



### **GDP growth falls short of estimates, second half expected to soften even more**

Canadian economic growth for the second quarter came in at 0.8 per cent q/q, or 3.3 per cent on an annualized basis, sharply missing the consensus estimate of an annual growth rate of 4.4 per cent and the Bank of Canada estimate of 4.0 per cent. In addition, preliminary estimates for July figures point to GDP growth being negative, down 0.1 per cent erasing the 0.1 per cent gain seen in June. This suggests that the economy is slowing down faster than previously expected as the aggressive rate hikes seen this year begin to propagate through the economy. However, it is not expected to temper the Bank of Canada's interest rate policies as inflation pressures remain too elevated for them to change tactics.

Higher interest rates are beginning to temper investment. Residential construction fell in the second quarter down 7.8 per cent on a quarterly basis while business investment also fell 2.4 per cent. Imports also accelerated in both goods and services as they are up 6.8 per cent and 7.5 per cent, respectively. This is significantly higher than the growth in exports, which was up only 2.6 per cent, not enough to offset each other. Businesses instead made major investments in inventory based on the strong demand they saw for goods and was a major factor in the overall increase in the second quarter. On the other hand, household spending was strong as it grew 2.3 per cent over the previous quarter. Demand for services was strong as they rose 3.9 per cent as well as demand for semi-durable goods, which is up 5.6 per cent. However, durable goods, which in some way is like investments, has fallen 3.1 per cent, likely affected by the recent sharp interest rate hikes.

Income growth accelerated in the second quarter, up 4.2 per cent as compared to 3.7 per cent in the first quarter. Businesses are benefitting substantially from the higher domestically produced goods as well as higher energy and commodity prices. Corporations saw a net operating surplus increase 13.0 per cent over the previous quarter. Employee compensation on the other hand slowed to increase only 2.0 per cent in the second quarter as compared to 3.8 per cent in the first quarter. Household savings also slowed down as inflation begins to erode consumer spending power. It fell to 6.2 per cent as compared to 8.1 per cent seen in the first quarter.

As mentioned despite the weaker numbers in GDP and the much greater slowdown seen than expected, inflationary pressures are still high with July numbers coming in at 7.6 per cent year over year as consumer demand remains robust. Markets are still expecting a rate hike next week of around 75 basis points as the Bank of Canada attempts to lower it closer to the target rate of 2.0 per cent. With that said and the current trend with a tight labour market, we are likely to see even softer growth for the second half of 2022.

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