HIGHLIGHTS OF THE WEEK

• Canadian Q1 GDP data are finally in, and as expected the collapse in oil prices late last year took a substantial toll. Canadian real GDP contracted 0.6% annualized in the first quarter of this year. The hit to income was more pronounced with nominal GDP down an even larger 2.9%.

• The hand-off into the second quarter of this year is also disappointing, with industry GDP down 0.2% in March. Our preliminary tracking suggests that real GDP growth could come in around 1% in the second quarter of the year, disappointing the Bank of Canada’s call for a 1.8% gain. This could turn the Bank of Canada a bit more dovish in upcoming meetings.

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Canada Q1 GDP data are finally in, and as expected the collapse in oil prices late last year took a substantial toll. Canadian real GDP contracted 0.6% annualized in the first quarter of this year. The hit to income was more pronounced with nominal GDP down an even larger 2.9%. The hand-off into the second quarter of this year is also disappointing, with industry GDP down 0.2% in March. While we don’t expect a repeat contraction in the second quarter of the year, we are braced for what could be another soft economic performance.

Economic weakness in the first quarter of the year was largely tied to the business sector, with corporate profits down 39% and real business investment down a hefty 11%. The oil and gas sector accounts for over 20% of business investment in Canada, and likely accounted for the bulk of the decline. It is hard to imagine that business conditions will improve significantly in the second quarter of the year. While oil prices have stabilized at around WTI $60 a barrel, they are still fairly low. In addition, changes in oil prices impact the economy with a lag. As such we are unlikely to see the positive knock-on effects of slightly higher oil prices until the second half of this year. Business confidence was fairly depressed in April and May, perhaps the first indication that Q2 is yet to bring brighter skies. The one positive string we can pull on right now is that some of the weakness in Canada’s international trade (exports fell 1%) will prove temporary. The combination of poor weather conditions and weak demand in the U.S. likely held back Canadian exports. As spring brings on better travelling conditions, we may see a reversal in exports.

Consumers and housing will likely provide a modest positive offset to further business sector weakness in the second quarter of the year – keeping real GDP from a second consecutive contraction. Consumer spending (+0.4%) was also fairly weak in the first quarter of the year. However, bad weather and uncertainty over what the economic backdrop likely kept consumers out of the malls. Personal disposable income (+6.5%) was actually up quite strongly, and the personal savings rate jumped to 5%, suggesting that consumers may have some spending wiggle room. Whether they choose to use that wiggle room in the second quarter will depend on how they are feeling about their future economic prospects. Favourably, we know that housing activity ramped up through March and April, which will at the very least feed through to higher expenditures on housing-related items. It may also be a sign that households were feeling better about economic prospects in the second quarter. Residential investment (+4%) was the one bright spot in this morning’s GDP report, and some of that momentum will likely carry forward given increased activity in the resale housing market.

Credit must be given where credit is due. Bank of Canada Governor Stephen Poloz certainly called the weak Q1 GDP numbers and may have very well been justified in the surprise rate cut back in January. In this week’s policy announcement, the Bank of Canada held to its slightly more positive view on expectations for Canada’s economic performance through the rest of 2015. However, the underlying details of this morning’s report may temper the central bank’s optimism. Our preliminary tracking suggests that real GDP growth could come in around 1% in the second quarter of the year, disappointing the Bank of Canada’s call for a 1.8% gain. This could turn the Bank of Canada a bit more dovish in upcoming meetings.

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