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GLOBAL ECONOMICS

SCOTIA FLASH

April 28, 2023

Canadian GDP Disappoints, But Be Careful About Drawing Overly Hasty Conclusions

- **Canada's economy grew a touch in February, retreated a touch in March...**
- **...for an overall decent quarter of front-loaded growth...**
- **...that offers a neutral hand-off to Q2 GDP as fresh data will inform growth tracking**
- **BoC unlikely to be fussed with the focus remaining upon inflation's broad drivers**
- **The public sector continues to do rather well**
- **Canadian 2s rallied mostly coincident to US 2s**
- **US inflation and employment costs remain too hot for the Fed**

CDN GDP, m/m % change, February, SA:
Actual: 0.1
Scotia: 0.2
Consensus: 0.2
Prior: 0.5
March 'flash' guidance m/m % change in GDP: -0.1

Canada's economy slightly disappointed expectations after a strong start to the year and first quarter that now hands off a flat start to Q2 before we begin to get any Q2 data. It's important not to reach overly hasty conclusions on the resilience of the Canadian economy such as what happened when headlines prematurely pounced on December GDP that only temporarily retreated given multiple distortions. That gave way to a strong January reading that pulled forward some growth momentum and drove a strong overall Q1 GDP jump from the flat and distorted Q4 print. Where Q2 goes from here will be entirely data dependent.

Markets barely reacted on a day more dominated by other developments flagged in my morning note and US indicators mentioned later in this note.

So what happened? GDP was up 0.1% m/m in February which was lower than the earlier guidance from Statistics Canada that indicated the economy was tracking 0.2% growth. Secondly, the preliminary guidance for March GDP pointed to a slight decline of -0.1% m/m.

This translates into tracking 2.5% q/q SAAR GDP growth in Q1 but the way the quarter ended relative to the prior months is tracking a flat reading into Q2 (-0.2% q/q SAAR) before we get any actual Q2 data (chart 1). That doesn't mean Q2 will collapse. It means that the hand-off math is neither giving a running head start for Q2 growth nor is it posing a significant headwind. There was significant breadth to growth in February (chart 2) but we don't get a breakdown of March GDP other than very light verbal guidance.

Applied to this tracking is the standard caveat that this is using monthly production/income side GDP accounts whereas we and the BoC focus more upon expenditure-based GDP that captures inventory and net trade effects (ie: the 'how' part of what drove production). Recall that the BoC's April MPR forecast Q1 growth of 2.3% q/q SAAR and 1% in Q2 uses the expenditure-based concept.

I'm still cautious toward the quality of the Canadian data we are getting. I think their sampling is suffering during the strike and/or more folks were away and not responding as much this March when offering assessments of February data compared to the prior ones. The record low sampling rate for retail trade was at least one indication of such. That could mean either up or down revision risk.

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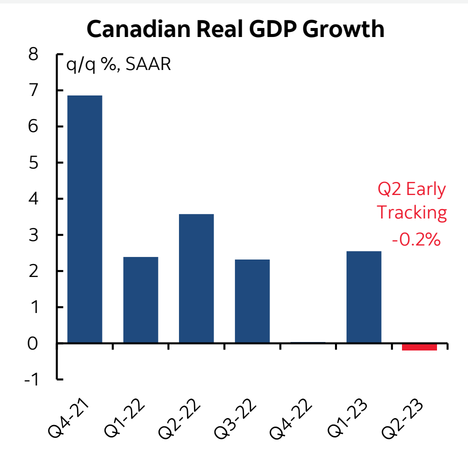
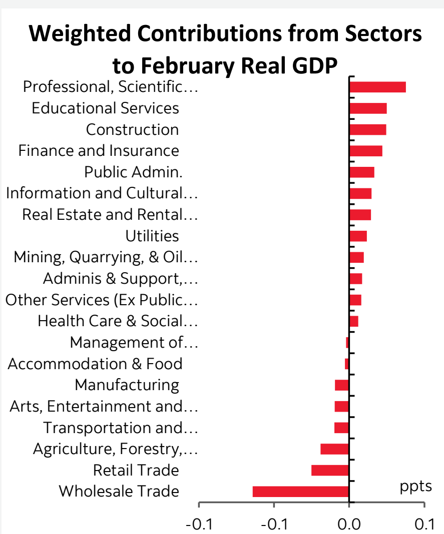
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

Government continues to do very well as shown in charts 3–4. How you measure the output of the civil service is always a question mark, but fwiw Statcan's attempt shows that public administration GDP continues to grow very strongly while tracking a q/q annualized gain of over 4% in Q1 and this continues the strong growth that has been enjoyed for some time now. Ditto for the education and health sectors that include large roles played by government funding. This supports broad economic growth given the 7% GDP weight on public administration, the 5% weight on the education sector and the 7% weight on health care and social services. It also means continued competition against the private sector for resources and particularly labour with a large number of job vacancies—a point I've made previously when tracking explosive growth in government payrolls and the impact of government spending upon inflation and the BoC's policy rate. This balanced take is important because one wants to acknowledge the role played by at least some of the more important parts of the public sector but also the stiff competition they represent in diverting workers and capital from elsewhere in the economy.

