Economic Flash!

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Johnny Canuck's Q3 Report Card: Needs to Do Better

Per/Per % chg, Annual Rate	2017	17:Q4	18:Q1	18:Q2	**18:Q3**	**Q3 Y/Y**
Real GDP (chained 2007$)	3.0	1.7	1.7	2.9	**2.0**	**2.1**
Final Domestic Demand	3.1	4.3	2.2	1.8	**-0.1**	**2.1**
Household Consumption	3.6	2.4	1.5	2.3	**1.2**	**1.8**
Government	2.7	6.1	2.3	1.2	**1.9**	**2.9**
Residential Investment	2.4	12.5	-7.9	-0.1	**-5.9**	**-0.7**
Business Fixed Investment	2.5	7.7	13.0	1.0	**-7.1**	**3.4**
Bus Inventory Investment ($Bn)	17.7	16.0	16.8	13.2	**6.9**	**NA**
Exports	1.1	5.7	2.3	13.0	**0.9**	**5.4**
Imports	4.2	7.7	4.7	5.9	**-7.8**	**2.4**
GDP Implicit Chain Price Index	2.6	4.6	1.5	1.5	**3.0**	**2.6**
Pre-tax Profits	20.1	2.5	1.5	13.4	**19.0**	**8.8**
Real Disposable Income	3.4	2.6	-1.8	2.5	**1.2**	**1.1**
Personal Savings Rate (%)	1.5	2.3	1.3	1.0	**0.8**	**NA**

- The quarterly GDP figures can be thought of as a report card on Canada's economy, and in this case, the message from the teacher is that Johnny Canuck needs to do better. The overall GPA was fine, with a 2.0% growth rate for real GDP being close to what we can sustain without an inflationary overheating, but the drop in output in September, and in business investment in the quarter, aren't good news for what lies ahead.
- Rate hikes and mortgage regulations are having their intended impacts in slowing credit-fueled activity. Consumer spending grew at a modest 1.4% annualized rate on a drop in durables. Moreover, the historical series for the personal savings rate has been revised sharply lower (on weaker incomes). It was only 1.5% in 2017 (vs. a previously reported 3.8%), and sits at a mere 0.8% after Q3, implying much less room for consumption growth ahead. Housing's contribution to growth was a negative in Q3, its third successive drop.
- But the Bank of Canada was hoping that business capital spending would emerge as a replacement for housing as a growth driver, and in Q3 it went the other way, as companies reduced equipment and structures by roughly 7% annualized. That is still coming down after a very brisk start to the year. Part of this was the energy sector where some projects were winding up, but unless oil stages a big rebound soon, the energy sector could be at least

somewhat of a negative for 2019. Transportation equipment and other manufacturing sectors saw a reduction in equipment spending in the quarter.

- There was weakness in inventories in Q3 on a sharp reduction in stockbuilding, but that doesn't signal a ramp-up in Canadian production ahead. Note that imports were also down in the quarter, and domestic manufacturing inventory actually picked up in the quarter. Moreover, the level of inventories in Q3 was still higher relative to sales than in Q2.
- Exports managed a modest climb in the quarter against the drop in imports. But on the home front, final domestic demand fell slightly in the quarter. That underscores our thesis that the Bank of Canada will have to be careful not to overdo rate hikes ahead, as we need to sustain at least moderate domestic demand to keep the economy in gear.
- The monthly GDP series for September registered a -0.1%, weaker than our below-consensus call for a flat outcome. There were broad-based declines in the goods sector, and weakness in wholesaling, behind that result. The fact that the quarter ended with a thud means that we'll need to see a much better October to have Q4 growth tracking something close to 2%.

Implications & Actions

Re: Economic Forecast — Today's data were a touch above our quarterly projection, but a bit worse than what we expected for September. Our Q4 GDP forecast for a 1.9% pace looks in jeopardy unless Johnny Canuck does a lot better in October, and we'll need to see that, as well as at least some upturn in oil, to avoid pushing back our forecast for a January rate hike. That said, the details here are in line with our view that 2019 will see fewer rate hikes than the consensus forecast, or what the Bank of Canada seemed to be hinting at in October.

Re: Market Impact — The headline results were in line with expectations for the quarter, but the weaker September figure may have been behind a modest dip in 2-year yields.