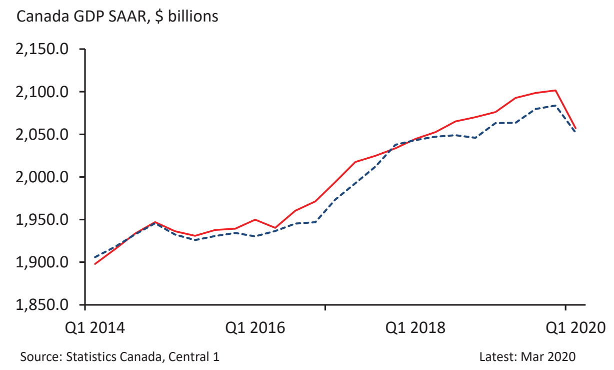
Economic Commentary

central 1

HIGHLIGHTS:

- Q1 GDP contracts 8.2 per cent on broad COVID-19 driven contraction
- April contraction expected to accelerate leading to plunge in Q2 output
- Recession is short-lived, but hike out of gorge will take time

Gross domestic product plunges in Q1 as COVID-19 bites



Few surprises as Canadian economy slams on the brakes

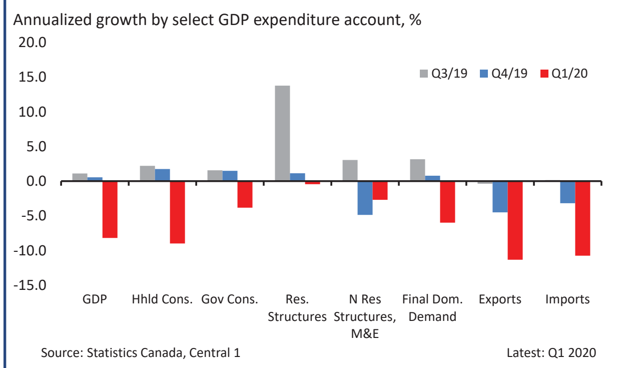
March industry and first quarter expenditure gross domestic product (GDP) showed record contractions in economic activity owing to COVID-19, but this was expected given record declines across many indicators over the past month. If anything, March data was slightly better than expected.

According to Statistics Canada, expenditure-basis GDP plunged 8.2 per cent (annualized) in Q1, compared to consensus expectations for a 10 per cent decline. The entirety of this contraction owed to the COVID-19 driven downturn in March.

Quarterly household spending declined 9.0 per cent as Canadians stayed home and limited major purchases and discretionary spending, while many storefronts and restaurants were closed (either voluntarily or on a mandatory basis) to limit the spread of the virus. As already seen in recent retail spending figures, spending on vehicle sales slammed the brakes on durable goods sales, while semi-durables also contracted. Less spending on restaurants and air travel lowered spending on services. Declines in consumer spending represented about 70 per cent of the overall decline. Government current spending fell at an annualized 3.8 per cent as schools shuttered and public administration activity slowed.

Investment spending fared better given the lagged effect of construction starts on economic accounts.

GDP growth by select expenditure



Residential investment slipped 0.4 per cent, although non-residential investment fell 2.7 per cent on a 13 per cent decline in machinery and equipment. No doubt businesses slammed on the brakes amidst the economic shock. Future investment weakness is likely to unfold as a slowdown in housing starts and other construction flow through the economy, while businesses confidence remains stunted. Trade activity plunged with exports down 11.3 per cent and imports down 10.7 per cent. The latter reflects declines in consumer demand and business investment.

There was some positive news on the income front as consumer compensation slipped 0.9 per cent on a quarterly basis, which was less than the economy as a whole. The economic contraction hit corporate profits harder than workers as federal wage subsidies (retroactive to March 15) provided some support.

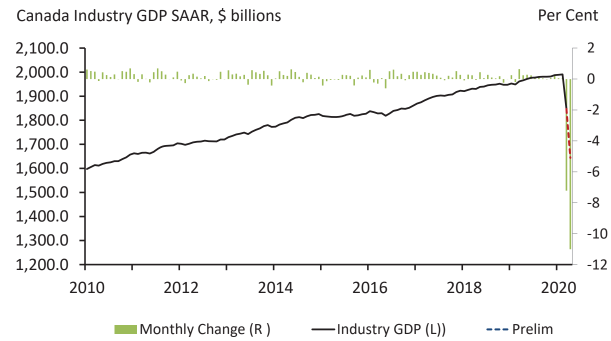
The Canadian Emergency Response Benefit has also supported Canadian households. Savings rates surged to 6.1 per cent from 3.6 per cent in Q4 and 2.3 per cent a year ago which could provide some firepower to consumer spending during the recovery.

There is no doubt that Q2 GDP will show a deeper contraction as the full effects of government containment measures were in place during April and into May, the only question is magnitude. Statistics Canada's preliminary estimate is that industry- GDP fell 11 per cent in April (not annualized) following a monthly contraction of 7.2 per cent in March.

There are signs that a recovery has emerged. A number of provinces have restarted sectors of the economy suppressed by COVID-19 measures. However, sectors restarts were inconsistent across provinces, while timing varied. With business investment expected to be weak and gradual re-opening, we expect May GDP to have declined slightly. A rebound in economic data is likely to be observed in June, as staggered starts drive higher consumer spending. Real GDP growth in Q2 is still forecast to contract at close to a 50 per cent annualized rate, albeit with weakness front-loaded into the quarter.

While the numbers rolling in remain terrible, they are largely in the rear view mirror. The recession will be short-lived, but Canada like other countries has a deep economic gorge to hike out of. Indeed, GDP is likely to remain below pre-pandemic levels into 2022 with starts and stops along the way Negative risks remain due to the potential for another flare up of COVID-19 leading to more suppression measures, but at this point we anticipate positive but uneven growth to emerge through the year. The pace of growth will depend on relaxation of government containment measures and confidence in the health system.

March industry GDP down 7.2 per cent, April to fare worse



Source: Statistics Canada, Central 1 Latest: Mar 2020, April 2020 preliminary estimate

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