Scotiabank

GLOBAL ECONOMICS

SCOTIA FLASH

November 29, 2024

Contributors

Derek Holt
VP & Head of Capital Markets Economics
Scotiabank Economics
416.863.7707
derek.holt@scotiabank.com

Canadian GDP Counsels Against Upsizing Cuts Again

- **Canada is posting slow GDP growth…**
- **…but the details are much better and led by the consumer…**
- **…while upward GDP revisions point to less slack**
- **If the BoC cuts in December, it should go small and sound less dovish…**
- **…until it can take fuller consideration of developments in the January MPR**

Canadian Q3 GDP, q/q SAAR:

Actual: 1.0

Scotia: 0.8

Consensus: 1.1

Prior: 2.2 (revised from 2.1)

Canadian GDP m/m September, SA:

Actual: 0.1

Scotia: 0.1

Consensus: 0.3

Prior: 0.0

Canadian GDP m/m October 'flash', SA: 0.1

This is a textbook case of how sometimes GDP just isn't the bee's knees. Sometimes the more important stuff lies under the hood. Upon lifting said hood, I see strength. Lots of it. Less slack than previously understood too. So much so that the BoC is unlikely to upsize again in December and the front-end of the Canadian bond market is too rich alongside overly aggressive market pricing for the December meeting.

While I think he'll cut 25bps, if I were Governor, I would give serious consideration to providing less dovish guidance in December after 125bps of cuts to date. I'd take a breather at least on the bias and come back with new information and full forecasts at the end of January. They'll have more data by then, they'll be able to revise forecasts based upon all the information we obtained today and previously, plus more evidence that government stimulus measures have been passed with probably more to come in an election year—and it will be 9 days after Trump takes power and when he threatens to raise tariffs which might draw out retaliatory measures along with concomitant inflation. GDP components like consumption and final domestic demand are strong. Recall there is warm tracking of core inflation with trend persistence (**here**) and with massive income gains being hoarded at first alongside evidence of pent-up demand and savings.

I don't think the BoC will see these numbers the same way markets are trading on the headline numbers this morning. Nothing here screams out that the BoC should be contemplating a 50bps move in December.

Skimming the Surface

On the surface, things don't look great. The economy grew only 1% q/q SAAR in Q3 which was a tick beneath consensus, and a couple of ticks up from Scotiabank Economics' estimate (chart 1). More importantly, it was a half point lower than the BoC's forecast in the October MPR that they had revised down from 2.8% in the prior July MPR's forecast.

Monthly GDP figures also look soft. September GDP was up 0.1% m/m, matching my estimate and two-tenths beneath Statcan's initial 'flash' guidance from a month ago and below consensus by the same magnitude. Chart 2 shows the breakdown by sector, and

Chart 1

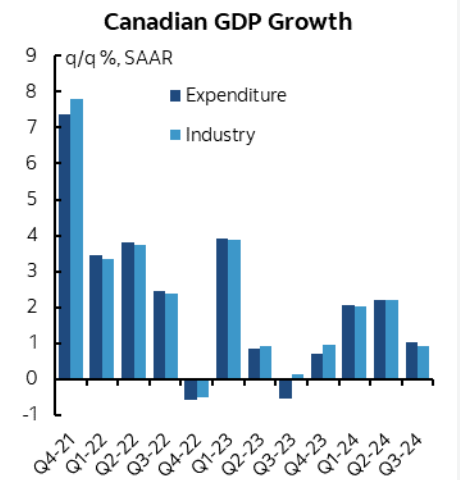
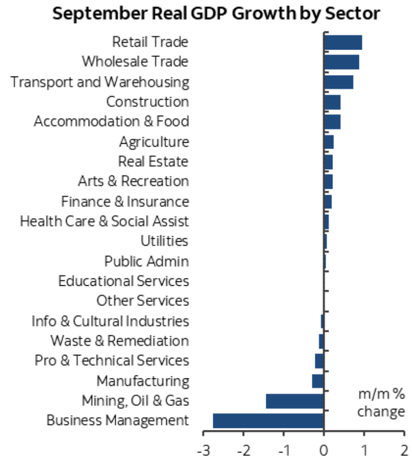


chart 3 shows the weighted contributions to GDP growth by sector.

