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GLOBAL ECONOMICS

SCOTIA FLASH

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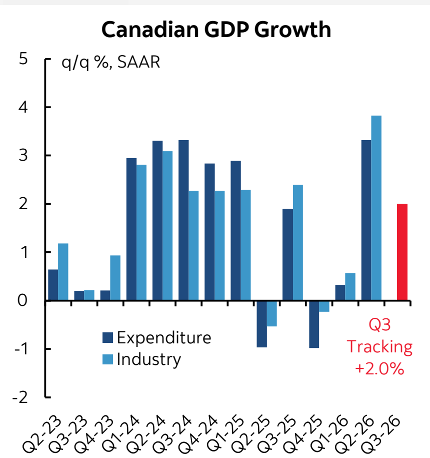
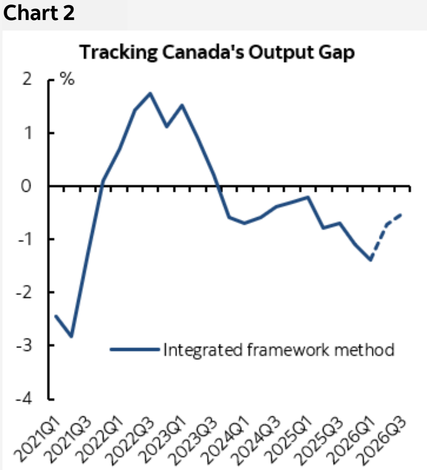
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Source: Scotiabank Economics.

Canada's Resilient Economy is Rapidly Closing Slack — Pressuring the BoC to Tighten

- **GDP was revised up to 3.8% in Q2…**
- **…and is tracking 2% in Q3…**
- **…as August posted solid growth after a flat July…**
- **…because of prior upward revisions**
- **The traditional output gap has been cut by two-thirds in two quarters…**
- **…opening the door to the BoC lifting off…**
- **…from the lower end of neutral and a negative real rate with soft C$**

Canadian GDP, m/m % SA, July:
Actual: 0.0
Scotia: 0.1
Consensus: 0.0
Prior: +0.4 (revised up from 0.3%)
August 'flash': +0.2

Canada's economy is proving to be much more resilient in Q3 than negative nellies feared after a strong second quarter that itself was revised to be stronger this morning. The result is that slack is being rapidly eroded with the takeaway being that the Bank of Canada probably needs to get on with tightening policy. Canada's 2-year yield climbed 2–3bps and CAD was flat post-data with the BoC priced as a coin flip in a month's time and 32bps priced for December's meeting.

July GDP matched consensus at 0.0% m/m SA against those of us who were a tick higher. The only reason for it not being higher is because June GDP was revised up a tick to solid growth of 0.4% which posed a higher than expected jumping off point.

August GDP is guided by Statcan to be tracking a gain of 0.2% m/m on a preliminary basis. I'm tracking a touch higher.

The result is that very strong growth in Q2 is being followed by decent growth in Q3 (chart 1). Q2 GDP growth was revised up from 3.6% q/q SAAR to 3.8% as Statcan revised up both April and June GDP by a tenth. Q2 GDP growth is tracking 2% q/q SAAR based on what we know about Q2 and most of Q3 while assuming September GDP will be flat solely in order to avoid skewing the math before we get any September data.

These quarterly estimates are based on monthly production-side accounts whereas the BoC and most shops put more stock in quarterly expenditure-based GDP accounts that do a better job at capturing volatile inventory and net trade effects.

But 2% after 3.8%? I'll take that!! Recall that after Canada posted strong

Q2 growth there were fears in some quarters—some legitimate, some biased—that growth would disappoint in Q3 and possibly retreat. That hasn't happened.

The traditional output gap (potential minus actual divided by potential GDP) is tracking around -0.5% in Q3 if the upward revision to Q2 monthly GDP flows through to a similar upward revision to quarterly accounts and based on Q3 tracking. It was about -1.4% in Q1 (chart 2).

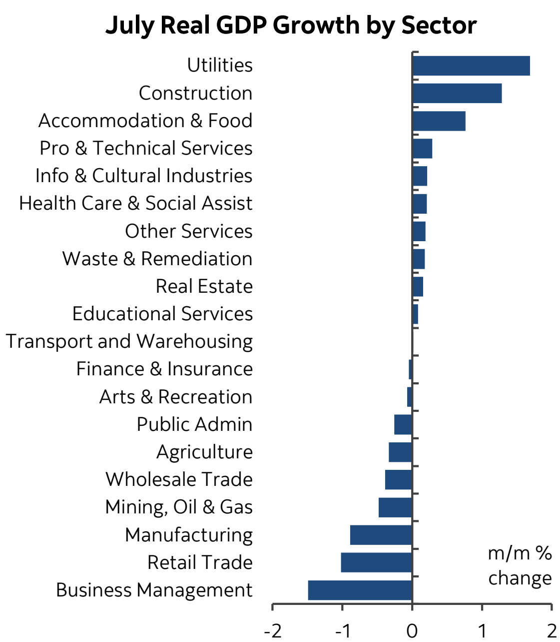
In other words, slack has been cut by two-thirds in just two quarters. There is only a fairly small amount of slack left in the economy and it's likely to close into 2027 and will probably be overwhelmed from an inflation standpoint by other factors. Tariffs? Oh please. DJT's gift to Canada has been high commodities and a weak C$.

Since monetary policy effects are lagged by 6–18 months for the most part, this continues to suggest that the BoC had better get on with it. Not in reckless fashion, but if you're close to eliminating slack within the monpol horizon and there are other drivers of inflation, then you probably don't need to still hang out at the lower end of the neutral rate range with a roughly zero to negative real policy rate and an undervalued C$.

Charts 3 and 4 show the breakdown of July figures in terms of unweighted and weighted contributions respectively. It was mixed. Upsides came from construction and utilities with smaller gains in about seven other sectors. There were also notable downsides like manufacturing, mining and oil and gas extraction and retail. Recall, however, that both manufacturing and retail had posted super-sized gains in June, so some takeback in July isn't all that surprising.

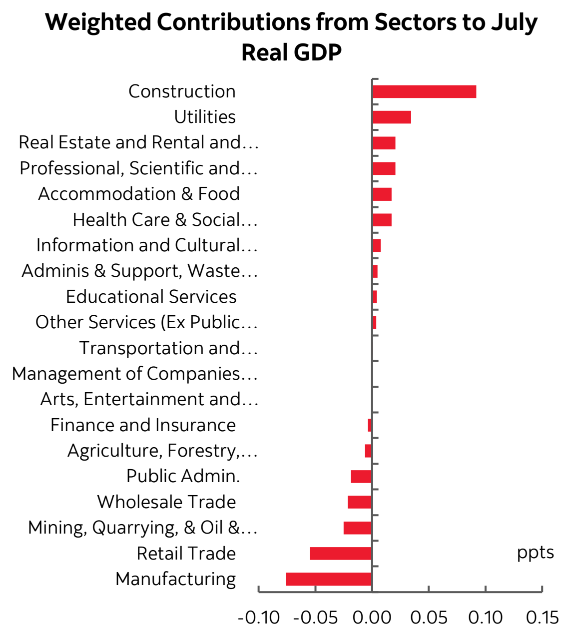
As for August, we don't get numbers for the flash August estimate, only verbiage: "Increases in mining and quarrying and retail trade were partially offset by decreases in oil and gas extraction."

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

Chart 4



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