Economic Commentary

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Economics

GDP contracts in Q3 but no recession yet with Q2 revisions

Economic growth soured in Q3 but big revisions to Q2 data meant Canada continued to avoid a technical recession. Expenditure-based gross domestic product (GDP) fell at an annualized rate of 1.1 per cent during the quarter following an upward revised 1.4 per cent during the prior quarter on updates to business investment and inventory. Q2 was previously estimated at a mild contraction of 0.2 per cent. Despite the adjustments, the latest data shows a stagnant path for the economy particularly when recognizing the underlying support from robust population growth. Moreover, the economy is sharply lagging the stunning performance south of the border where Q3 growth is estimated at 5.2 per cent. The associated monthly industry output data pointed a slight uptick in activity in September after three months of contraction, and there may be life in the economy with preliminary data for October up 0.2 per cent m/m.

The third quarter contraction was driven by a sharp pull back in exports and business investment, weakening inventory accumulation and a consumer that looks to be hunkering down in light of financial pressures. This is all signaling deteriorating business conditions. On an annualized basis, exports fell 5.1 per cent, which reversed a Q2 uptick but are still tracking at an elevated level. However, businesses are ratcheting back amidst uncertainty a sharp decline in inventory investments, while investment in non-residential structures (-7.7 per cent) fell for the first time in since Q1 2021, while spending on machinery and equipment recoiled 14.4 per cent after a sharp increase in Q2. Government spending was an area of growth with a 2.4 per cent gain.

On the consumer front, there was slight change for a second straight quarter. Annualized growth was unchanged at 0.1 per cent after a 0.1 per cent contraction in Q2. Consistent with retail spending data and an upswing in vehicle spending, durable goods sales rose at a rate of four per cent. This was offset by a sharp drop in semi-durable spending (-10.8 per cent) and non-durables (-1.6 per cent), while services spending rose 1.4 per cent. Housing expanded for the first time since Q1 2022 with an 8.3 per cent annualized advance but still down 20 per cent over that period as high interest rates have frozen the resale market and the market for new homes and renovations remains weak.

Final domestic demand (stripping out trade and inventory) came in at 1.3 per cent annualized and was consistent with Q2 performance.

On the income front, Statistics Canada reported an acceleration in gross national income from a (non-annualized) 0.8 per cent in Q2 to 1.6 per cent in Q3 even as real activity sank. While there were slower but still positive gains in employee compensation (1.3 per cent), gross operating surplus or profits rose 2.3 per cent due to higher oil prices and motor vehicle production. Financial corporations' profitability weakened due to declining net interest margin due to higher policy rates.

Despite the Q2 upward revision, the Q3 pullback was substantial and continued to highlight the challenges in the economy heading into 2024 even with the uptick in monthly GDP for October. Household spending is weak despite a strong population and likely to remain so as mortgage renewals sap household finances, and businesses ratchet back investment and hiring considering this demand. We remain of the view that challenging economic conditions keep the Bank of Canada on the sidelines next week and drive a rate cut early in the second quarter.

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