Economic Commentary

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Economics

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Fun seeking consumers lift economic activity, weaker trend expected in second half

Canada's economy performed better than expected in May as industry Gross Domestic Product (GDP) held steady after a gain of 0.3 per cent in April. Preliminary estimates had pegged May growth as negative. Moreover, early June estimates were unexpectedly strong positive at 0.1 per cent with broad growth among industries. The latest data points to a 1.1 per cent q/q growth in Q2. Annualized, the 4.6 rate of growth marks an acceleration from the 3.7 per cent print in Q1 and strong momentum heading into H2.

Looking back at May, flat GDP reflected a drop off in goods-producing sector output (-1.0 per cent) while services activity rose (0.4 per cent). Of the former, residential construction fell 1.9 per cent to lead a general pullback in construction, while manufacturing contracted 1.7 per cent on a steep drop in motor vehicles and parts (-9.0 per cent). Re-tooling of plants and ongoing issues related to supply of semiconductors pulled vehicle production to the lowest level since January. Oil and gas extraction fell 1.4 per cent.

In contrast, services- sectors posted solid growth during the month led by growth pandemic recovery sectors. Increased travel activity propelled transportation and warehousing up 2 per cent. Fun- seeking recreational travelers pushed air transportation up 14 per cent to a pandemic era high although still 40 per cent below February 2020 – this will continue to grow but constrained by challenging environments at Canadian airports. Meanwhile, restaurants saw continued expansion with activity up 2.7 per cent, events driving activity driving a 2.6 per cent increase in arts/entertainment/recreation. In contrast, a slowing housing market is pushing output for real estate agents and brokers which fell 5.7 per cent m/m, with levels down 25 per cent from February. Professional/scientific/technical services and public administration both expanded by about 0.5 per cent.

The latest GDP report was firm and reflective of solid growth momentum into the second half. That said, there are plenty of reasons to expect slowing momentum going forward. The U.S. economy slowed again in Q2 with a second negative GDP print, although we are not calling this a recession given labour market strength. Nonetheless, momentum is clearly waning. For similar reasons, Canada's economy will experience negative pressure from higher interest rates through housing channels, while high inflation tempers consumption, and slowing external growth will temper trade-oriented growth. A firm labour market and strong population growth is a positive offset. High inflation and a tight labour market will continue to bolster the need for higher policy interest rates from the Bank of Canada, but we expect levels to top out at 3.25 per cent by Q4 that holds through most of 2023 before the Bank cuts late in the year.

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