

CANADA

Real GDP surprises with a drop in the first quarter of 2015

HIGHLIGHTS

- Canada's real GDP slipped 0.6% (quarterly annualized) in the first quarter of 2015, and growth in the fourth quarter of 2014 was revised downward from 2.4% to 2.2%.
- Domestic demand fell 1.6%.
- Consumer spending was up only 0.1%. The 0.5% increase in services was well short of what was needed to offset the large decrease in durable goods.
- Gross fixed capital formation was down 7.0% during the quarter due to a 15.5% slide in non-residential investment. Residential investment grew 4.0%.
- Since imports (-1.5%) retreated more than exports (-1.1%), the balance of trade improved slightly, making a small positive contribution to real GDP.
- The change in inventories accelerated, going from \$8.5B to \$11.5B, generating a +0.8% contribution to real GDP in the first quarter.

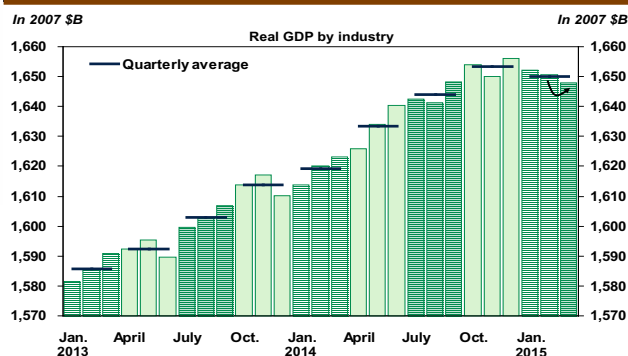
COMMENTS

The magnitude of the decrease in real GDP in the first quarter of 2015 is surprising. All of the forecasters surveyed by Bloomberg were expecting a better result.

That said, sources of weakness in the Canadian economy during winter were not a surprise. For one, the fall in non-residential investment no doubt stems from the negative effects of plummeting oil prices on activity in the energy sector, although the magnitude of the slide was much greater than expected. For another, weak retail sales left no doubt about the decrease in spending on durable goods. Consumption of services is usually enough to offset this kind of upset. That was not the case this time.

Monthly results for real GDP by industry released this morning indicate a 0.2% reduction in March and a downward revision from 0.0% to -0.1% for February. The pullback in March is particularly surprising since so many economic indicators had increased significantly during the month. For example, the volume of manufacturing sales

Carryover for the second quarter is slightly negative



Sources: Statistics Canada and Desjardins, Economic Studies

increased 2.9%, a result hardly compatible with an increase of just 0.1% in manufacturing production. The energy sector is the real centre of attention for March, with production decreasing 2.7%. Deterioration of profitability in certain extraction sites seems to be turning into a determining factor.

Implications: Given the decreases in real GDP by industry in recent months, the carryover for the second quarter is around -0.5%. As many forecasters predicted, it will be difficult to achieve robust economic growth in the second quarter with such a gap to bridge. Everything suggests that economic growth will struggle to surpass 1% in the second quarter. Such a projection increases the possibility that the Bank of Canada will order a new decrease in key rates soon.

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