May 31, 2017

TD Economics

Data Release: Hot first quarter growth marks a Canadian GDP 'Three-peat'

- The Canadian economy roared ahead in the first quarter of the year, expanding 3.7% q/q annualized. Including price effects, nominal GDP growth was an impressive 8.3%.
- Consumers were the star of the show as household spending rose 4.3% on the back of robust durables spending (+9.9%). It seemed that Canadians still can't shake their debt habit, as nominal household expenditures outpaced disposable income growth, resulting in a 1 percentage point drop in the household savings rate (to 4.3%).
- The positive story was not confined to consumers. Business investment rebounded significantly (+10.3%) on strength in machinery and equipment investment (+25.3%), while investment in intellectual property products rose 6.3% supported by an eye-popping 67.1% rise in mineral exploration. On the residential investment side of things, a 15.7% gain in activity marked the strongest performance since 2012 on the back of strong construction activity and a significant increase in resale activity.
- Net trade was a modest drag on growth as exports were effectively flat (-0.3%) and imports gained sharply (+13.7%), as the impacts of earlier one-offs worked their way out of the data. Of course, imports must go somewhere, and in the first quarter, they appear to have largely made their way into inventories, which rose $14.9 billion, adding 3.6 percentage points to first quarter growth.
- The 0.5% expansion of monthly GDP in March was also encouraging, providing a healthy starting point for the second quarter. The goods-producing side of the economy led the way (+0.9%) on strong gains in utilities and manufacturing (both +1.6%). The service sector expanded at a still healthy 0.3% monthly pace, with gains in retail trade (+1.0%), finance and insurance (+0.8%), and wholesale trade (+0.7%) leading the way. Encouragingly, on an industry basis, the Canadian economy continues to demonstrate a breadth of expansion: 80% of Canadian industries, representing approximately 90% of output expanded in March, the best performance since May 2014.

Key Implications

- Wasn't it America that was supposed to be made great again? And yet boring old Canada saw a first quarter pace of growth that more than tripled what was seen for the U.S. Moreover, although helped by a post-wildfire recovery, the 2016Q3 to 2017Q1 'three-peat' marked the fastest three-quarter string of growth since the post-crisis recovery in early 2010. Beneath the surface however, there are reasons to expect a less exciting pace of expansion going forward.
- To begin with, there is already evidence that key housing markets are beginning to cool off, suggesting that the robust pace of first quarter growth is not likely to be seen again any time soon. At the same time, the environment for business investment should remain supportive, but elevated uncertainty is likely to cap the pace of growth. Finally, consumers are likely to keep their wallets open, helped by past gains in housing wealth. But, it is again unlikely that the pace of first quarter growth, particularly for durable goods spending, can be maintained, and the credit-fueled nature of recent spending growth remains concerning.
- It is not all bad news however – strong March figures provide a solid start to the second quarter, setting the Canadian economy up another quarter of well above-trend growth.
- For the Bank of Canada, despite the March GDP figures, concerns about the durability of growth and still soft consumer price inflation will likely result in continued near-term caution. That said, we remain of the view that growth is likely to moderate but remain above-trend, supported by a continuation of the broad based growth trend that has emerged in recent months (See our recent report). This broad-based growth, alongside nascent inflationary pressures, should set the stage for the beginning of a gradual tightening cycle early next year.

Brian DePratto, Senior Economist
416-944-5069

@TD_Economics