Economic Commentary

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Economics

GDP handily beats expectations in Q4

Canada economic growth surprised on the upside during the fourth quarter, to handily best even the most optimistic forecasts. GDP growth rose 2.3 per cent from the previous quarter, with annualized growth of 9.6 per cent. This followed the third quarter rebound of 40.6 per cent (annualized) when the economy re-emerged from early pandemic restrictions and shutdowns. Fourth quarter growth far outpaced the median consensus of economic forecasts of an already rosy 7.5 per cent via Reuters and our expectation for a gain of 7.2 per cent. Moreover, this was far above the Bank of Canada's forecast for a 4.8 per cent print in its January Monetary Policy Report. Annual GDP still declined 5.4 per cent despite the Q4 gain.

Annualized growth figures are normally presented by convention but less useful in the current context of large quarterly fluctuations due to the pandemic downturn and recovery phase. Nevertheless, it provides context for the main drivers for the most recent quarter.

The latest gains were driven by changes in business inventories, higher government spending, business investment and housing. In contrast, consumption spending took a back seat in the latest quarter. Annualized growth in government spending rose 6.2 per cent, while residential investment jumped 18.4 per cent on broad strength in construction, homeownership transfers, and renovations. Non-residential investment increased 4.2 per cent. Trade flows broadly slowed with both exports (up 5.0 per cent) and imports (up 10.8 per cent) slowing from the third quarter. Household consumption fell in the latest quarter by 0.4 per cent due in large part to a sharp contraction in demand for durable goods like vehicles after a strong Q3 rebound.

A primary driver of the stronger than expected Q4 gain was business inventories which were drawn down in the third quarter but rose slightly in the latest quarter contributing to less drag on growth. In fact, the inventory swing contributed to the bulk of the Q4 gain (seven per cent) as firms may be readying for better times ahead. The unexpected strength in Q4 comes as a positive surprise for the economy but we should probably temper the enthusiasm to an extent. December industry-GDP estimates showed a slowing of growth to monthly growth to 0.1 per cent compared to 0.8 per cent in November. GDP remained about three per cent below pre-pandemic levels. The large drops came in retail trade and hospitality sectors which reflects additional restrictions. This was offset by stronger activity in resources, construction and professional services.

The effects of the second wave of the pandemic extended into the first quarter, particularly as restrictions continue to affect short-term employment which will contribute to soft consumer spending. That said, early estimates for January industry-GDP are for a 0.5 per cent month-to-month gain, point to an offset from other sectors. The boost from inventory adjustment is unlikely to repeat during Q1 but the housing cycle remains robust, and the improved macro- economic backdrop of stronger economic growth, higher commodity prices, and vaccine deployment will contribute to more robust gains in Q2 onwards.

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