Data Release: Q1 real GDP growth is 'atrocious' compared to expectations

- Reflecting the negative impact of lower oil prices, Canada's economy contracted 0.6% (annualized rates) in the first quarter, the worst showing since Q2 2009. This is a marked deceleration from the 2.2% pace in Q4 (revised down from 2.4%), and well below the 0.3% advance expected by markets. The Q1 print also came in below the Bank of Canada's call for no growth in the quarter.

- While the headline number was bad, the underlying details were worse. Lower oil prices took a bite out of corporate profits (-39.7%) in Q1, leading to a deep contraction in real non-residential structure investment (-19.7%). The drop in investment was concentrated in those sectors most closely tied to oil sands investment. Meanwhile, investment in machinery and equipment (-7.4%) also fell markedly in the quarter, although this can largely be chalked up to temporary factors. On a positive note, real residential investment advanced 4.0% in Q1, thanks to an increase in new construction (although some of this will likely be unwound in future revisions).

- Canadian consumers also went into hibernation in Q1, as real expenditures on consumer durables (-5.5%) fell for the first time since 2013. However, real household spending (+0.4%) managed to tread water in the quarter, as consumption of other goods and services advanced. This was in spite of a 6.2% jump in personal disposable income – the strongest quarterly advance since Q1 2011 – on strong growth in employment earnings (4.5%). As a result, the savings reached 5% - the highest level in two years.

- Net exports were one of the few bright spots in the quarter, contributing 0.2 percentage points to growth. However, it was for all of the wrong reasons, as real exports fell 1.1% and real import dropped 1.5%. Investment in inventories also contributed 0.2 percentage points to growth in Q1.

- On a monthly basis, March real GDP growth also surprised on the downside, falling 0.2% m/m as opposed to the 0.2% advance expected by markets. At the same time, January and February growth were revised lower, both months having now contracted. A 1.0% decline in goods-producing industries was entirely responsible, as oil and gas extraction (-2.3%) and support activities for mining and oil and gas extraction (-17.3%) led the decline. Utilities (-1.6%) and construction (-0.8%) also fell sharply in the month. Meanwhile, services-producing industries (+0.2%) kept their head above water, on modest advances in most major categories.

Key Implications

- Today's Q1 GDP release surprised sharply on the downside, coming in well below consensus and the Bank of Canada's call for no growth in the quarter. As a result, some serious soul searching is likely going to be happening on the part of economists. All told, there were few bright spots in the quarter, as the sharp decline in oil prices fed into lower corporate profits and real investment in non-residential structures. As such, real GDP growth in Q1 seems to have satisfied Governor Poloz's premonition for an 'atrocious' Q1 print. That said, the notable advance in personal disposable income growth and the savings rate provides a modest silver lining. However, some of this spike in personal incomes reflects an increase in one-off payments by the federal government to its employees, and so enthusiasm should be appropriately dampened in this case as well.

- All told, today's release calls into question the view that the Bank of Canada will remain on hold until 2016. Depending on how the U.S. economy continues to shape up in Q2, the balanced language accompanying Wednesday's interest rate announcement may give way to a much more dovish tone in the July Monetary Policy Report and an increased weight on the view that a cut may be around the corner.
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