Economic Flash!

December 21, 2018

Avery Shenfeld (416) 594-7356

Canadian GDP: Something for Under the Tree

Per/Per % chg	18:Q2*	18:Q3*	Aug	Sep	Oct	**Oct Y/Y**
GDP (at Basic Prices)	2.9	1.5	0.1	-0.1	0.3	**2.2**
Goods-producing	2.5	-1.2	-0.2	-0.8	0.3	**1.8**
Services-producing	3.1	2.4	0.2	0.2	0.3	**2.4**
Business	3.0	1.4	0.1	-0.1	0.3	**2.2**
Non-business	2.7	1.7	0.1	0.0	0.2	**2.1**

** annualized*

- Canada's economy was in desperate need of a Christmas present, and October's return to growth was at least something to put under the tree this week. The 0.3% rise in monthly GDP matched our call but was a tick above consensus, and came after two months with zero growth overall. Real GDP is up at a respectable 2.2% pace from a year ago using these monthly measures, a few ticks above what the Bank of Canada sees as its non-inflationary potential. But the weak handoff from August and September means that Q4 growth is likely to be below that speed limit, and weaker than the Bank of Canada had projected in its October forecast.
- Gains were led by a 0.7% bounce in manufacturing after a matching decline the prior month, although the earlier shipments data suggested that some of that growth was to feed inventories rather than actual sales. Real factory GDP is up 3.3% in the past year, but the signposts for what lies ahead aren't as encouraging, given cooling global growth.
- We were also looking for a climb in oil production after some earlier disruptions and maintenance shutdowns, and the 3.6% climb in that sector didn't disappoint. But voluntary production cuts in Alberta that began in November, and a mandatory cut in the new year, will leave the sector as a drag on growth through Q1.
- Construction activity eased 0.1% in October, and is now 2.2% lower than a year ago. The cooling housing sector is showing its mark in the most recent month, and a high level of condo completions in the next couple of years will leave the sector as a drag on growth unless new starts surprise on the high side.
- Services growth was slightly above trend with a 0.3% real gain in October. Retailing wasn't part of that story, with GDP up a lean 0.1% and standing -1.2% from a year ago. Today's retail sales figures for October were a tick below our call and two ticks below consensus with an autos-driven 0.3% gain, but that was only flat in volume terms. We're expecting a reasonably

good holiday shopping season, with slower housing activity and cheaper gasoline leaving more money for discretionary gift purchases. Earlier package delivery issues due to a postal strike may also have encouraged Canadians to shop domestically in the holiday period rather than ordering online from US sites.

Implications & Actions

Re: Economic Forecast — The 0.3% gain matched our forecast, and we'll need good ex-energy figures over the balance of the quarter to hit our 1.7% forecast for Q4 GDP given the coming drop in crude output. That's below what the Bank of Canada sees as the country's non-inflationary trend, so it's not enough to make a case for a rate hike in January, particularly with oil prices still in a nose-dive. Q1 GDP will also be held back by additional energy production cuts, so our call for two Bank of Canada rate hikes in 2019 will depend on seeing better news in the rest of the economy, and at least some visible upturn in global oil prices.

Re: Market Impact — The better than consensus GDP figures should have been a bit supportive for the Canadian dollar and negative for short-term fixed income securities, but were not really enough to move the needle in pre-holiday trading. The Bank of Canada outlook survey is out at 10 AM, and given the degree to which Governor Poloz seems to rely on it, the market might be waiting for that news before reacting today.