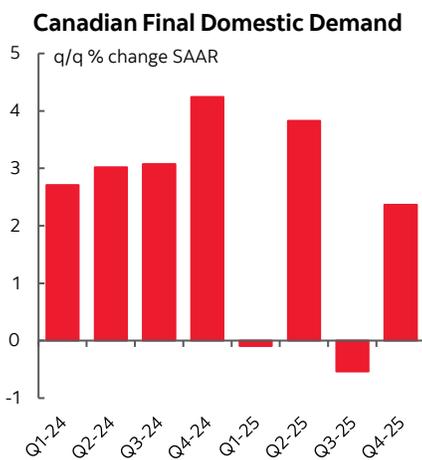


Contributors

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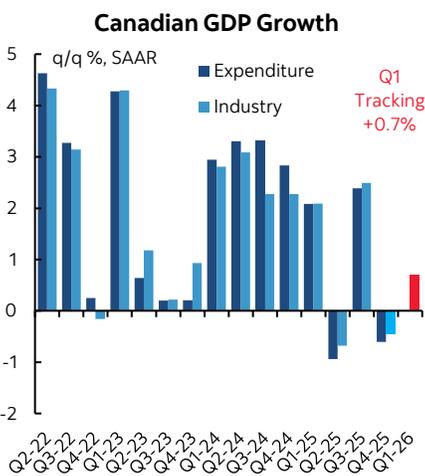
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Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

The BoC Will Welcome a Surging Domestic Economy

- Q4 GDP was weak...
- ...because of the biggest inventory drawdown in three years
- The domestic economy posted impressive growth...
- ...aided by export growth
- Q1 GDP is tracking a rebound
- The BoC was likely to ignore GDP no matter what...
- ...and more so now given what's under the hood

Q4 GDP, q/q SAAR %:

Actual: -0.6
Scotia: -0.5
Consensus: -0.2
Prior: 2.4 (revised from 2.6)

GDP m/m % SA, December:

Actual: 0.24
Scotia: 0.1
Consensus: 0.1
Prior: 0.0

January 'flash' estimate: "essentially unchanged"

My instant reaction in client-focused chat rooms upon seeing these numbers was that they were much better than expected because of the details. Headlines dwelled on the GDP contraction of -0.6% q/q at a seasonally adjusted and annualized rate (SAAR). That placed emphasis upon the wrong thing from a Bank of Canada standpoint. Markets generally understood the points that followed because there was very little reaction in bonds and CAD.

Key is that final domestic demand was strong which adds consumption plus investment plus government spending. That was up by 2.3% q/q SAAR in Q4 for the strongest gain since 2025Q2 (chart 1). It's a better gauge of strength in the domestic economy over which monetary policy has greater influence.

What explained the gulf between GDP and FDD?

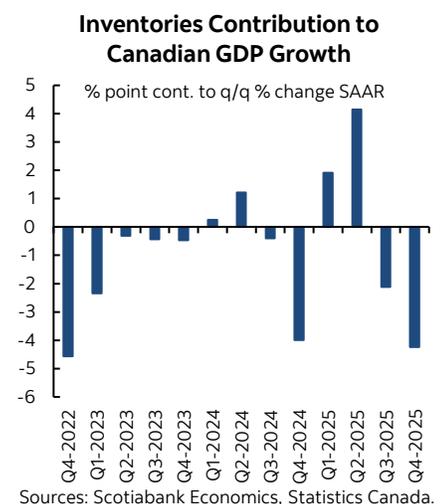
The biggest inventory drawdown in three years. Inventories drove a whopping 4.2 percentage point drag on GDP growth which is the biggest inventory drawdown effect since 2022Q4 (chart 2). Therefore, chart 3 provides a misleading depiction of what's going on in the Canadian economy.

What drove FDD? Chart 4 breaks things down in terms of weighted contributions to GDP growth.

Consumer spending added 0.9 ppts to GDP growth through higher services spending that added 1.11 ppts to growth versus a -0.2 ppts drag from goods spending. Chart 5.

Investment by businesses added 0.2 ppts to growth as investment in structures subtracted -0.2 ppts but investment in equipment added 0.35 ppts.

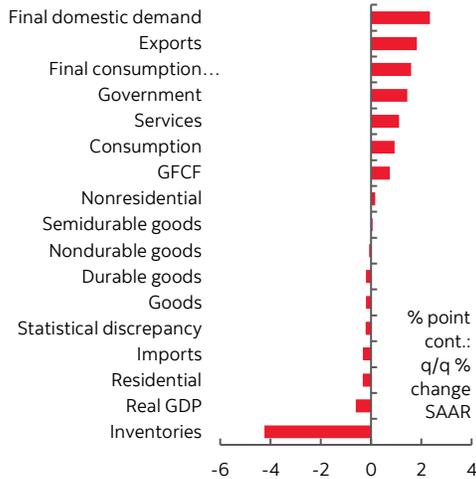
Chart 2



Sources: Scotiabank Economics, Statistics Canada.

