Economic Commentary

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Economics

Economy grows less than expected in Q1, green lights a Bank of Canada cut

Canada's economy grew at a slower than anticipated pace during the first quarter which should green light a Bank of Canada rate cut at next week's meeting. Annualized real gross domestic product (GDP) rose 1.7 per cent in Q1 (0.4 per cent non-annualized) and while accelerating after a sharply revised Q4 (from 1.0 per cent to no change), this was well below consensus for a 2.2 per cent increase. The Bank of Canada had projected a 2.8 per cent pace in its April Monetary Policy Report.

On a monthly basis, industry GDP was unchanged in March. Construction sector growth was offset by flat to negative growth across most other industries. The advanced estimate of 0.3 per cent m/m in April points to an uptick but still weak trend.

Underlying the headline expenditure growth was a mixed message in the data. While overall growth was modest domestic drivers gained some traction. Specifically, consumer spending rose at a pace of 3.0 per cent, which was consistent with the 3.2 per cent advance in Q4. Spending on services (4.3 per cent) and semi-durables (9.6 per cent). That said, this is driven by the robust pace of population growth with real per capita spending unchanged. Housing rebounded but growth remained tepid at 1.3 per cent annualized, lifted by an early year but temporary boost in housing activity. There was also some movement up in investment after deep contractions in prior quarters. While nowhere near enough to erase recent declines, non-residential construction investment rose 1.9 per cent while machinery and equipment investment increased 6.3 per cent. Government spending remained a support for growth with consumption and investment both up about 2.1 per cent. Final domestic demand rose 2.9 per cent after no gain in Q4.

The drag on GDP came from net trade and adjustments in business inventory. Exports slowed from 3.2 per cent growth in Q4 to 1.9 per cent in Q1, while import growth moved higher to 1.5 per cent from 0.9 per cent. After adding to net growth in Q4, trade had little impact in the latest quarter. Businesses slowed the pace of inventory accumulation which was a key drag on overall growth.

On the income side, quarter-over-quarter data showed an advance of 0.1 per cent in nominal income compared to 1.5 per cent in Q4. Export prices moved against Canada with export prices down 1.3 per cent, driving a 1.2 per cent drop in the terms-of-trade measure. The GDP deflator fell 0.3 per cent. Compensation for employees rose 1.5 per cent, reflecting job gains, while corporate profits fell 4.9 per cent. Household savings remained elevated at 6.9 per cent, which was up from 6.2 per cent in Q4.

Despite the mixed drivers in Q1, the softer GDP print was more than full point below the Bank of Canada's outlook and should allow for a policy rate cut next week. A downward revision to Q1 points to an even weaker trend. The economy is still faltering on a per capita basis, inflation is under control, and risks from mortgage renewals are still in view. Firmer consumption growth numbers could trigger a hawkish tone from the Bank, and U.S. Fed policy will also factor into future moves. Nevertheless, we anticipate a 25 bps cut next week and a total of four cuts this year to bring the policy rate to 4.0 per cent by year end.

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