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GLOBAL ECONOMICS

SCOTIA FLASH

September 27, 2024

Canadian Economy—Faster, Yet Slower

- **July GDP grew faster than consensus, matching Scotia's estimate…**
- **…with broadly supportive details…**
- **…but growth would have been stronger absent wildfire effects…**
- **…which may mean August and onward could rebound…**
- **…as part of why you should ignore August's "essentially unchanged" guidance…**
- **…along with the fact that flash guidance is commonly awful**
- **Q3 GDP is tracking softly, pointing to BoC Q3 forecast downgrade of uncertain magnitude**
- **Backcasting versus forecasting and what it means for the BoC**

Contributors

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Canadian GDP, July, m/m %, SA:
Actual: 0.2
Scotia: 0.2
Consensus: 0.1
Prior: 0.0
August 'flash' guidance: "essentially unchanged"

I thought the overall tone and details behind the numbers were solid. Markets didn't care one bit as Canada 2s rallied in lock-step with US 2s after US core PCE inflation undershot consensus by a tick (+0.1% m/m SA). USDCAD also shook it off. OIS markets continue to price just shy of a percentage point of rate cuts over the remaining two meetings this year which seems excessive to me absent a crisis.

GDP was faster than expected in July, I would ignore August guidance, but the BoC will have to downgrade its Q3 growth tracking.

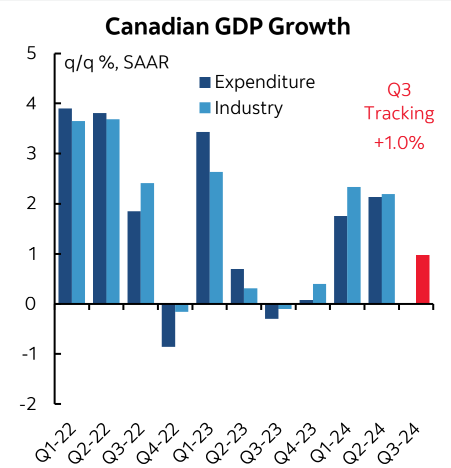
July GDP grew by 0.2% m/m, matching my above-consensus estimate and exceeding three-quarters of the estimates in consensus. August GDP was guided to be "essentially unchanged" which I would ignore for reasons I'll return to in a moment.

This marks the fourth consecutive month of GDP growth and the sixth gain in the past seven months. Trend growth is mild, but you'd think the economy was collapsing with all the negativity out there especially the politically driven variety.

What this gives us is tracking 1% q/q SAAR GDP growth in Q3 using monthly production-side accounts if we take July's 0.2, August as flat as per the agency's highly tentative guidance, and September as flat simply to focus the math on what is known to date (chart 1).

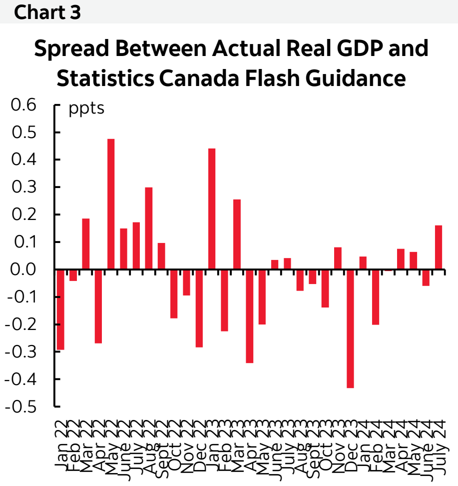
This may or may not translate well into quarterly expenditure-based GDP growth as the latter does a

Chart 1



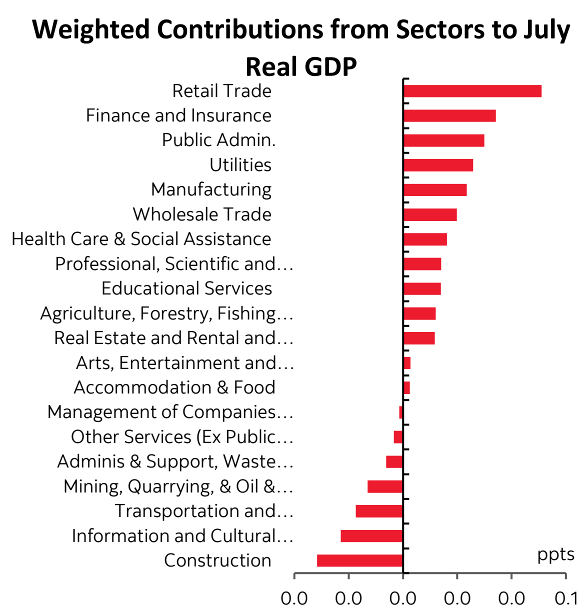
Sources: Scotiabank Economics, Statistics Canada.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

better job at capturing inventory and net trade effects. It probably counsels significant downside to the BoC's initial 2.8% q/q forecast for Q3 GDP growth that is more likely to come in one-handled when they revise it next month, but exactly where is highly uncertain.

