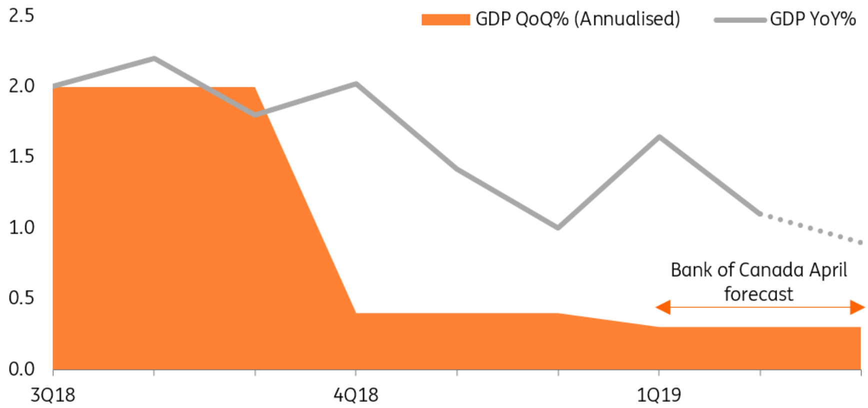
Canadian growth struggles to sustain momentum

After January's upside GDP surprise, economic activity slipped back again in February. But will the first quarter be as weak as the Bank of Canada anticipates?

Source: pexels

The Bank of Canada's (BoC's) decision to formally remove its tightening bias at last week's meeting was somewhat supported by the latest GDP figures for February. That said, barring a significant fall in monthly GDP for March, the overall first-quarter figure has the potential to come in higher than the BoC's latest, sharply revised, 0.3% annualised forecast.

Annual GDP growth in March would have to be below 1.0% to meet Bank of Canada expectations



Source: ING, Bank of Canada

Bank of Canada: A little too pessimistic?

When it comes to growth, the central bank is squarely focussed on global trade uncertainty, the difficult outlook for the energy sector, as well as concerns surrounding household activity. This is partly why the recent growth trajectory has been lower, but also suggests the near-term growth outlook is skewed to the downside.

Nevertheless, the outlook for the first quarter as a whole may not be quite as bad as the Bank of Canada's forecasts suggests. For example, the manufacturing sector took a slight hit in February and sales fell 0.2% month on month, but we don't see this trend persisting. Fewer motor vehicle sales were a key reason behind the fall in sales, yet both solid retail and wholesale trade reports suggest this drag may only prove temporary. These two components were both boosted by positive contributions from the sale of motor vehicle parts.

Moreover, the underlying strength of the labour market - coupled with signs that the US economy is still performing well - bodes well for good levels of both domestic and foreign demand for now. This should also continue to support the manufacturing sector.

We aren't convinced of a rate cut this year

Having said all of that, we aren't saying that an upside surprise in first-quarter growth would prompt the BoC to inch back towards a more hawkish stance. But it would reinforce our view that a rate cut is unlikely to be delivered this year – something which markets are now gearing up for. We think it's more likely that the policy rate is maintained at 1.75%, given the scope for some upbeat news on the economic outlook as we enter the second half of the year.

(See here for more details on whether the next move in rates will be up or down).

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