The October GDP ‘flash’ estimate from Statcan is 0.1% m/m. That’s weaker than I’m tracking given higher frequency activity readings not least of which includes the 0.3% gain in hours worked. I think there is upside to their ‘flash’ but this will be further informed by more data. Statcan offers no numerical details to its preliminary estimate of 0.1%, and only general guidance: "Increases in real estate and rental and leasing, transportation and warehousing and retail trade were partially offset by decreases in construction and mining, quarrying, and oil and gas extraction"

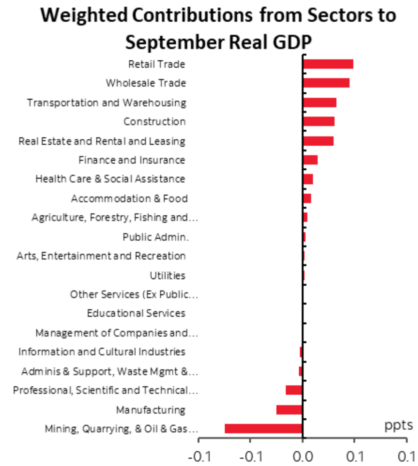
Using the monthly production-side GDP accounts reveals Q4 GDP tracking of 0.6% q/q SAAR. This is based upon the Q3 average and the October GDP flash while assuming no change in November and December in order to focus the math upon what we know so far. ‘Nowcasts’ that take in more information are slightly weaker than this, but in all cases we have very little data to go by so far and so treat any Q4 estimate as a shot in the dark.

Chart 2



Sources: Scotiabank Economics, Statistics Canada.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

Bullish Details

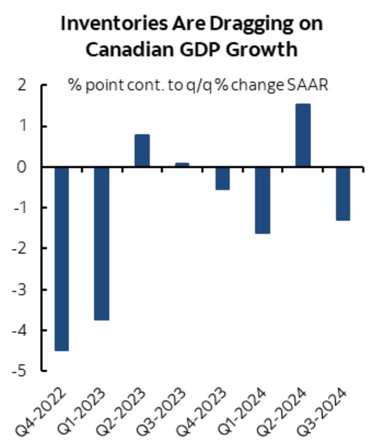
Here are the reasons why I think the economy was much stronger in Q3 than GDP suggested and they will reference chart 4 that shows the decomposition.

Chart 4

Sources: Scotiabank Economics, Statistics Canada.

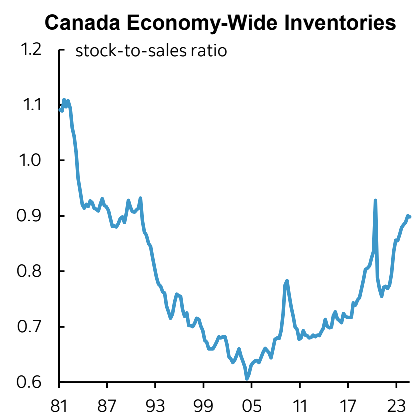
- Let’s start with revisions. We previously had Statcan’s annual GDP revisions covering 2021–23. Now we have quarterly revisions and can track them up to 2024Q2. By the end of 2024Q2, the economy was 1.45% bigger than previously estimated. For a C$2.42 trillion economy this is a massive upward revision.
- We need to fiddle more with the components and their implications for potential GDP, but as previously guided, the revisions likely give us less slack than previously estimated to the tune of around -0.6% for the output gap instead of -1%. It's more about direction imo, than faking precision with output gaps. Less slack than previously estimated because actual GDP was probably revised up more than any offsetting potential GDP revisions means less disinflationary pressure. That alone would suggest that the BoC should be less dovish before even looking at the Q3 and October GDP figures.
- Next, inventories knocked a large, weighted 1.3 percentage points off of GDP growth in Q3 (chart 5). The inventory drag did nothing to the inventory overhang on an inventory-to-sales basis as it is still quite high (chart 6). That continues the same debate. Are inventories too high because companies are mismanaging their inventories again? Or are they too light or just right given how the pandemic and geopolitical matters changed supply chain management toward holding higher inventories and now Trump is about to slam supply chains again. I would think there may be an ordering frenzy to get in ahead of tariffs which may lift the I:S ratio higher in the short-term and add to Q4 and monthly GDP growth. Any firm wishing to keep its customers next Spring would probably wish to have pre-tariff product on hand to sell.

Chart 5



Sources: Scotiabank Economics, Statistics Canada.

Chart 6

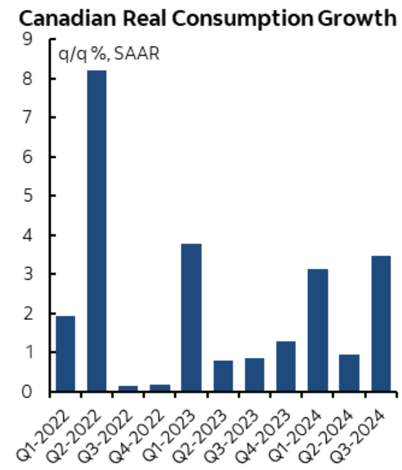


Source: Scotiabank Economics, Statistics Canada.

