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Economic Flash!

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Canada's Economy De-Energizes in November

Per/Per % chg	11:Q2*	11:Q3*	Sep	Oct	**Nov**	**Nov Y/Y**
GDP (at Basic Prices)	-0.2	3.5	0.2	0.0	**-0.1**	**2.0**
Goods-producing	-2.4	6.2	0.4	-0.1	**-0.6**	**2.7**
Services-producing	0.8	2.2	0.1	0.1	**0.1**	**1.7**
Business	-0.7	3.9	0.3	0.0	**-0.2**	**2.2**
Non-business	1.8	1.2	0.0	0.1	**0.1**	**1.1**

** annualized*

- While it initially appeared that the Canadian economy smoothly decelerated late last year, it now looks like Canada stumbled as it approached the 2011 finish line. The economy was dealt an acute blow from its energy sector in November, as a plunge in resource-related output contributed to a 0.1% drop in GDP. That's in sharp contrast to market hopes for a 0.2% gain that month. Plunging output in other goods-sector categories such as construction and utilities also added salt to the wounds. With the month's surprise contraction in output, GDP growth for Q4 is now tracking around 1.7%—below the previous market consensus and modestly lower than the Bank of Canada's own forecast of 2.0%.

- November's drop in energy output caught the street by surprise, as by all other measures, energy activity looked to have been holding up that month. Manufacturing shipments of petroleum and coal products posted gains, while real exports of energy, based on the goods trade data, actually increased mildly. However, the weakness in the energy sector was centered on a 2.5% drop in oil and gas extraction activity, which may only impact associated exports in a measurable way in the months ahead. Note that a sharp plunge in oil and gas extraction activity was also seen in May 2011, with weakness in exports dragging on for the following two months.

- Low natural gas prices could be one factor that discouraged extraction activity, and exports of that commodity have been broadly softening, in line with falling prices in recent years. Also, according to StatCan, maintenance shutdowns were a contributing factor to the month's weakness. Note that it's unusual for maintenance closures to impact activity in the fall, as they usually take place around the spring months. That was the case in the spring of 2011, when heavy maintenance shutdowns plagued oil and gas extraction activity, contributing to the Q2 contraction in GDP.

- Had energy sector output (which accounts for around 7% of GDP) been flat, output would have still barely been positive due to weakness in other goods sectors. Utilities output fell for the second straight month, dented by an unusually warm start to the winter that crimped electricity demand. As well, construction output fell by 0.3%. The weakness there could continue as housing construction slows, and the winding-down of stimulus activity hits non-residential building. The only real ray of hope was a 0.6% gain in factory production, driven by motor vehicle manufacturing, as Canadian producers benefitted from sales gains stateside.

- Services sectors managed to eke out a 0.1% gain in output, although strength in the month's retail print was almost entirely offset by a weaker wholesale sector. The important 'finance, insurance, and real estate' sector, encompassing about a fifth of the Canadian economy, posted no gains in November. Although real-estate-related output was buoyed by increased home resale activity that month, the finance/insurance sector sagged on weaker stock exchange volumes and falling mutual fund sales.

Implications & Actions

Re: Economic Forecast —As 2011 came to a close, the trend of monthly GDP growth took a turn for the worse; in the span of four months, output growth decelerated from August's 0.4% pace to -0.1% in November. The surprise drop in November GDP adds measurable downside risk to our prior call of 2.3% GDP for Q4. As such, we are revising down our outlook for growth in Q4 to 1.7%.

Re: Market Impact — Today's weaker-than-expected print was supportive for fixed income, and dented the C$.