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GLOBAL ECONOMICS

SCOTIA FLASH

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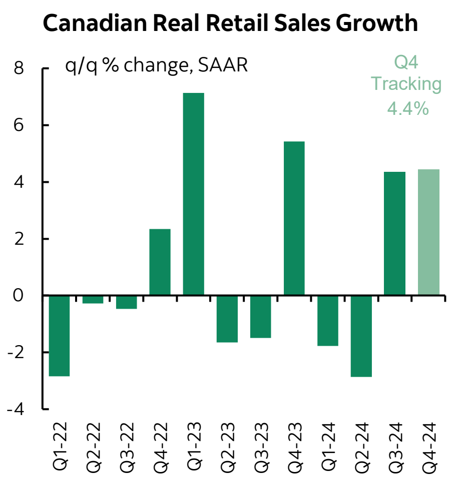
Chart 1



Sources: Scotiabank Economics, Statistics Canada.

The Underappreciated Canadian Consumer

- **Back-to-back quarterly sales volumes were up by the most in eight years**
- **November softened, December surged...**
- **...and no, it wasn't just the GST/HST cut**
- **There is momentum into Q1**
- **Quit talking your book or rate view. The consumer is doing fine.**

Retail sales, m/m %, November, SA:

Actual: 0.0

Scotia: 0.1

Consensus: 0.2

Prior: 0.6

December 'flash' guidance: +1.6 m/m % SA

Oh walk it off. By that I mean the incessant negative nellie nonsense about the Canadian consumer. Let's look at some facts. Respect the data over ignoring it by being overly wedded to your rate call. I'll lay out the trends and themes and address the data details and all the 'yeah but' arguments below.

A BULLISH SECOND HALF FOR RETAIL SALES

Retail sales volumes posted the strongest back-to-back quarterly percentage gains in 2024H2 since 2017 if we exclude only the period over 2020H2 when the economy was reopening.

Volumes were up by about 4½% q/q SAAR in Q3 and at least that much again in Q4, perhaps significantly more (chart 1).

Further, because of the way Q4 appears to have ended, there is already a running head start baked in for Q1 of over 2% q/q SAAR before we even get any Q1 data. That's enough to accommodate what might be some pulled-forward effect, but I'm not even sure that will happen.

UPS AND DOWNS ALONG A STRONG TREND

November volumes slipped by -0.4% m/m, but the 'flash' nominal guidance for 1.6% m/m suggests a volume gain of at least over 1% in light of what we know about CPI, maybe well over and closer to 2%.

The trend is what matters and it all started at the beginning of 2024H2. Retail sales volumes in m/m SAAR terms were up by 10% in July, 7% in August, 11% in September, 3% in October, fell by over 4% in November, and were up by double digits estimated to be 12%+ in December.

The point this isn't a one-month flash in the pan we're talking about.

Yet bears play on the November softness and how it must be obvious that December was only a tax cut effect while also relying on only a small snapshot of consumer spending. This leads to an incorrect understanding of what's going on with the Canadian consumer in my opinion and I'll address the related arguments.

WHY IT WASN'T JUST ABOUT THE GST/HST CUT

December's gain was an aberration simply due to the GST/HST cut that is sure to give way to a drop, right?? Some of it, yes, but don't get carried away with that spin.

Key in not getting carried away with that spin is that the lion's share of the GST/HST cuts in December affected categories of spending that are not included in the way Canada reports retail sales. Spending on 'food purchased from restaurants" that was exempt from the GST/HST accounted for about 40% of the CPI consumer-weighted items subject to the GST/HST cut and that category isn't even included in retail sales in Canada. Spending on alcoholic beverages is another nearly one-fifth of the items exempted from the GST/HST in December, some of which was in store (included in retail) and some of which was in bars/restaurants (not in retail).

In other words, over half of the items targeted for the tax cut don't even get captured by retail sales. The GST/HST cut was targeted to a modest portion of overall consumer spending and the way in which Canada reports retail sales didn't even capture a lot of it.

Furthermore, the tax cut kicked in only mid-month. Storms closer to Christmas may have held back some of the surge in holiday spending after the tax cut kicked in.

And there is the point about how other core prices went up in December as trimmed mean CPI (+3.5% m/m SAAR) and weighted median CPI (2.8% m/m SAAR) were hot in December (**here**). That should have held back some of the spending enthusiasm. Those measures exclude the effects of changes in indirect taxes like sales taxes and indicated a) momentum in pricing power over several recent months, and b) 'crowding-in' as retailers either offered less discounting or hiked prices to capture some of the space vacated by the tax cut through the incidence effects.

And there is momentum here not only because of the hand-off momentum math I gave above, but also because the GST/HST cuts, mortgage rule easing in mid-December, and stimulus cheques will continue into 2025.

SUPPLEMENTING RETAIL SALES

It's worth elaborating upon how data captures consumption in Canada. What Canadians spend on airfare, restaurants and bars, concerts and sporting events, hotels, financial services etc etc is not included in retail sales. At least the US includes 'eating and drinking establishments' but not Canada.