July's details were solid and likely understated underlying conditions in the Canadian economy. Twelve of sixteen sectors were up, four were down but none of the downers did much to GDP growth in weighted contribution terms (chart 2).

Why understated? Because, as Statcan put it, "Wildfires impacted several industries across the country in July." Think the tragedy in Jasper as the most extreme and heartbreaking example among several of what happened to a whole community in a beautiful area of the country.

The wildfire effect is probably why the simple model I run for monthly GDP was spitting out faster growth than my 0.2% estimate.

This could mean that the dampening effects of wildfires in July could reverse higher from August onward as the wildfire effect stabilizes.

It also means we should be careful toward how July GDP translates into Q3 expenditure-based GDP tracking. Wildfire disruptions—and perhaps later disruptions to rail in August—could explain why inventories were up sharply in July. Manufacturing inventories were up by 0.9% m/m SA in July and wholesale inventories were up by 0.5% m/m SA. Inventory investment is some combination of undesired, planned given serial shocks to supply chains, and driven by rolling shocks and it could be a significant driver of Q3 GDP on an expenditure basis.

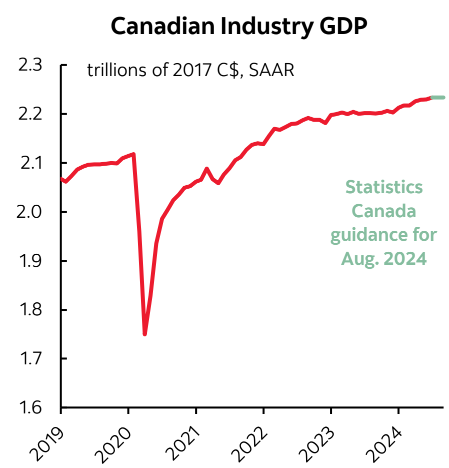
Which takes us back to Statcan's August 'flash' guidance that GDP was "essentially unchanged." First, who cares, as their initial estimates have a lousy track record. Chart 3 shows the spread between the flash estimate and where monthly GDP growth ultimately lands. Revisions are common and can often be quite large. Statcan had previously guided that July GDP was "essentially unchanged" and here we just got 0.2%.

Second, the wildfire hit to July could drive a rebound in August onward.

What we're left with is a picture of an economy that is underperforming, but still growing in trend terms despite massive rate hikes in the pandemic and serial shocks being thrown at it.

And as for the per capita debate, regular readers know what I'm of two minds on this. Canadian productivity is terrible, but no political party has a useful plan for what to do about it and both the business community and workers are too willing to schlep off responsibility for their roles. Second, be careful with population growth as a driver of falling per capita GDP. One reason is that we haven't given enough time for the population shock to impact GDP and it certainly doesn't happen in one or two years versus multiple years. Another reason is that you have to take out temps (non permanent residents) made up of international students, temporary foreign workers, and asylum seekers. I believe you have to do that because quotas for them are being reduced which should dramatically lower population growth going forward not in one month or quarter but over the next couple of years. They are a transient population that shouldn't be expected to contribute to short-term GDP in proportionate terms to born in Canada folks and permanent resident immigrants.

Chart 4



Sources: Scotiabank Economics, Statistics Canada.

In any event, the core debate in Canada lies around two tensions. Should the BoC upsize and swing into near panic mode because GDP growth is mild, underperforming, and adding to a fairly modest amount of spare capacity with an output gap estimated around just over –1%? Or should it be more patient, stick to its forecast rebound and be careful toward upside risks given massive pent-up savings and demand in the household sector plus ongoing fiscal stimulus that may increase into an election year plus mortgage finance easing and runaway real wage gains relative to weak productivity? I lean toward the latter. If the BoC leans toward the former and pursues rapid easing, then I would counsel raising growth and inflation forecasts and the potential resumption of hiking. Governor Macklem's first half of his seven year mandate was a disaster. If he wants to redeem himself before his term is up in June 2027 then I think he should play the longer game.