Canadian GDP growth slowing into the summer

- GDP rose 3.3% (annualized) in Q2 to build on a 3.1% Q1 gain
- Bounce-back in services spending and higher business investment offset housing downturn
- Pace of growth slowing into the summer as inflation and Bank of Canada rate hikes bite - advance estimate of July output down 0.1%

The Q2 GDP gain was roughly a percentage point (at annualized rates) lower than expected, but still marked a small tick up from the 3.1% increase in Q1. Residential investment pulled back sharply as housing markets slowed following Bank of Canada rate hikes. But consumer spending jumped 9.7%, led by a bounce-back in travel and hospitality spending after winter pandemic lockdowns were largely lifted. Businesses spent more on investment (13.9%) and accumulated more inventories. But much of those purchases came from abroad via a huge 30.5% increase in imports, so net trade was a large net subtraction from the GDP addup despite a solid export gain (10.9%).

Still, the Q2 GDP reading was likely the last 'above-trend' increase of this economic cycle. The bulk of GDP growth in Q2 came earlier in the quarter. Monthly output was little changed over May (0%) and June (+0.1%) and declined outright (-0.1%) in the advance estimate for July. Our own tracking of consumer purchases to-date in Q3 still looks strong, but has clearly shown signs of plateauing. And residential investment will remain a large drag on GDP growth near-term as housing markets continue to retrench.

We continue to expect growth to be slower over the second half of the year with the economy slipping into a 'moderate' recession in 2023. Inflation is still running at an exceptionally high rate, and won't ease fully back to the Bank of Canada’s 2% target without further slowing in consumer demand. The Bank of Canada is widely expected to look through early cracks in the economic outlook and push ahead with further aggressive interest rate hikes. Our forecast assumes another 100 bps of hikes to push the overnight rate to 3.5% by October.