



Gone fishing: Canadian economy takes a break in Q2

Canada's economy slowed more sharply than expected during the second quarter which should keep the bank of Canada's policy rate anchored at the current 5 per cent at next week's meeting. Expenditure-based Gross Domestic Product (GDP) slipped to an annualized 0.2 per cent from the first quarter, missing the consensus forecast for a 1.2 per cent increase and our call for a [1.1 per cent expansion](#). The Bank of Canada had forecast a 1.5 per cent expansion in its July Monetary Policy Report. On an industry- basis, monthly output was negative in June following a slight downward revision to May data.

The economy saw a broad deterioration in conditions during the second quarter in a sign that rate impacts are having an impact on demand. After popping higher in Q2 by an annualized 4.7 per cent, household consumption growth stalled to a 0.2 per cent pace. Goods-expenditures edged up on an increase in new trucks and vans as supply chain issues ironed out and vehicles were delivered, but off set by fewer sales for outdoor recreation durables, new passenger cars and natural gas. Services-expenditures pulled back from a 4.7 per cent increase to -0.1 per cent, annualized.

Housing continued to detract from growth with a fifth consecutive quarterly decline (8.2 per cent, annualized), even as transfer costs accelerated due to the upswing in home sales during the first half of 2023. Residential investment is down 20 per cent since Q1 2022 as new home construction and renovations have pulled back sharply on higher borrowing costs. On the investment front, these declines were off set in part by the surprising growth in non-residential investment in structures (10 per cent) and machinery and equipment (11.1 per cent). In other segments, government investment in capital edged lower (0.8 per cent annualized), while government consumption growth rebounded to 2.5 per cent after a 3.7 per cent decline in Q1. A drawdown in inventory also marked a drag on growth.

Global trade also restricted growth for the quarter. Following a 10 per cent annualized gain in Q1, exports were unchanged in Q2 as weaker oil and agricultural exports weighed. Imports rose, in part reflecting the stronger non-residential investment. Excluding trade and inventory adjustments, growth in final domestic demand looked better, but still held at subdued 1.0 per cent and was lower than the 1.2 per cent in Q1.

On a nominal basis, GDP rose 0.7 per cent from Q1 (2.7 per cent annualized) which remained stronger than real growth reflecting ongoing but marked decelerating price pressures in the economy. Wages and salaries rose at a 9 per cent annualized pace while corporate profits fell 26 per cent annualized (7.4 per cent non-annualized) as resource driven activity retreated. Higher wages supported an increase in the household savings rate which rose from 3.7 per cent to 5.1 per cent.

The Q2 economic slowdown is expected to extend through the second half of the year. Monthly industry-GDP fell 0.2 per cent in June, on a goods-sector pullback as wildfires and droughts affected resource industries across the country. The early estimate suggests no change in July, although west coast port strikes impacted trade and wildfires continued to hamper activity through August. While some of these factors are temporary drags, the cumulative impacts of past rate hikes are still seeping through activity. It is also noteworthy that real per capita GDP is running negative given the strength in population growth.

This is the last key data release heading into the Bank of Canada's September interest rate decision and the miss should prove highly influential in keeping the Bank on the sidelines as it adds to a signs of slowing core inflation, softening labour market and weaker consumer demand. We expect the Bank to hold until the end of Q1 2024 when it commences rate cuts.

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