Canada's Economy Continues To Beat Expectations

- **Canada's economy beat expectations in October…**
- **...and guidance points to sustained gains in November**
- **Q4 GDP is tracking above BoC expectations…**
- **...as lock downs bite into conditions into near-term prospects…**
- **...with vaccines on the way**
- **Spare capacity forecast to close in 2022**

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Canada GDP, m/m % change, October, SA :
Actual: 0.4
Scotia: 0.2
Consensus: 0.3
Prior: 0.8
November guidance: 0.4

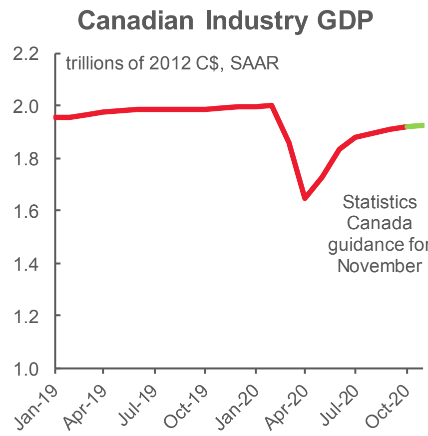
Canada's economy solidly beat expectations not only for the month of October but also in terms of preliminary guidance for November. There is obvious downside risk that is emerging from December through the winter months as lockdowns and restrictions bite once again, but it's important to acknowledge that a) the economy has continued to perform better than many had thought possible right up to November, and b) the earlier than expected arrival of vaccines combined with pent-up demand from the renewed lockdowns should lend greater confidence toward expecting a more sustained expansion.

GDP grew by 0.4% m/m and that doubled StatsCan's initial guidance that had indicated an advance of 0.2% m/m. **Preliminary guidance for November indicates the economy grew by another 0.4%** m/m. We had advised that the tone of the November data was looking solid on balance including hours worked as an offset to the late month lockdown in the Toronto area and restrictions elsewhere.

Current tracking for Q4 indicates GDP growth of 6.3% q/q at an annualized rate following 42% growth in Q3 using the monthly GDP figures. After contracting by 18% from February to April, the economy has now recovered 98% of the initial pandemic hit and it took just seven months to do so. We'll see weaker figures going forward through at least December and January, but put this in perspective by noting that the portion of consensus that believed this would be a deflationary depression that would take a decade to recover from while walloping stocks has been absolutely dead wrong to date. The economy has rebounded faster than anticipated and core inflation remains sticky and just a few tenths beneath the BoC's target.

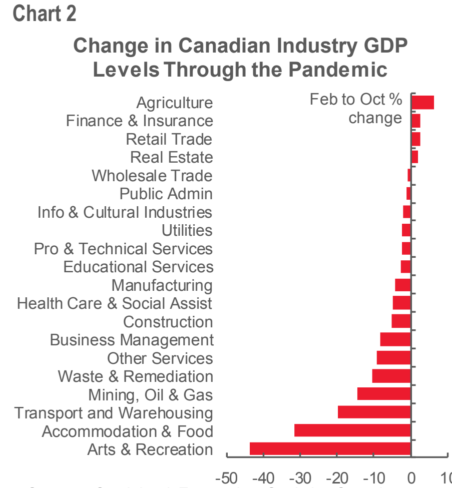
Chart 1 shows the progress to date. Chart 2 shows where individual sectors of the economy now stand in relation to their output back in February in order to provide a depiction of the unevenness of the recovery. Some sectors like agriculture,

Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

finance, retail and real estate have more than recovered. Some barely remain in contraction like wholesale, public administration, info/culture, utilities, professional services and education. About a half dozen sectors are where the recovery still has a long way to go and particularly arts and recreation, accommodation and food services and transportation/warehousing.

Chart 3 shows a break down of the GDP growth by sector unweighted for their relative importance.

So what does it mean to the BoC? On balance I still think there are greater odds that Canada is on track to close spare capacity earlier than the BoC forecast in its October MPR rather than later as the tracking risks to their forecasts generally land on the more optimistic side of the picture on balance (chart 4).

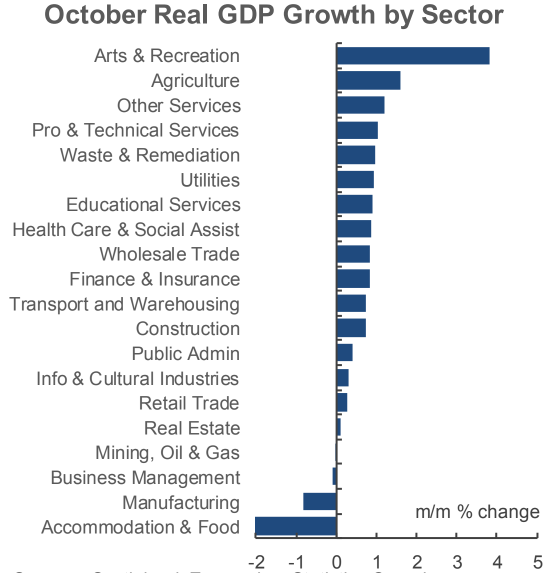
For starters, Q4 is blowing the barn doors off the BoC's projection, so far. The BoC had forecast 1% annualized Q4 GDP growth on an expenditure basis and at this point tracking is pointing toward over 6% using the monthlies. There are various reasons why the two GDP concepts may not line up, but they still leave us tracking a material overshoot of the BoC's expectations.

Second, the arrival of renewed lockdowns will take at least some of that tracking for Q4 downward and set up a weaker start to Q1 which involves taking a step backward. What makes it more like 'lockdown lite' this time, however, include considerations like greater adoption of work-from-home practices, heavy tech investment, an accelerated shift to on-line sales and curbside pick-up alongside a vastly different stimulus backdrop both in terms of cheap financing and extended income supports.

Thereafter, however, the earlier than expected arrival of vaccines should buoy optimism as 2021 gradually unfolds. We obviously didn't have that during the initial lock downs. Overall, vaccines and better Q4 tracking generally offset the resumption of downside risk in between the two effects. Additional forthcoming fiscal stimulus in the winter federal budget is likely to be an added upside consideration.

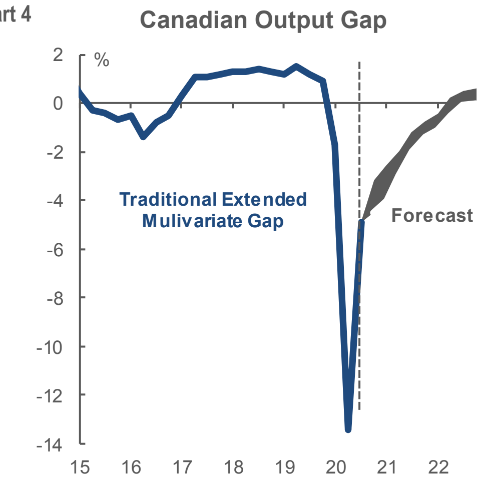
If spare capacity closes earlier than anticipated, then that may drive some upward pressure toward the 2% inflation target that we forecast to be achieved in 2022H2. Output gaps only go so far, however, as indicated in part by BoC research (here). With core inflation remaining quite sticky at 1.7% y/y, individual sector derived sources of pressure could reinforce the march to the inflation target earlier than the BoC forecasts (more here).

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.