- Why did inventories drag on GDP? Partly because the consumer did very well last quarter. Consumption added 1.8 percentage points to GDP growth in Q3 on a weighted contribution to growth basis. Inflation adjusted consumer spending was up 3.5% q/q SAAR in Q3 (chart 7). This follows a mild 0.9% rise in Q2 that itself followed a 3.1% gain in Q1. That's a strong picture in my opinion. So much for the weak, terrible, worse than ever, can't possibly ever spend because of mortgage resets Canadian consumer! The consumption contribution to Q3 growth blew away the BoC's expectations. They had just under a 1% consumer contribution to Q3 GDP in the October MPR and at 1.84 we're quite a lot higher.

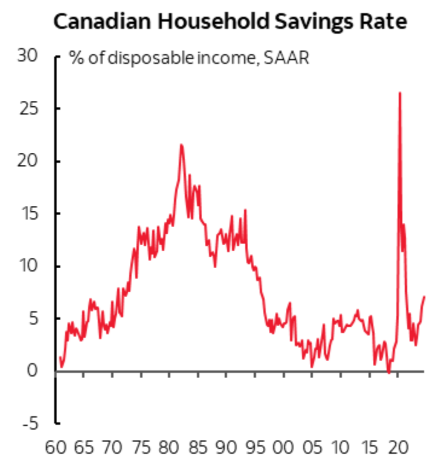
- The usual folks will complain that per capita consumption grew less impressively, but the usual counters should be applied. First, don't use total population, and remove at least the temporary immigration category made up of folks with naturally far lower spending propensities and far likelier to be a transitory population headed lower into 2025. Second, give the surge of permanent residents time to spend after arriving in a new country, getting a job, maybe trading up, maybe starting a new business, renting, maybe buying a home, and buying all sorts of stuff to go in said home. That doesn't happen overnight. I have a strong feeling that the folks who have been harping away at this issue will see the per capita numbers go right back up in future.
- Oh but wait, consumers are only spending on a few items, right? Oh shush with the excuses. Real services spending was up 2.9% q/q SAAR in Q3. Durables were led by autos that were up 11.8% q/q SAAR. Some retail segments are doing poorer than others, but don't take your guidance on the consumer just from the ones that are not doing as well.
- What's more is that there is a lot left to spend in the pipeline. Canada's household saving rate is still high at 7.1% (chart 8). All measures of cumulative excess saving remain very high in Canada.
- Alongside a high saving rate are strong income gains. Statcan noted that compensation of employees was up by 1.7% q/q SA, or 7.1% at an annualized q/q rate. Compensation has been tracking this kind of growth in every quarter of this year. Leading sectors in terms of Q3 compensation gains were finance, real estate, company management, and educational services after collective bargaining agreements in Ontario and Quebec along with retroactive payments.
- All that income surge in Q3 paired with GST/HST cuts and mortgage stimulus and then cheques is going to be spent in a significant lagging way. In prior notes throughout this year, I have argued that there is significant pent-up demand for housing and consumption, the lagging effects of immigration, and high pent-up household savings to fund gains in consumer spending and demand for housing and expect this to build in 2025.
- And so I'll say it again: stop being so negative toward the Canadian consumer!!
- Gross exports knocked 0.3 ppts off growth, while imports added 0.1 ppts for a net contribution to GDP growth from trade of -0.2 ppts.
- Investment knocked 1.05 ppts off of GDP growth. All of that weakness came through lower investment in machinery and equipment that knocked 1.06 ppts off Q3 GDP growth. You can't get a productivity turnaround if businesses don't invest….
- Housing added 0.2 ppts to GDP growth in Q3.
- Total government spending added 1% q/q SAAR to Q3 growth while gov't investment added another 0.25%

Chart 7



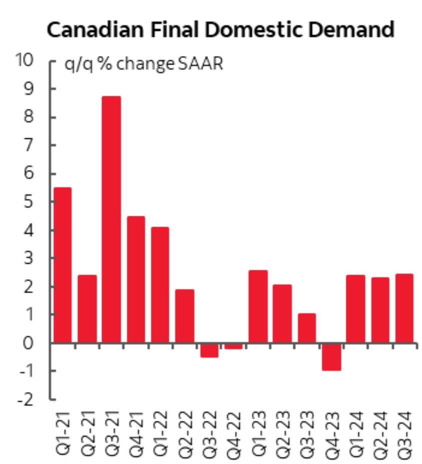
Sources: Scotiabank Economics, Statistics Canada.

Chart 8



Sources: Scotiabank Economics, Statistics Canada.

Chart 9



Sources: Scotiabank Economics, Statistics Canada.

- Final domestic demand was up 2.4% q/q SAAR in Q3 (chart 9). This measure adds consumption plus investment plus government spending and therefore focuses more closely upon the domestic economy and after removes the effects of inventory swings. It can be a better guide to what's going on in the domestic economy and it has been up by 2.3–2.4% q/q SAAR in every quarter so far this year.