TD Bank Financial Group

# TD Economics

Commentary

March 31, 2008

## CANADIAN GDP BACK TO NOVEMBER'S LEVEL

- **Real GDP grew by 0.6% in January after dismal December**
- **Manufacturing regains some, but not all, of December's output loss**

Canadian real GDP posted a 0.6% gain in January, a hair above the expected figure of 0.5%. After having recorded a significant decline in December (-0.7%), mostly pulled down by manufacturing, particularly auto production, the Canadian economy is essentially back to where it was, on a level basis, in November of last year. Recall that the economy slowed sharply from an annualized 3.0% growth rate in the third quarter of 2007 to an anaemic 0.8% rate in the final quarter. The direct impact of the U.S. slowdown was evident in the breakdown of Canadian growth. Final domestic demand remained buoyant while net exports weighed the economy down significantly. January's gains were broad-based, but the reversal of fortunes for manufacturing (+1.7%) in particular was not enough to erase the whopping 3.4% drop in December. The rest of the goods-producing side of the economy offered mixed performances, with gains in mining and oil & gas extraction (+0.7%), declines in other primary industries and utilities (-0.6%), and a flat performance for construction (+0.1%).

On the service side of the economy, the growth stars of wholesale and retail trade led the way with gains of 2.8% and 1.2% respectively. Other gainers of interest where art, entertainment & recreation and accommodation & food services (+0.6%). Finance, insurance, and real estate recorded a decent 0.3% gain, thereby extending the growth streak in that industry to 43 months.

All said, while the bounce-back in January was expected and welcome, particularly in durable goods production (+2.6%), it offers little to celebrate when considering what lies ahead. While the Canadian dollar has retreated from its peak of November 2007 against the U.S. dollar, the lagged impact of a currency near parity will continue to be a strong headwind for exporters. The loonie could retreat further but probably not enough on a sustained basis to provide much near-term relief to the export-lead manufacturing industry. Furthermore, the U.S. appears to be in the thick of a recession, which means that there is very little room for an upside surprise from Stateside demand for Canadian products. Lastly, the pace of domestic demand is expected to slow from the breakneck pace seen in the fourth quarter. While the wheels aren't expected to come off the Canadian economy because many fundamentals, most importantly employment, should provide enough support to avert a national recession, the most likely scenario is that real GDP will barely grow in the first half of this year. As a consequence, with the Canadian output gap shrinking faster than an iceberg in the Arctic, along with a muted inflation outlook, we expect the Bank of Canada to continue a 'super size' (-50 basis points) monetary policy easing cycle at its April 22nd meeting.

**REAL GDP AT BASIC PRICES - CANADA**

| | January 08 | | |
|---|---|---|---|
| | **Level* (Billions)** | **% Chg. M/M** | **% Chg. Y/Y** |
| **All INDUSTRIES** | **1,235.2** | **0.6** | **2.2** |
| **GOODS INDUSTRIES** | **374.4** | **0.8** | **-0.6** |
| Manufacturing | 180.7 | 1.7 | -2.2 |
| Mining, oil & gas extraction | 57.5 | 0.7 | -0.3 |
| Construction | 78.2 | 0.1 | 2.6 |
| Utilities | 31.4 | -0.6 | 3.5 |
| **SERVICE INDUSTRIES** | **862.0** | **0.5** | **3.6** |
| Wholesale trade | 74.6 | 2.8 | 8.9 |
| Transport. & warehousing | 56.8 | 1.0 | 2.0 |
| Retail trade | 75.3 | 1.2 | 6.0 |
| Finance, Insurance, Real Estate | 244.7 | 0.3 | 3.7 |
| Education Services | 58.4 | 0.0 | 2.7 |

* 2002 Chained Prices; Source: Statistics Canada / Haver Analytics.

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