compelled to respond to. An example of which was in early 2015 under former Governor Poloz. Back then it was oil, today it's tariffs.

WARM US INFLATION AS AMERICANS SPEND BEYOND THEIR INCOMES

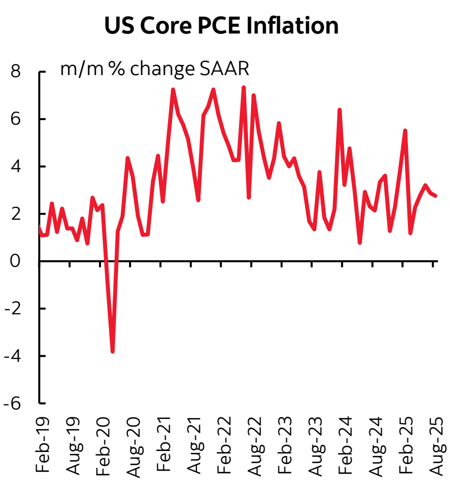
US core PCE inflation landed at 0.23% m/m SA, or 2.8% m/m SAAR. That's not light and maintains the pattern of core readings above the 2% total PCE target (chart 3).

Key is also that despite all the focus on tariff effects on goods, the heat continues to come from the services side. Core services PCE excluding energy—and housing-services was up by 4.1% m/m SAAR (chart 4). This category is about a quarter of the PCE basket.

US consumer spending grew by 0.6% m/m SA in nominal terms (0.5% consensus) and 0.4% in inflation adjusted terms.

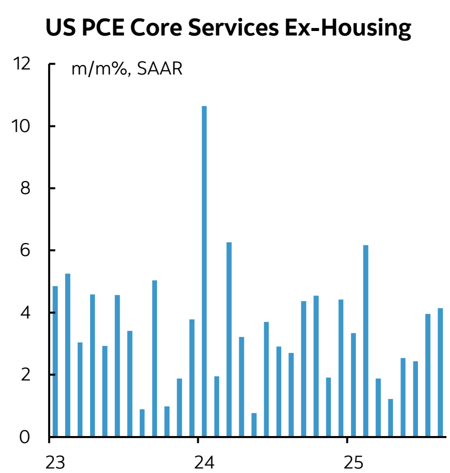
This may be unsustainable. That's because spending is outpacing income growth. Q3 is tracking real consumption growth of 3% q/q SAAR versus real growth in personal disposable income of only 0.2% q/q SAAR. As a result, the personal saving rate remains under downward pressure (chart 5). The saving rate was 5.7% back in April and has fallen by 1.1 ppts since then.

Chart 3



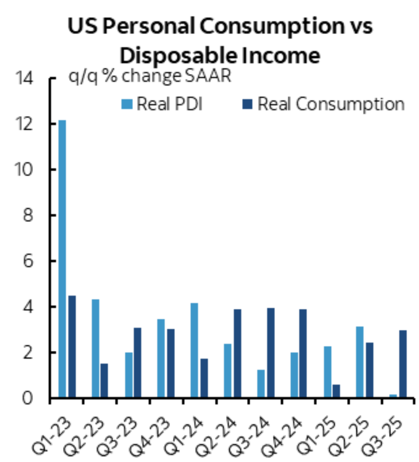
Sources: Scotiabank Economics, BLS.

Chart 4



Sources: Scotiabank Economics, BLS.

Chart 5



Sources: Scotiabank Economics, BEA.