



Canadian economic resilience persists in early 2023

After stalling in the fourth quarter, Canada's economy recorded a stronger than anticipated start to 2023 with a 3.1 per cent (annualized) rate of growth in expenditure real gross domestic product (GDP) that outpaced consensus for a 2.5 per cent expansion. While showing signs of slowing late in the quarter, there is no clear picture that has emerged as early estimates of industry- output showed growth in April. On a nominal basis (inclusive of prices), GDP expanded by an annualized 4.2 per cent in the first quarter.

The first quarter surprise was led by the resilient consumer and international trade. Household consumption expenditures soared 5.7 per cent (all figures annualized unless noted) during the quarter. This was led by large increase in the pace of durable goods spending, which for a second straight quarter climbed more than 13 per cent, while semi-durable goods rose 18 per cent. Strong gains in the demand for motor vehicle and parts which could reflect improved supply and clothing drove this increase as consumer continued their spending ways. Non-durable goods spending edged lower while services-spending increased 5.4 per cent. Offsetting some of this consumer demand was a decline of 1.5 per cent in government consumption.

Meanwhile, international trade flows added to growth with exports up 10.1 per cent annualized, while imports were up 0.9 per cent. Export growth led by the vehicle sector, mining and agriculture.

In contrast, weakness in the housing cycle continued to drag on growth despite signs of stabilization and growth in the existing home sales. Residential investment contracted for a fourth straight quarter with 14.6 per cent annualized drop. After peaking in Q1 2022, residential investment is down nearly 19 per cent. This latest decline reflected a drop off in new home construction and renovations which is not surprising at the former lags trends in the existing home market. Business investment saw a 2 per cent increase as non-residential construction (up 8.7 per cent) offset a decline in machinery and equipment.

On an income basis, the economy grew by 1.0 per cent quarter-to-quarter (4.2 per cent annualized). Household disposable income fell 1.0 per cent despite gains higher employee compensation of 1.7 per cent driven by a tight labour market. This was more than offset by lower government transfers and net property income. Repayment of benefits and higher interest on mortgages did not keep pace with deposits. Corporate incomes fell with net operating surplus down 4.1 per cent as terms of trade deteriorated with lower energy prices, and financing costs rose.

On the savings front, with consumption outpacing disposable income the savings rate fell from 5.8 per cent to 2.9 per cent.

Statistics Canada also reported the latest industry-GDP data which captures the production side of the economy. Monthly GDP came in unchanged as expected following a 0.1 per cent month-to-month gain in February as goods-production edged down but services held steady. However, it looks like the economy picked up steam again in April with preliminary estimate for a 0.2 per cent gain. Mining, real estate transactions, and warehousing lifted growth. Wildfires could be a drag on May data.

The latest GDP data points to a mixed but still resilient economy. Consumers are seemingly holding up better than expected in the higher rate environment, although housing is still a drag. Moreover, a deceleration trend is not entirely clear given the uptick in April growth. For monetary policy this latest data adds to the potential for further rate hikes considering firm inflation, a tight labour market and recovery in home prices. While we expect the impacts of higher interest rates to ultimately slow consumer spending, particularly as savings rates normalize and excess savings ease, this may not be enough to bring down inflation quick enough for the Bank's liking. We expect the Bank to hold its policy rate steady at 4.5 per cent next week but risks are to upside for July.

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