



Economic Flash!

March 2, 2018

Avery Shenfeld (416) 594-7356

Hot Canadian Spending, Lukewarm GDP

Per/Per % chg, Annual Rate	2017	17:Q1	17:Q2	17:Q3	17:Q4	Q4 Y/Y
Real GDP (chained 2007\$)	3.0	4.0	4.4	1.5	1.7	2.9
Final Domestic Demand	3.0	4.5	3.6	3.9	3.9	4.0
Household Consumption	3.5	3.5	4.6	3.7	2.1	3.5
Government	2.5	2.5	1.1	4.8	4.0	3.1
Residential Investment	3.1	9.4	-2.9	-0.2	13.4	4.7
Business Fixed Investment	2.6	12.1	9.5	5.4	8.2	8.8
Bus Inventory Investment (\$Bn)	13.9	10.8	13.6	17.0	14.2	NA
Exports	1.0	2.7	6.3	-10.4	3.0	0.2
Imports	3.6	13.9	6.2	0.3	6.3	6.6
GDP Implicit Chain Price Index	2.3	3.2	-0.3	0.0	5.0	1.9
Pre-tax Profits	20.2	37.2	-7.4	-3.5	15.0	8.9
Real Disposable Income	3.7	-1.2	5.7	6.3	3.0	3.4
Personal Savings Rate (%)	3.6	3.0	3.1	4.0	4.2	NA

Canadian business, governments and households are spending with abandon, so they aren't to blame for a slower pace to growth in the latter half of 2017. It's our trading partners, who aren't as enthusiastic about what we have to sell them, who have been the trouble spot for production here. That, and a slower pace to inventory building, held GDP growth in Q4 to 1.7%, matching our forecast but a few ticks below consensus expectations, and weak exports were also the tale in a downward-revised 1.5% pace to Q3. Note that an upward revision to Q1 meant that GDP for 2017 came in at 3.0%, a tick higher than we had expected.

The lukewarm gain in real economic output in the final quarter masked solid real domestic demand, which ran at a 3.9% annualized rate, matching the third quarter pace. Consumer spending eased to a still healthy 2.1% gain, but that was well backed by income growth, with the savings rate moving up two ticks to 4.2%. Retail sales ended December on a down note, and we expect that despite an improvement in compensation, given high debt levels and now-higher interest rates, consumption will remain relatively moderate in 2018 when compared to the torrid pace we saw through the first three quarters of 2017.

But households were still snapping up houses ahead of tighter mortgage rules this year, and overall residential construction spending surged in the final quarter. That was joined by an upturn in business investment spending, although recent data on plans for 2018 suggest that momentum isn't slated to continue. Remember those big government infrastructure plans? They finally showed up in both of the final two quarters of 2017.

The trade front hasn't had a lot of good news, and Q4 was a mixed report at best. Export volumes recovered less than a third of the drop in Q3, and were outpaced by imports. The only blessing was that

export prices ran faster than those for imports in Q4, lifting the value of what Canadians can buy at home and abroad from what they produced, as reflected in real gross national income advancing at a roughly 4% annual rate.

Inventories had been piling up at an aggressive rate in Q3, and we expected that to ease in Q4. However, you can't simply drop the inventory swings from the GDP figures and argue that without the easing in stock building, GDP growth would have been that much faster. In an open economy, inventory building often is as much tied to imports as domestic production. Moreover, the level of Q4 inventory building was still elevated relative to the norm, so we might face still another quarter of even leaner production for inventory building.

Implications & Actions

Re: Economic Forecast — The GDP news matched our Q4 forecast, and although the December monthly tally, at +0.1%, beat our flat forecast, we don't see anything in the data to change our projections. Q1 could rebound above 2%, but overall, despite healthy domestic demand, we're clearly past the surge activity that coloured the first half of 2017. While including healthy domestic demand, the data were decidedly softer than the Bank of Canada's 2.5% expectation from their last forecast, and the central bankers will want to see some evidence that growth is rebounding to above potential before hiking again. That's consistent with our view that the next rate hike, and likely the only remaining one for 2018, won't be seen until July.

Re: Market Impact — Canadian short bond yields were actually marginally higher after the release, perhaps reflecting the underlying health in domestic demand within the report. The Canadian dollar has lost a lot of ground of late and didn't move much on the news, with a lot of concern about a potential trade war looming with the US.

This report is issued and approved for distribution by (a) in Canada, CIBC World Markets Inc., a member of the Investment Industry Regulatory Organization of Canada, the Toronto Stock Exchange, the TSX Venture Exchange and a Member of the Canadian Investor Protection Fund, (b) in the United Kingdom, CIBC World Markets plc, which is regulated by the Financial Services Authority, and (c) in Australia, CIBC Australia Limited, a member of the Australian Stock Exchange and regulated by the ASIC (collectively, "CIBC") and (d) in the United States either by (i) CIBC World Markets Inc. for distribution only to U.S. Major Institutional Investors ("MII") (as such term is defined in SEC Rule 15a-6) or (ii) CIBC World Markets Corp., a member of the Financial Industry Regulatory Authority. U.S. MIIs receiving this report from CIBC World Markets Inc. (the Canadian broker-dealer) are required to effect transactions (other than negotiating their terms) in securities discussed in the report through CIBC World Markets Corp. (the U.S. broker-dealer).

This report is provided, for informational purposes only, to institutional investor and retail clients of CIBC World Markets Inc. in Canada, and does not constitute an offer or solicitation to buy or sell any securities discussed herein in any jurisdiction where such offer or solicitation would be prohibited. This document and any of the products and information contained herein are not intended for the use of private investors in the United Kingdom. Such investors will not be able to enter into agreements or purchase products mentioned herein from CIBC World Markets plc. The comments and views expressed in this document are meant for the general interests of wholesale clients of CIBC Australia Limited.

This report does not take into account the investment objectives, financial situation or specific needs of any particular client of CIBC. Before making an investment decision on the basis of any information contained in this report, the recipient should consider whether such information is appropriate given the recipient's particular investment needs, objectives and financial circumstances. CIBC suggests that, prior to acting on any information contained herein, you contact one of our client advisers in your jurisdiction to discuss your particular circumstances. Since the levels and bases of taxation can change, any reference in this report to the impact of taxation should not be construed as offering tax advice; as with any transaction having potential tax implications, clients should consult with their own tax advisors. Past performance is not a guarantee of future results.

The information and any statistical data contained herein were obtained from sources that we believe to be reliable, but we do not represent that they are accurate or complete, and they should not be relied upon as such. All estimates and opinions expressed herein constitute judgments as of the date of this report and are subject to change without notice.

This report may provide addresses of, or contain hyperlinks to, Internet web sites. CIBC has not reviewed the linked Internet web site of any third party and takes no responsibility for the contents thereof. Each such address or hyperlink is provided solely for the recipient's convenience and information, and the content of linked third-party web sites is not in any way incorporated into this document. Recipients who choose to access such third-party web sites or follow such hyperlinks do so at their own risk.

© 2018 CIBC World Markets Inc. All rights reserved. Unauthorized use, distribution, duplication or disclosure without the prior written permission of CIBC World Markets Inc. is prohibited by law and may result in prosecution.