

Canada: Three takeaways from the 1Q growth report

The underlying Canadian growth story looks reasonable, despite what the headline figure might suggest. This supports the Bank of Canada's more upbeat tone on growth, and we don't expect a rate cut this year



Source: pexels

Taken at face value, the first-quarter growth figure for Canada looks fairly lacklustre and is unlikely to encourage markets to shift away from the current, more pessimistic mindset on interest rates (investors are now pricing in a full rate cut over the next 12 months). In fact, at 0.4% (quarter-on-quarter annualised), it wasn't much of an improvement from what we saw back in the final quarter of last year (0.3%).

But as is often the case, the headline figure only tells part of the story, and beneath the surface, there are some more encouraging signs - reinforcing our view that the first-quarter will represent the nadir for the economy this year.

1

Exports were a significant drag on net trade, and in turn on the overall growth figure

At -4.1% QoQ annualised, exports experienced the largest drop seen in a year and a half. This was predominantly driven by the material weakness in the energy sector, not least because of the mandatory oil production cuts. These were enforced by the Alberta government in January. More generally, the lagged impact of the late-2018 oil price decline was still working its way through into the economy during the first quarter.

Canadian exports of crude are likely to remain subdued given uncertainty surrounding pipeline approvals. But as the sector fully adjusts to the output limits, as well as a possible shift towards alternative forms of transportation (such as rail), we should slowly start to see investment in the sector pick-up. This should prompt a decent recovery in export figures, and will also be supported by our commodities team's view that global oil prices should edge slightly higher through this year and next.

2 Households showed few signs of a knock in confidence

Household spending grew 3.5% QoQ annualised, which was the fastest pace of growth in almost two years. This bumper figure is likely to have been supported by ongoing strength in the labour market, which for some time has been the only silver lining in the economy. This strength had struggled to translate into higher household spending late last year, but the fact that average hourly wage growth has been creeping upwards since the start of this year may have helped drive better spending growth during the first quarter.

3 The comeback of business investment

Global trade uncertainty and energy sector issues evidently didn't prevent firms from delaying investment decisions in the first quarter. Business investment had fallen for three consecutive quarters but bounced back in 1Q19 and there are signs that this won't be temporary:

- Now that US metal tariffs have been lifted, there has been renewed hope that the [United-States-Mexico-Canada-Agreement \(USMCA\) may finally be ratified](#) by the US Congress over the summer. That would lift one element of uncertainty for Canadian firms, although admittedly [President Trump's latest signal](#) that he will place tariffs on Mexico appears to have put a spanner in the works for the time being.
- The trade war between the US and China certainly has the potential to get worse before it gets better. However we think a deal is still ultimately possible (albeit it may not come this year), and if an agreement is reached, it would lift a large cloud from the global economy - including Canada.
- Better economic data should be on its way, as the economy continues to adjust to higher interest rates and recovers from the late-2018 oil price decline. There are also some indications that the housing market will emerge from its current slump, and we anticipate economic growth will slowly regain some momentum as we enter the second half of the year.

The bottom line is that the underlying growth story looks fairly reasonable in Canada, despite what the headline figure might suggest. This supports the [recent narrative from the Bank of Canada](#), which has recently adopted a more upbeat tone on growth.

In our view, the Bank of Canada is likely to remain firmly on hold throughout the course of this year – although a lot depends on how the global trade war evolves, how the Federal Reserve subsequently responds, as well as what happens domestically following the Federal election campaigning process.

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