May 31, 2022

Solid Canadian Q1 GDP growth to reaffirm BoC rate hike

- GDP grew by 3.1% quarter over quarter annualized in Q1, led by strong consumption and investment activities.
- On a monthly basis, GDP rose 0.7% in March and the preliminary estimate is for a 0.2% gain in April.
- Resumption in leisure services to drive near-term output growth; inflation pressures and heated labour market conditions pushing the Bank of Canada to hike interest rates fast.

Canadian GDP rose by 3.1% quarter over quarter annualized in Q1, supported by robust household consumption and business investment that offset a sizable decline in net trade. Consumption expenditure increased 3.4% from the prior quarter despite a soft start to the quarter in January when virus spread and containment measures weighed on services spending. Since then spending on services has surged back – leisure and travel spending in our tracking of credit and debit card purchases outpaced growth in spending on goods from pre-pandemic levels for the first time in May. Business fixed investment also posted an outsized increase, up by 9% annualized and residential investment surged by 18.1%, supported by strength in renovation activities. Despite a decline in export volumes (-9.4%), surging commodity prices pushed Canada's terms of trade (ratio of export prices to import prices) to a record high, leading to an increase in net trade in nominal terms.

Near-term growth momentum remained firm, driven by the recovery in household services consumption - along with strength in the mining sector on higher commodity prices. On a monthly basis, March output rose 0.7% and the preliminary estimate for April was for another 0.2% tick higher. But for the rest of the economy, production capacity constraints are limiting the amount that output can increase. Rising costs, worsening supply chain conditions and acute labour shortages were all once again reported as key obstacles for future growth by businesses that were surveyed in the Q2 Canadian Survey on Businesses Conditions. Many are planning capital investments to increase productivity, but they have also planned for further price increases which will add to already broad/heightened inflation pressure.

Many of these supply constraints cannot be addressed in the short run, especially labour shortage issues that have been underpinned by long run structural shifts including aging demographics. Central banks globally therefore are acting fast to tame demand. And Canadian housing markets already cooled substantially in April. We look for another 50 bps increase in the overnight rate from the Bank of Canada tomorrow, and more follow-up hikes until the overnight rate reaches 2.5% later this year.

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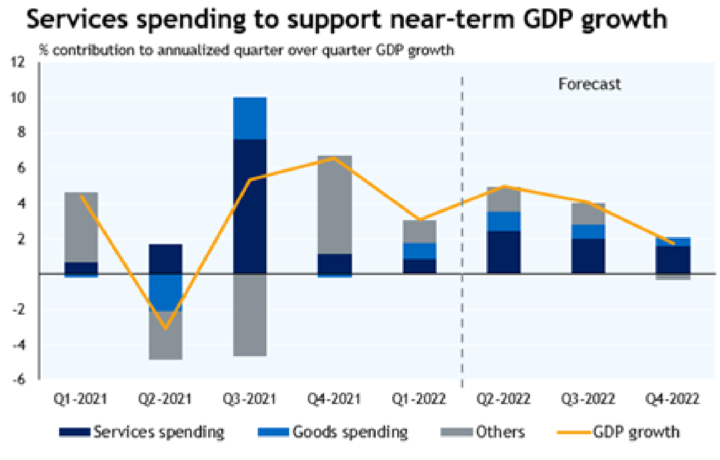

Source: StatCan, RBC projections

Canadian GDP Growth

	Q/Q annualized %			*% from Q4/2019 (pre-shock)*
	2021/Q3	**2021/Q4**	**2022/Q1**	**2022/Q1**
Consumer spending	20.1	1.8	3.4	1.0
Goods	9.9	-0.6	3.8	5.3
Services	29.8	3.9	3.0	-2.1
Government	1.7	2.3	1.8	6.4
Res Investment	-30.3	12.4	18.1	19.2
Business investment	2.3	10.2	9.0	-3.7
Net trade (ppt cont, annualized)	2.3	-0.9	-2.3	
Inventories (ppt cont, annualized)	-4.3	3.7	0.6	
Canada GDP	**5.3**	**6.6**	**3.1**	**0.8**
	Q/Q percent change			*% from Q4/2019 (pre-shock)*
Household disposable income	0.0	-1.1	3.3	13.2
Saving rate	9.5	6.9	8.1	

*Source: Statistics Canada, RBC Economics