Taylor Swift's six T.O. concerts plus later ones in Vancouver? Not included in retail. Nor is any of the related spending on hotels, cabs, flights, restaurants, bars etc.

Open Table data for restaurant spending in Canada is shown in chart 2, with the caution it's not seasonally adjusted and since they revised their methodology they don't provide more history. But it looks like spending popped, which wouldn't have been included in retail sales, but we can't really tell using their measure how much of that was seasonally normal.

For that, we need another report. Statcan separately reports spending on restaurants and bars with a lag. Nominal (they don't give real) sales in that report were up 1.4% m/m SA nonannualized in November. We don't have December yet. The levels are robust and the recent trend is up (chart 3).

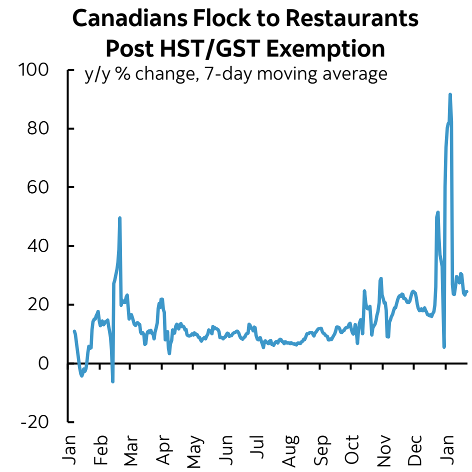
Air travel is strong as well (chart 4) and not included in retail sales.

In Canada, retail sales basically capture only goods. Goods, in a services rebound. Hello old economy data.

A CONSUMPTION-DRIVEN REBOUND—INCLUDING IN PER CAPITA TERMS

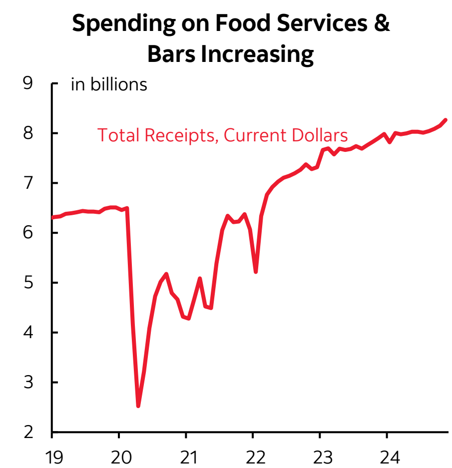
As for total consumption, of which retail is just a part largely by excluding services, I'm figuring that after real consumption grew 3.4% q/q SAAR in Q3, it could be up another 3–4% q/q

Chart 2



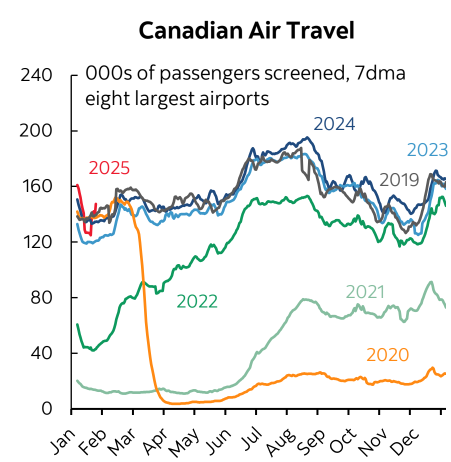
Sources: Scotiabank Economics, OpenTable.

Chart 3



Sources: Scotiabank Economics, Statistics Canada.

Chart 4



Sources: Scotiabank Economics, CATSA.

SAAR in Q4. If so, then the real consumption growth pattern over 2024 would include a 3.1% q/q SAAR gain in Q1, 1% in Q2, 3.4% in Q3 and 3–4% in Q4.

Which remains my thesis on how—barring the world falling apart with sustained tariffs—there is excessive bearishness toward the Canadian consumer that is not respecting the data.

And don't give me per capita nonsense. Much of the population surge has been via temps, and yet international students, temp foreign workers, and asylum seekers don't spend like born in Canada or permanent residents and so you've got to take them out instead of being misleading by using total population in per capita consumption calculations. The temps will be reduced under immigration policy changes going forward, and the ones who remain represent future spending and with that we should see spending per capita rebound—again, barring total calamity thanks to Trump.

BASE CASE MOMENTUM VERSUS THE TARIFF QUESTION

Going forward—subject to whether tariff wars are just balony or for real—the base case conditions are robust for Canadian consumption. Consider the lagging effects of rate cuts, lagging immigration effects into housing, pent-up demand, high horded household net worth way above what trend drivers would have predicted, idled deposits and cash waiting to be turned into down payments, fiscal stimulus with billions arriving in 2025H1, December's easing of mortgage rules etc etc.

We all know tariffs could derail this.

But don't lose sight of the momentum and drivers into a period of uncertainty. Make your assumptions as you see fit about probability of tariffs (I think high), probability of retaliation (high), absence of carve-outs (high) and longevity (don't know). And make assumptions about mitigating measures, like how fiscal policy stands in, and how monetary policy evolves which is critically dependent upon retaliation.

On the latter, be open to rates going up or down in tariff wars.

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