Economics

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Canadian GDP: Just don't dig too far

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National accounts (period/period % chg, annual rate, unless otherwise noted)	2021	21:Q4	22:Q1	22:Q2	22:Q3	Q3 Y/Y
Real GDP (chained 2012$)	5.0	6.9	2.8	3.2	2.9	3.9
• Final domestic demand	5.8	3.7	3.0	2.4	-0.6	2.1
• Household consumption	5.1	1.3	2.3	9.5	-1.0	2.9
• Government	5.5	3.0	0.7	-2.2	3.9	1.3
• Residential investment	14.9	11.7	8.8	-31.5	-15.4	-8.4
• Business fixed investment	4.3	14.7	7.7	17.0	4.3	10.8
• Bus inventory investment ($Bn)	-4.4	6.9	19.9	55.3	57.4	NA
• Exports	1.4	16.2	-7.6	8.1	8.6	6.0
• Imports	7.8	20.4	0.2	29.5	-1.5	11.4
GDP implicit chain price index	1.5	7.9	13.0	13.3	-5.4	17.0
Pre-tax profits	11.9	41.0	20.1	56.0	-30.7	49.7
Real disposable income	1.7	-9.5	10.6	-4.2	0.3	-1.0
Personal savings rate (%)	16.3	6.5	8.8	5.1	5.7	NA

Source: Statistics Canada

- On the surface, the Canadian economy performed much better than expected in Q3, with GDP rising by 2.9% (consensus +1.5%) and representing only a modest cooling relative to the prior quarter. However, the more you dig into the detail, the weaker the economy looks, with growth driven largely by exports and inventory building. Domestic demand was actually lower than in the prior quarter, with that drop including an unexpected decline in consumer spending. Because of this, the stronger headline growth figure shouldn't be a concern for the Bank of Canada, and we continue to see only a further 50bp of tightening to a peak interest rate of 4.25%.
- The primary driver of growth in Q3 was exports, with the 8.6% increase in volume terms led by oil and agriculture. Combined with a modest decline in imports, net trade contributed 3.4%-pts to the headline reading. While we expect Canadian exports to continue to fair well even in the face of a slowing global economy, due to demand for non-Russian resources and easing supply disruptions in autos, the pace of growth should be expected to slow. A modest acceleration in the pace of stock building from an already strong prior quarter meant that inventories contributed +0.2%-pts to the headline reading as well. Stock building has been necessary following pandemic-related supply chain disruptions. However, with the economy wide stock to sales ratio now slightly above its Q4 2019 level, inventory building will likely slow and turn into a drag on growth in the coming quarters.
- Business investment (+4.3%) and government spending (+3.9%) also contributed to growth during the quarter. However, overall domestic demand was down (-0.6%), as these positives were offset by ongoing weakness in housing and an unexpected decline in consumer spending. While household spending on services continued to increase, the pace of growth slowed and failed to offset a decline in goods consumption. While spending on services is above its pre-pandemic peak in level terms, it remains below the trajectory it was on prior to 2019 suggesting that there is still pent up demand. As such, the unexpected decline in consumer spending this quarter could be an early

sign that higher interest rates and the squeeze from inflation are impacting spending decisions. While inflation adjusted incomes rose during the current quarter, the increase was only modest (+0.3%) and offset only a small proportion of the squeeze seen in Q2. Real disposable incomes remain down on a year-over-year basis.

- While GDP growth was stronger than expected in real terms, the decline in commodity prices from their earlier peak meant that the value of economic output (nominal GDP) was actually lower than in the prior quarter.
- Monthly data showed the economy decelerating as the third quarter progressed, and at the start of Q4. September GDP was in line with expectations at +0.1%, however the advance estimate for October showed that activity was "essentially unchanged".

Implications & actions

Re: Economic forecast — While headline growth was stronger than expected in Q3, it shouldn't change the trajectory for Bank of Canada policy. The rise in inventory ratios and weakness in domestic demand should be a signpost of weaker domestically-driven inflationary pressures in the future. As such, we continue to expect a final 50bp rate hike to a peak of 4.25%, before the Bank moves to the sidelines in 2023 to observe how the economy is coping with these higher interest rates.

Re: Markets — Market reaction was somewhat mixed, with bond yields higher but the Canadian dollar modestly weaker following the data release.

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