Canada GDP preview: A reason to smile?

Canadian GDP growth was probably flat in January and while there are reasons to be optimistic about an improvement going forward, a dovish Federal Reserve and lingering uncertainties surrounding both the domestic and global economic backdrop suggest the chances of a rate hike are diminishing

Source: pexels

At the start of the year, there was reason to think Canada could outperform its G7 peers. But so far, the dataflow suggests otherwise. The late-2018 oil price plunge depressed GDP in December (falling 0.1% month-on-month). Construction has also declined for seven consecutive months.

Oil prices were still a drag in January

We think economic growth was probably flat in January, although there are some potential bright spots. After three months of weakness, manufacturing sales recovered (+1% MoM). Encouragingly, sales rose 2.5% in Alberta. This province has the most exposure to the oil industry.

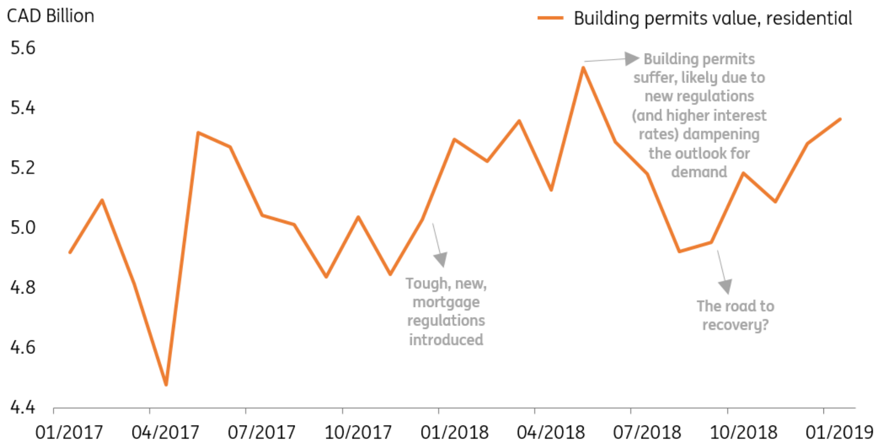
That said, the oil story could still prove to be a drag on the retail side. While oil prices regained some poise in January, the lagged impact of the earlier decline saw average gasoline prices dip. Lower receipts at gasoline stations dragged retail sales lower in January.

Are things really that bad in the housing market?

One area to watch is construction. Higher interest rates and tighter mortgage rules have triggered a housing market slowdown. Nonetheless, investment in residential construction has picked up in recent months and in particular, single-dwelling construction has started to improve. So are things really that bad?

Of course, it's important not to focus solely on the monthly figure due to the sector's volatility but when you look at building permits – which tend to be a leading housing market indicator given that you (typically) can't construct without a permit- things look to be recovering.

Are building permits pointing to a recovery?



Source: Macrobond

The above chart shows permits in the residential sector have generally risen since September last year, which offers some reassurance when it comes to investment in the housing market going forward. This should also be supported by the Liberal government's federal budget for 2019. First-time home buyers are being incentivised to jump on the housing ladder with government plans to absorb part of the cost. That said, this inducement won't come until effect until the autumn so some home buyers may delay their decisions until then. This could make the housing market appear weaker-than-expected in the near-term.

Bank of Canada: Two minds

This latter point could muddy the waters slightly for the Bank of Canada (BoC) when it looks to gauge the effect of higher interest rates on the housing market. We also suspect that policymakers will want to wait and see how oil prices and the global trade backdrop develops over coming weeks. So if the BoC does opt to hike in 2019, it's unlikely to come much before the end of the year. With the Fed firmly in dovish territory, it's possible that the BoC follows suit and prolongs its current pause. As is the case in the US, investors are currently pricing in at least one rate cut this year.

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