Chart 4

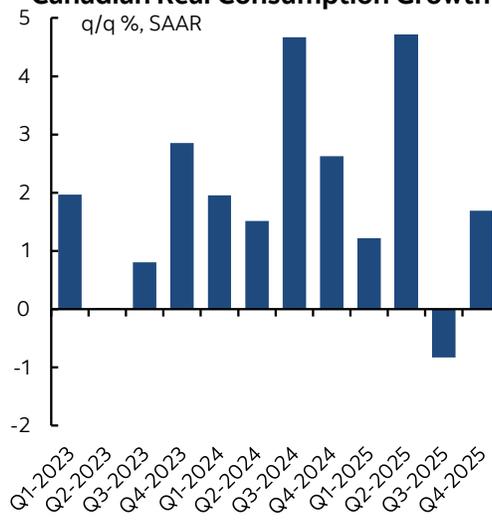
Contributions to Canada's Q4-2025 Real GDP



Sources: Scotiabank Economics, Statistics Canada.

Chart 5

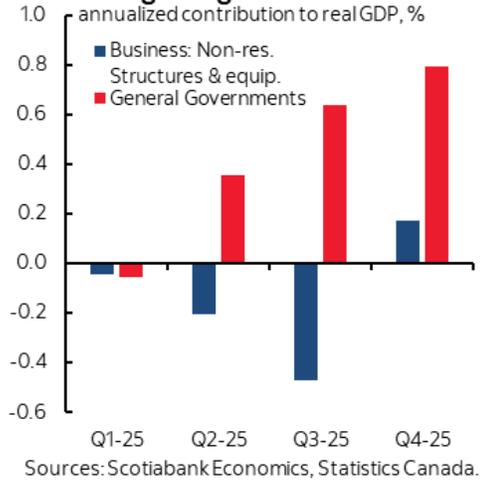
Canadian Real Consumption Growth



Sources: Scotiabank Economics, Statistics Canada.

Chart 6

Canadian Government Taking Charge of Investments



Sources: Scotiabank Economics, Statistics Canada.

Exports added a whopping 1.8 pts to growth.

Higher imports subtracted 0.3 pts since GDP accounting treats that as a leakage effect.

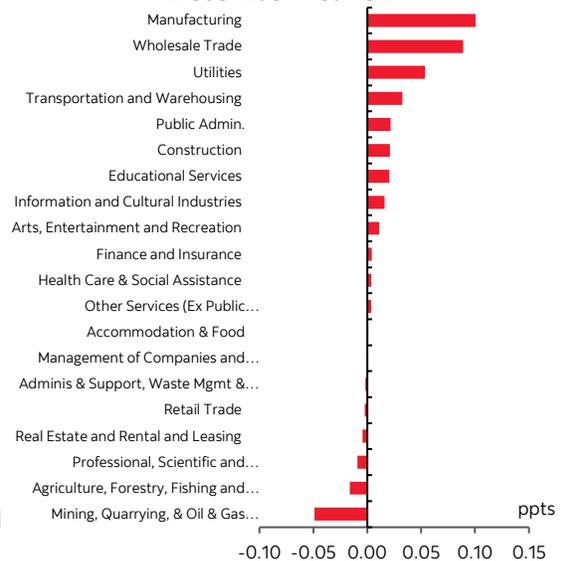
Government played a significant role. Government current spending added 0.66 pts to growth while government cap-ex added 0.8 pts (chart 6). Government haters will pounce on this as an illusory sign of strength in the economy. Those same people are often the ones beseeching government to spend more on defence and infrastructure. You can't have it both ways, folks. And note that Statcan specifically noted that the government cap-ex line was "driven by increased investment in weapons systems." Canada fell behind on infrastructure, major projects and defence and now that it's contributing to growth you can't complain about it.

Chart 7 breaks down weighted contributions to December GDP growth of 0.24% m/m SA. Manufacturing was the single biggest positive contribution followed by the wholesale sector that is also related to trade. Note that transportation and warehousing—also related to trade—is fourth on the list of weighted contributions to growth.

As for Q1 tracking, it presently sits at about 0.7% q/q SAAR using the Q4 average of monthly GDP figures and the January estimate while assuming no change in February and March in order to focus the math on the knowns. This is using production/income side GDP accounts.

Chart 7

Weighted Contributions from Sectors to December Real GDP



Sources: Scotiabank Economics, Statistics Canada.

Expenditure-based quarterly GDP accounts—which is how the BoC and the street forecast—could well be tracking stronger in Q1 on the view that the inventory drag in Q4 could give way to some inventory replenishment. The BoC's 1.8% q/q SAAR Q1 GDP forecast could well be within reach, though it's too early to tell.

So what would the Bank of Canada think overall? Q4 GDP of -0.6% was weaker than their January MPR forecast (0%) but when disappointment is due to things like inventories while final domestic demand is strong they tend to fade it. They'll want to see how Q1 evolves but so far they're probably pretty happy about the preliminary evidence.

In short, the BoC is very likely to retain its patient messaging. It was likely to do that regardless of this morning's numbers in any event since it is focused upon long-tailed developments across supply and demand channels that only time and a lot of data will inform pending material further information on things like trade negotiations that will take a long time to unfold.

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