Economic Commentary

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Canada GDP: On the road to nowhere, fast

The Canadian economy moved sideways again in August, underperforming forecast consensus for a mild uptick and signaling a sluggish second half for the economy. Real industry gross domestic product (GDP) was unchanged as contractions in the goods industry, driven by resource extraction and agriculture and manufacturing offset an uptick in services, particularly wholesale trade. While treading water and evading a technical recession, the economy is weak and continues to contract once adjusted for the huge surge in population growth over the past year of 3.0 per cent. Year-over-year growth in industry output came in at a meek 0.9 per cent. There are scant signs of any traction in September to cap off the third quarter advanced estimates suggest output was again unchanged.

A scan of industry details pointed to weakness in the agriculture sector where output fell 3.2 per cent, marking a sixth straight monthly decline and a year-over-year drop of 16 per cent. This was driven by lower crop production (-5.0 per cent) during the month as poor farming conditions contributed to the slide and a retreat from last year's surge. While forestry and logging were down 0.2 per cent on the month, levels were 16.6 per cent lower than a year ago. Oil and gas extraction rose a significant 1.0 per cent, along with robust growth in mining output (4.2 per cent). Among other goods sectors, construction was unchanged with some lift in residential activity, while manufacturing slipped on food production.

While there was mixed activity in the industrial sectors, there were signs that consumers are retrenching. Wholesale trade was the key contributor to maintaining positive services-sector growth with a 2.3 per cent increase, albeit still flat on a 6-month basis. This looks to be owing to demand from machinery and equipment rather than household products, which aligns with retail weakness.

Retail sector output fell for a third straight month with a 0.7 per cent decline in August. A sharp decline in motor vehicle and parts dealerships could reflect both a pullback due to high interest rates and some ongoing supply chain impacts on some models, while other housing-oriented spending also slipped. Food services activity fell 2.2 per cent on the month and 3.6 per cent over the last six months, which is aligning to consumer slowdown. Pass through of weakening housing activity following summer rate hike also cut output from real estate offices by 3.8 per cent.

Travel also provided some lift to economic activity, both inbound and outbound. Transportation and warehousing rose 0.8 per cent, due to air transportation (up 1.1 per cent) but owing to a bounce back from a weak summer when the weather curbed activity. Public services, including education and healthcare, were little changed.

Today's GDP report underscores recent themes of a stalling economy that continued through the third quarter. Only robust population growth has helped the economy skirt an outright contraction in the economy, but the pullback in consumer activity means that more individual households are feeling the pinch and cutting back due to the bite of high inflation and interest rates. This is unlikely to change course any time soon as the impact of past interest rate hikes continues to impact both households and businesses, leading to flattening job growth and financial pain.

With the advanced estimate for September pointing to little growth in the third quarter, growth will fall short of the Bank of Canada's forecast 0.8 per cent annualized growth (although expenditure measures can differ from industry estimates). Underperformance in the economy should lead to further easing inflation, and we remain of the view that the Bank's rate cycle has peaked. That said, inflation is still sticky and wage growth remains higher than preferred, which keeps the Bank on hold well into Q2 if not longer, before rate reductions commence.

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