Scotiabank Nowcast: Strong Jump in Manufacturing Sales Pushes Q2-2019 Up to 2.8%

This note is part of a series that will be published after important data releases, documenting mechanical updates of the nowcast for Canadian GDP coming from the Scotiabank nowcasting model. The evolution of this nowcast will inform Scotiabank Economics' official macroeconomic outlook.

The model is described in a related note here. Changes to the model this quarter are detailed in the box on page 2.

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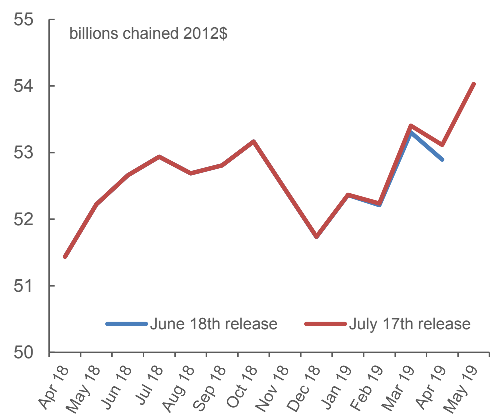
- **Real manufacturing shipments jumped 1.7% m/m in May, buoyed by a sharp increase in shipments of durable goods (+3.0% m/m). Sales of transportation equipment posted the largest gains (+7.8% m/m) in real terms, in a snapback as the assembly plants came back online after maintenance shutdowns in April.**
- **A continuing rise in inventory levels in May shows that a) there is as yet no evidence of inventory drawdown that could have been expected to offset some of the strength in international trade in terms of GDP impact, and b) going forward growth might suffer as businesses attempt to get their stock-to-sales ratios under control.**
- **The shipments data is consistent with a significant expansion in exports in May that Statistics Canada reported at the beginning of July, and supports our view of a rebound in activity in Q2-2019, pushing our nowcast up to 2.8% Q/Q SAAR, slightly stronger than the latest Bank of Canada forecast of 2.3% (July MPR). The industry-level GDP is expected to expand by 0.18% m/m in May.**

Table 1: Canadian GDP Nowcast, Q2-2019

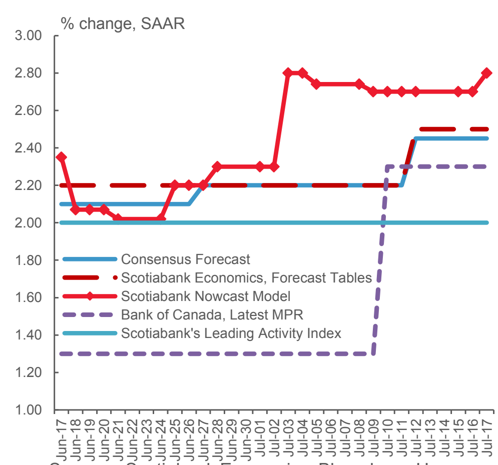
	Nowcast Date	Q2-2019 GDP Growth, %	GDP by industry, %m/m Apr actual	May	Jun
Previous nowcast	*09-Jul-19*	2.70	0.26	0.13	0.29
Revisions		0.00			
Manufacturing sales, Canada		+0.10			
Manufacturing inventories, Canada		0.00			
Current Nowcast	*17-Jul-19*	2.80	0.26	0.18	0.28

Chart 1: Manufacturing Shipments, Canada



Sources: Scotiabank Economics, Haver Analytics, Statistics Canada

Chart 2: The Evolution of the Scotiabank Economics Q2-2019 Nowcast



Sources: Scotiabank Economics, Bloomberg, Haver Analytics.

Box 1. Changes to the Nowcasting Model

Starting in Q2-2019 we made the following tweaks to the model used for the Canadian GDP nowcast. A recent paper from the Bank of Canada points out that revisions to monthly GDP for the first month of the quarter are very significant, construction industry being one of the most heavily-revised (see Rizetto, P., 2018. GDP by industry in real time: are revisions well-behaved? Staff analytical note 2018-40, Bank of Canada). Given that in Q1-2019 the main reason for the forecast miss was data revisions and construction industry in particular, we made the following modifications to capture these aspects of the Canadian data:

1) Within a given quarter we treat observed monthly GDP as more uncertain than later vintages. This implies that first releases of monthly GDP are compared against all other available data and the model is used to back-cast monthly GDP in real-time. Technically this is accomplished by increasing the variance in the observation equation related to monthly GDP.

2) In order to cover real estate and construction in more detail we add average seasonally adjusted house price in Canada, as reported by CREA. This is also in line with evidence that house prices have leading information for Canadian GDP (see Lalonde, Perevalov, 2019, A New Approach to Forecasting Economic Downturns).

Other data we included are i) a measure of equity prices (S&P TSX index), and ii) Canadian employment from the Labour Force Survey.