HIGHLIGHTS

- Real GDP was up 2.0% (annualized) in Q3, in line with our expectations.

- But that increase is covering up bad news: domestic demand has gone down 0.1%, ending nine quarters of growth in a row.

- For one thing, consumer spending slowed down compared to previous quarters, gaining only 1.2%. For another, investments fell by 5.0%. Residential investments dropped by 5.9%, while investments in non-residential structures and machinery and equipment plunged 7.1%.

- However, international trade made a major contribution to growth in Q3. Exports increased by 0.9% while imports fell 7.8% in reaction to the weak domestic demand. The balance therefore went from -$14.0B in 2012 dollars to +$1.0B in 2012 dollars.

- The contribution from the change in inventories to real GDP is -1.3%.

COMMENTS

The 2.0% rise in real GDP is not so bad, especially on the heels of the previous quarter’s 2.9% gain. But we are disappointed, since there is no solid base for that growth and the many challenges surrounding domestic demand are cause for concern. Does this reflect the impact of previous key interest rate hikes on the Canadian economy? It is too soon to tell, but we will have to watch the situation closely over the coming months.

That said, the picture was no doubt clouded by some isolated factors in Q3. The drop in non-residential investment is counter-intuitive against a backdrop of strong production capacity utilization and some shortages. The outlook is still positive for that component, even if the energy sector could suffer short-term losses as a result of lower Canadian oil prices.

IMPLICATIONS

With the weak domestic demand, the risks have just moved up a notch in the country. As the Bank of Canada (BoC) has said many times, the reaction of the Canadian economy to interest rate hikes is fraught with uncertainty, due to household debt. In the circumstances, the monetary authorities are not likely to increase the overnight rate target when they meet next week. The BoC may even hold back in January. We will find out next week when the BoC releases its statement.

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