



# Economic Flash!

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Emanuella Enejor (416) 956-6527

## Canada's Q3 GDP: Powering Ahead

| Per/Per % chg, Annual Rate      | 2010 | 10:Q4 | 11:Q1 | 11:Q2 | 11:Q3 | Q3 Y/Y |
|---------------------------------|------|-------|-------|-------|-------|--------|
| Real GDP (chained 2002\$)       | 3.2  | 3.1   | 3.5   | -0.5  | 3.5   | 2.4    |
| Final Domestic Demand           | 4.5  | 4.8   | 1.5   | 3.1   | 0.9   | 2.6    |
| Consumption                     | 3.3  | 4.4   | -0.1  | 2.1   | 1.2   | 1.9    |
| Government                      | 4.7  | 3.4   | -0.9  | 0.9   | 0.0   | 0.9    |
| Residential Investment          | 10.2 | -0.9  | 6.7   | 1.6   | 10.9  | 4.5    |
| Business Fixed Investment       | 7.3  | 13.5  | 12.3  | 14.6  | -3.6  | 9.0    |
| Bus Inventory Investment (\$Bn) | 8.9  | 0.2   | 9.9   | 20.8  | 10.3  | NA     |
| Exports                         | 6.4  | 8.8   | 6.2   | -6.4  | 14.4  | 5.5    |
| Imports                         | 13.1 | -0.5  | 8.4   | 13.6  | -3.2  | 4.4    |
| GDP Implicit Chain Price Index  | 2.9  | 6.0   | 3.9   | 2.6   | 1.3   | 3.4    |
| Pre-tax Profits                 | 21.2 | 43.0  | 20.5  | -7.8  | 18.1  | 17.0   |
| Real Disposable Income          | 3.6  | 5.0   | -0.3  | 1.0   | -1.2  | 1.1    |
| Personal Savings Rate (%)       | 4.8  | 4.4   | 4.3   | 4.1   | 3.5   | NA     |

- **A second quarter lapse in growth proved to be a false warning signal on the Canadian economy, with activity regaining its stride in Q3.** Coming in a touch better than expectations, Canada's GDP bounced back at a hot 3.5% annualized pace, following the prior quarter's slightly downwardly revised 0.5% contraction. A rebound to stalled exports in energy and manufacturing was the main source of the lift, as final domestic demand moved forward at only a tepid 0.9% tempo, owing to weak business investment and consumption. Activity should cool from here as the temporary "bounce" wears off, particularly as September's slightly softer-than-expected 0.2% pace of growth provides the final quarter of 2011 with only a modest handoff.
- Today's report confirmed what monthly export data had already indicated—that Q3 would be a good quarter for shipments abroad. Exports bounced back at a hearty 14% annualized pace, more than making back the lost ground of Q2's export pull-back. Energy and factory-related exports led the charge, as restarts to stalled activity boosted fortunes there. But going forward, **exports will have a hard time maintaining their momentum, with decelerating global economy likely weighing on the pace of growth.**
- **Things on the home front weren't as rosy.** Final domestic demand barely perked up, rising a tame 0.9%, as personal consumption expenditures decelerated to a 1% pace. But consumers spent what they could, tapping into nest eggs and taking the savings rate down by 0.6%-pts to 3.5%. With wages rising at a comparable pace as in the prior quarter, the fault lay with weak investment receipts and softer social security/other transfers. That kept personal disposable incomes more or less flat in the quarter, with real disposable incomes declining due to the drag from inflation. Decelerating inflation from here will lessen the drag to consumer purchasing power; however, a slowing pace of

income growth owing to tepid hiring and weaker wage dynamics will likely continue to put downward pressure on consumption activity. Note that the pace of final domestic demand has been consistently slowing since 2010, weakening from around 6% to its current sub 1% pace.

- After quarters of booming housing starts data, the residential construction bonanza finally translated into the GDP numbers, with an 11% surge in housing construction activity. However, the gains were swamped by an 11% pull-back in machinery and equipment investment, the first such contraction since 2009. Surveys of private sector investment plans including the Bank of Canada's *Business Outlook Survey*, point to continued elevated intentions for capital investment. That factor, along with elevated cash positions and pressure to boost productivity/replace depleted capital suggests that the Q3 lapse in capital spending will likely prove temporary.
- A slower pace of inventory restocking (across manufacturing, retail and wholesale industries) saw that category subtract nearly 2.5%-pts from the quarter's pace of GDP growth.
- The quarter ended on a tame note, with September GDP rising at a slightly softer-than-expected 0.2% pace as a strong performance in goods sectors was met by a slight contraction in finance/insurance/real estate.

## Implications & Actions

**Re: Economic Forecast** — Today's GDP report was a touch stronger than our expectations, but given the prior quarter's contraction in GDP, the Q3 rebound still leaves average growth over the last two quarters at a sub-2% pace—a tame underlying tempo. The modest lift to September GDP is still consistent with our call that the heady pace of Q3 activity could downscale towards 2% in Q4 as temporary boosts to activity weaken.

**Re: Markets** — Reaction to the release was limited as attention focused instead on coordinated moves by central banks to boost US\$ liquidity,

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