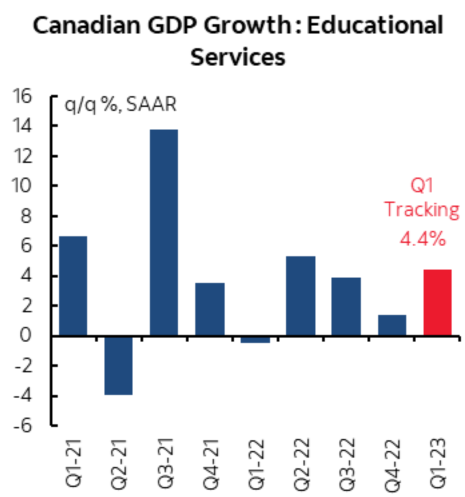
US INFLATION DRIVERS REMAIN TOO HOT FOR THE FED'S LIKING

Charts 6–8 depict the numbers we got out of the US this morning. Core PCE inflation remains sticky at rates well above the Fed's comfort zone. Chair Powell's favourite measure of services inflation eased but remains above comfort on a trend basis. The Employment Cost Index that captures all forms of labour cost continues to grow at an explosive rate.

Chart 3

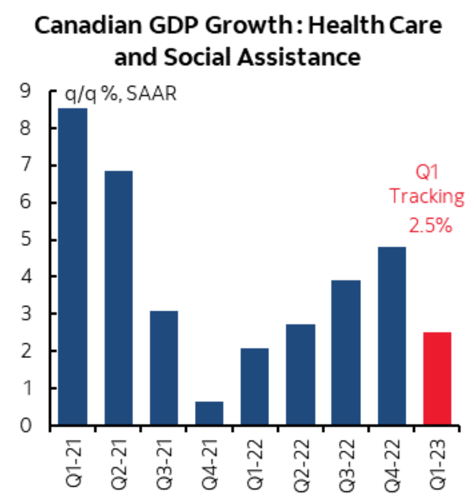
Sources: Scotiabank Economics, Statistics Canada.

Chart 4



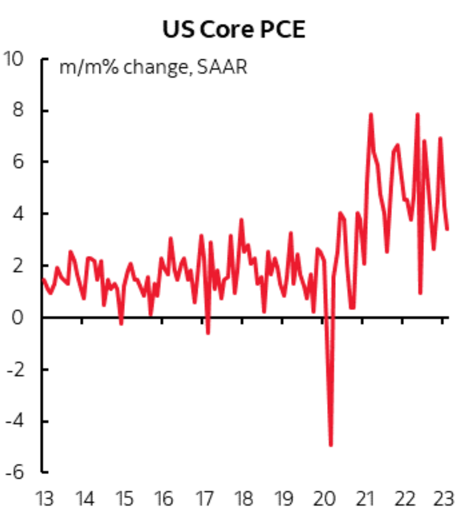
Sources: Scotiabank Economics, Statistics Canada.

Chart 5



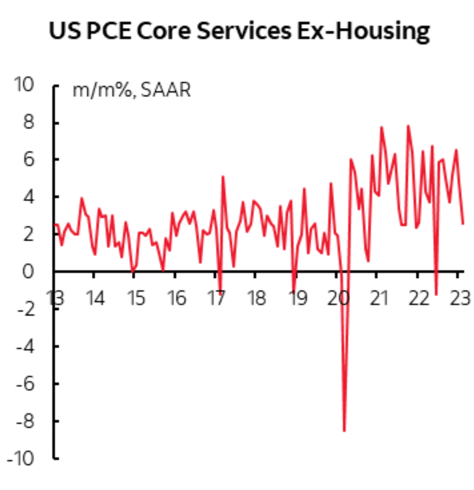
Sources: Scotiabank Economics, Statistics Canada.

Chart 6



Sources: Scotiabank Economics, Bloomberg.

Chart 7



Sources: Scotiabank Economics, Bloomberg.

Chart 8

Sources: Scotiabank Economics, Bloomberg.