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Canadian GDP: Cooler trends

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National accounts (period/period % chg, annual rate, unless otherwise noted)	2021	21:Q3	21:Q4	22:Q1	22:Q2	Q2 Y/Y
Real GDP (chained 2012$)	4.5	5.3	6.6	3.1	3.3	4.6
• Final domestic demand	5.6	7.3	3.7	3.5	2.9	4.3
• Household consumption	5.0	20.1	1.8	2.6	9.7	8.3
• Government	5.6	2.7	2.9	2.8	-1.2	1.8
• Residential investment	15.3	-30.3	12.4	7.3	-27.6	-11.7
• Business fixed investment	2.3	2.3	10.2	9.0	13.9	8.8
• Bus inventory investment ($Bn)	-2.5	-12.7	4.0	15.2	47.0	NA
• Exports	1.4	6.6	13.6	-9.0	10.9	5.2
• Imports	7.7	-1.2	16.9	-1.4	30.5	10.4
GDP implicit chain price index	1.5	5.2	7.9	12.7	14.0	18.9
Pre-tax profits	11.1	-22.2	28.7	33.2	62.8	54.5
Real disposable income	1.6	-4.3	-9.0	13.9	-3.8	-1.2
Personal savings rate (%)	16.6	9.5	6.9	9.5	6.2	NA

Source: Statistics Canada

- As the weather heated up, the Canadian economy was cooling down. While growth in Q2 as a whole was solid at an annualized +3.3%, and little changed from Q1's pace, it was disappointing relative to consensus expectations (+4.4%) and was largely driven by an acceleration in early spring. The latest monthly GDP figures, including an advance estimate for a slight decline in July, have shown a broadly flat trend starting in May. While we still expect that the Bank of Canada will hike interest rates further to combat high inflationary pressures, a cooling economy supports our view that the peak will be lower than financial markets have been pricing in.
- GDP growth in the second quarter was driven largely by a surge in consumer spending on services, as restrictions continued to ease and demand for travel, dining out etc. recovered more fully. The surge in services spending contributed +4.3%-pts to the headline reading, managing to outweigh a big -3%-pts negative contribution from the slowdown in housing (particularly resale activity). While inventories made a big positive contribution to growth (+5.9%pts), that rebuilding of stocks was helped by a surge in imports. Net trade made a big negative contribution to Q2 GDP (-5.2%-pts) which was of similar magnitude to the positive from inventories.
- Unfortunately from a consumer inflation point of view, the rebuilding of inventories in the economy as a whole did little to change the stock-to-sales ratio within the retail sector. At 0.369, this ratio was little changed from the prior quarter and still well below where it stood prior to the pandemic (around 0.5). While today's figures suggest that the household savings rate (6.2%) remains higher than it was before the pandemic, despite the surge in spending this quarter, the data also showed that inflationary pressures are taking a bite out of disposable incomes. In real terms, disposable incomes fell by an annualized 3.8% on the quarter.
- The growth rate in Q2 as a whole largely reflected an acceleration in early spring, with monthly data suggesting that the economy was losing momentum as the quarter progressed. The monthly print for June showed only a 0.1%

increase, following a flat prior month. Meanwhile the advance estimate for July suggests activity edged down by 0.1%. Those figures make it unlikely that third quarter growth will reach the +2% MPR forecast from the Bank of Canada.

- The details for June's monthly GDP showed that while recoveries in hotels & restaurants, air travel and arts & entertainment continued, they were at a slower pace than seen in previous months potentially due to supply constraints starting to come into play. Real estate, finance and construction continued to see declines in activity, likely related to the rapidly cooling housing market.

Implications & actions

Re: Economic forecast — Today's GDP figures were far from a disaster, and still show that the Canadian economy managed to achieve solid growth during a period of time that the US economy was contracting. However, somewhat cooler growth in Q2 and Q3 than the Bank of Canada recently forecasted should give policymakers comfort that inflation will start to ease more meaningfully later in the year without interest rates needing to move too far into restrictive territory. We still forecast a 75bp hike from the Bank next week, that will take the overnight rate to 3.25% and into a range that policymakers think is restrictive (above 3%). However, we also expect a pause after that as the Bank reassess the impact of these restrictive rates on growth and inflation.

Re: Markets — Bond yields and the Canadian dollar moved lower after the release, as markets reassessed just how aggressive the Bank of Canada would have to be in terms of interest rate hikes to cool growth and inflation.