Economic Commentary

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Economics

Canadian economy pops in May but looks to retreat in June

Canada's economy remained resilient to the elevated interest rate environment and uncertain economic backdrop through May as GDP growth accelerated despite a drag from the raging wildfires in Alberta that impacted the energy sector production as a stronger resale housing market and return of federal workers from the picket lines added to activity. GDP growth rose 0.3 per cent during the month after a 0.1 per cent expansion in April. However, this pick up is temporary with early estimates pointing to a retreat in June of 0.2 per cent which would align with a Q2 growth rate of about one per cent.

May growth was driven by several key drivers. Among goods producing sectors, broad energy output fell 2.1 per cent, driven by a 3.6 per cent drop in oil and gas extraction. Alberta wildfires were the key contributor to this pullback which impacted activities in the western part of the province. These numbers will rebound in the coming months. Residential construction fell another 1.7 per cent to mark a seventh straight drop to extend a drop from April 2021, with levels 4.5 per cent below pre-pandemic levels. Residential construction is down largely on lower renovations and single-family housing activity which is highly sensitive to higher rates. In contrast, manufacturing activity rose 1.6 per cent as a significant driver and led by transportation equipment (2.2 per cent), machinery (3.0 per cent), and chemical manufacturing (5.7 per cent). Supply chain improvements contributed to the increase. Broadly goods production fell 0.3 per cent.

Services-producing industries gained 0.5 per cent from April, but this will not last, and we can expect to see flattening conditions. Indeed, much of the growth came with the end of the federal government employee strike which drove a 3.1 per cent monthly advance in related public administration, reversing the April contraction. This contributed about a third of net GDP growth for the month. Wholesale trade advanced 2.9 per cent, which was helped by supply chain improvements. On the housing front, the early year pick up in home sales lifted real estate office activity rose 7.6 per cent. That said, the latest interest rate hikes are likely to wring out momentum in the sector in the back half of this year.

May's pop in economic activity may be the last in a while as the economy transitions to slower conditions in the back half of the year. June's estimated retreat is driven by reversals in manufacturing and wholesale trade growth partly owing to the B.C. ports strike. Meanwhile, successive interest rate hikes by the Bank of Canada in June and July will likely slow the resale housing market and spending on consumer goods. With Q2 industry GDP growth tracking about one per cent, growth is likely to fall slightly below the Bank of Canada's forecast expenditure-based GDP forecast of 1.5 per cent. We expect this weaker pattern to continue as rate hikes work through the economy. More data is to come in advance of the September interest rate decision, but this GDP reading supports our expectation for a rate hold.

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