

Energy-hit growth won't stop the Bank of Canada hiking later this year

Turbulence in the energy sector looks set to drag Friday's fourth quarter Canadian growth figure lower. Global risks are building too, but there are still some reasons for optimism on the outlook this year



Source: Shutterstock

Tumbling oil prices and production difficulties hit Canadian growth late last year

It is fair to say Canada's 2018 growth hit something of a peak in the second quarter. The third quarter story wasn't necessarily bad either (2.0% quarter on quarter, annualised), but given fourth-quarter growth will reflect the increasing difficulties in the energy-sector, figures won't be great. We forecast a slowdown to 1.4% QoQ, annualised in data due on Friday.

The root cause of the damage is a mixture of the late-2018 decline in oil prices and the weakening in Canadian oil differentials over much of the year. Pipeline constraints restricted export flows, leading to large inventory builds in the domestic market, which weighed on Western Canada Select significantly more than global benchmarks. The weakness in Canadian differentials saw the province of Alberta announce mandatory production cuts for producers towards the end of 2018, which has since led to a strengthening in Canadian differentials.

The New Year has seen global oil prices regain some poise, but the impact of the production cuts will continue to be a drag on economic growth this year. More broadly, manufacturing fell for three consecutive months at the end of 2018 and business confidence dipped, which likely reflects the more uncertainty picture for global growth. This latter point may see investment dip back the fourth quarter growth numbers.

That said, we still view the [economic slowdown to be mild, not major](#).

Away from energy, there are positives for the economy

Trade developments between the US and China have recently taken a slight turn for the better as the 1 March US tariff increase on Chinese goods deadline was pushed back. There's a long way to go, but if a more permanent resolution can be found, the outlook for US growth still looks fairly reasonable. The solid US consumer backdrop and healthy jobs market isn't likely to fade anytime soon, which is good news for Canadian exports. Better news on trade would also likely help oil prices, reinforcing our commodities teams' view that Brent Crude and WTI should edge higher throughout this year and next.

Canada's labour market is also showing signs of strength. January saw wage growth finally pick-up ([see here](#)), and we don't expect this to just be a one-off. Business surveys have recently suggested that firms view labour availability as an increasing constraint on production, which would point to further upside in wage growth over the coming months.

These points bode well for both domestic and foreign demand, as well as sentiment generally, and is why we think the [manufacturing sector looks better than the numbers suggest](#).

A rate rise from the Bank of Canada this year looks likely

The Bank of Canada will also be keeping a keen eye on the severity of any housing market downturn, trade developments between the US and China, as well as oil prices. If these downside risks don't materialise, we expect the central bank to hike once (if not twice) this year. The next move is most likely to come in the third quarter, allowing time to see how the Federal Reserve acts over the next few months.

Author

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. *ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies)*. The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss

arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit www.ing.com.