Data Release: Canadian economy grew at a solid pace in Q4, but cracks are starting to show

- Real GDP grew by 2.4% annualized in Q4, decelerating from the 3.2% pace in Q3 (revised up from 2.8%). This is in line with our January 2015 Canadian Economic Forecast Update and is only modestly below the Bank of Canada's 2.5% projection published in its most recent Monetary Policy Report (MPR).
- While the headline number for growth was decent, the details of the release were more mixed. Much of the strength in Q4 rode on household consumption (+2.0%), as waning motor vehicle sales were offset by consumer strength elsewhere. Residential investment also made a positive contribution to economic growth in Q4, however growth has slowed considerably relative to the previous two quarters. In contrast, growth in investment in non-residential structures (-1.8%) and machinery and equipment (-3.2%) fell back. Meanwhile, trade was a net drag on Q4 growth, with the energy-led decline in real exports (-1.6%) having been complemented by a modest increase in real imports (+1.7%). Finally, inventories made a notable contribution to growth in Q4 (+1.8 percentage points), after subtracting from growth for three consecutive quarters.
- Nominal GDP (+0.1%) posted the weakest advance since the second quarter of 2009. This weakness was largely the result of a decline in prices (-2.4%), as export prices (-6.2%) fell off a cliff due to lower oil prices and a weaker Loonie. Meanwhile, corporate profits (-11.3%) also took a plunge in Q4, following five consecutive quarterly increases. At the same time, employment earnings (+2.1%) posted their weakest quarterly advance in over a year and the second weakest since 2009, while the household savings rate (+3.6%) reached its lowest level since early 2010.
- On a monthly basis, Q4 ended on a strong note, with GDP by industry rising 0.3% (m/m) in December. The gain was driven by growth in the goods sector (+0.6%), paired with a solid showing from the services sector (+0.2%).
- For 2014 as a whole, real GDP growth posted a 2.5% (y/y) advance, broadly in line with consensus. Household final consumption expenditure rose 2.8%, while total investment (ex-government) was barely positive, despite a 2.8% increase in investment in residential structures. Government investment (-2.3%) fell for the fourth consecutive year. All major industrial sectors rose in 2014 with the exception of the agriculture and forestry sector. Mining and oil and gas extraction as well as manufacturing were the main contributors to overall growth in goods production (+2.4%), while services-producing industries also recorded a 2.4% increase in 2014.

Key Implications

- While the real GDP growth print for Q4 was solid, the numbers underlying the release point to stormy seas ahead. Similar to the narrative in our January 2015 Canadian Economic Forecast Update, we have begun to see corporate profits and non-residential investment contract, while lower oil prices and a weaker Loonie have led to softer aggregate income growth. Indeed, without inventories expanding in Q4, real GDP growth would have barely stayed in the black, pointing to more weakness than the headline growth number would suggest.
- On a trend basis, weakness in the Canadian economy is already becoming apparent. After reaching a recent high of 3.8% in Q2 of 2014, real GDP growth has decelerated in each subsequent quarter. This is a trend that we expect to see continue into 2015, with growth in Q1 of 2015 expected to be in the 1% to 2% range.
- As Q4 real GDP growth came in very close to the Bank of Canada's projection in its January 2015 MPR, and with growth forecast to be around the Bank's 1.5% projection in the first half of 2015, we expect that Governor Poloz will keep interest rates on hold at tomorrow's fixed announcement date.
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