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Canadian GDP: growth is hardly on fire

by **Katherine Judge** katherine.judge@cibc.com

National accounts (period/period % chg, annual rate, unless otherwise noted)	2022	22:Q3	22:Q4	23:Q1	23:Q2	Q2 Y/Y
Real GDP (chained 2012$)	3.4	2.3	-0.1	2.6	-0.2	1.1
• Final domestic demand	2.7	-0.9	0.2	1.2	1.0	0.4
• Household consumption	4.8	0.3	1.1	4.7	0.2	1.6
• Government	2.0	3.2	3.5	-1.7	2.0	1.7
• Residential investment	-11.2	-18.4	-9.9	-19.1	-8.2	-14.0
• Business fixed investment	8.0	1.0	-5.1	5.7	10.3	2.8
• Bus inventory investment ($Bn)	39.8	53.5	24.8	15.5	11.3	NA
• Exports	2.8	11.3	2.2	10.2	0.4	5.9
• Imports	7.5	-2.3	-12.6	0.7	1.9	-3.2
GDP implicit chain price index	7.2	-4.8	-2.8	0.6	2.9	-1.1
Pre-tax profits	8.4	-28.5	-41.3	-25.9	-26.7	-30.9
Real disposable income	-0.4	-0.7	5.2	-5.0	6.5	1.4
Personal savings rate (%)	6.1	4.7	5.8	3.7	5.1	NA

Source: Statistics Canada

- Forest fires may be taking a few decimal places off the data, but the Canadian economy is hardly on fire in terms of growth, casting doubts on claims that it can shrug off the impact of higher interest rates. After what looks like a one quarter flash in the pan, GDP contracted in the second quarter, making the last rate hike seem like overkill, and virtually ruling a further hike next week.
- The -0.2% annualized quarterly change was in stark contrast to the consensus expectation of 1.2%, and the Bank of Canada's last published forecast of 1.5%. A sharp drop in housing investment compounded slower inventory investment and sluggish export growth, while consumption growth slowed to 0.2% annualized, with the first quarter's spending spree now looking like a-one off amidst tame readings in three of the last four quarters. So much for the consumer resilience that the BoC had cited as a reason to press on with still-higher rates. Adding to the dismal report was the advance GDP estimate for July, which suggested a flat month after a decline in June, setting the stage for a weak third quarter in which the rise in the unemployment rate will likely weigh on consumer activity further.
- Real disposable incomes rebounded in the second quarter on solid employee compensation, but households opted not to spend all of the increase, and consumer caution was on full display in the climb in the savings rate to 5.1% after it fell to 3.7% in the prior quarter. That's an elevated level relative to pre-pandemic norms, but is roughly in line with what was seen in the second half of 2022, and consistent with how high interest rates tilt decisions towards less borrowing and spending, and more saving.
- The sharp slowdown in consumer demand reflected a slight negative for services consumption, including a 3.6% annualized drop in food and accommodation consumption, and a drop in durable goods categories including recreational items, and areas tied to the housing market, such as furniture. New passenger car purchases were down after surging in the first quarter, and demand could be limited by the impact of higher rates ahead.

- The decline in housing investment was somewhat surprising given the pickup seen in unit home sales, but it reflected a drop in new construction and renovation activities. Weaker construction isn't of course great news for inflation in housing, but the general slowing in activity and labour markets should, overall, still be disinflationary.
- The other big negative for the quarter was slower inventory investment amidst bloated inventories relative to the pace of sales in the economy, a result of flagging demand for goods. It's not just domestic consumer demand that is flagging, as goods exports fell by 2.1% annualized. Some of that likely reflected disruptions to energy production due to fires in Alberta, but global growth prospects look soft enough at this point to suggest that trade won't help much from here.
- Final domestic demand decelerated only by a touch, to 1.0% annualized from 1.2% in Q1, but that reflected a rebound in government spending that masked weakness in the private sector. Business investment accelerated, but is only marginally above its 2019 level, and still well below where we stood in 2014 before weaker energy prices and a tougher regulatory climate took the steam out of the oil/gas sector's contribution.
- The -0.2% quarterly figure was in contrast to what had been implied by the monthly GDP by industry figures, as there were negative revisions to those figures in the GDP by industry release that coincided with today's quarterly release. Importantly, the advance monthly GDP estimate for July suggested no growth following a weak handoff of -0.2% m/m in June, setting the stage for a weak third quarter. Statistics Canada did not elaborate on the degree to which the July advance estimate was impeded by the port strikes in BC, although the transportation industry was noted as one of the sectors that was contracting.

Implications & actions

Re: Economic forecast — The deterioration in consumption will likely prevent any further hikes from the BoC from here. The third quarter also looks to be off to a weak start, and should contribute to the trend towards more labour market slack, a key ingredient in quelling domestically-fueled inflation ahead.

Re: Markets — Bond yields fell and the Canadian dollar weakened after today's data, as the case for any further Bank of Canada action melted away on the downside miss.