

Canada: Services sector lifted economy in the third quarter

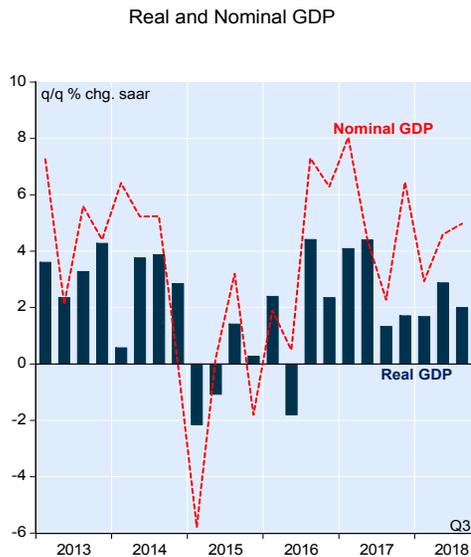
By Krishen Rangasamy

The Canadian economy decelerated in Q3 after unsustainable gains the prior quarter. The surprise, however, was the atypical weakness in domestic demand, particularly for business investment. Uncertainties related to the trade situation with the U.S. (recall the USMCA was only agreed on the last day of September) likely weighed on investment. While consumption grew in Q3, that came at the expense of the savings rate which plunged near all-time lows as Canadians dipped into their nest eggs to compensate for weak real disposable incomes. Looking ahead, don't expect a stellar Q4. True, solid corporate profits could help business investment bounce back, more so after the USMCA trade deal, while restocking could also assist growth. But a bad handoff from September – GDP fell 0.1% (unannualized) in that month – warrants caution. A moderation in the oil & gas sector is likely as producers in Alberta consider cutting back output to tackle record oil inventories and sinking prices. Consumption could also remain soft in light of fading housing wealth effects, rising interest rates and a very low savings rate. So, while the Q3 GDP growth print came in slightly better than the Bank of Canada's estimate of 1.8%, that's unlikely to hasten the central bank into tightening monetary policy considering challenges ahead.

HIGHLIGHTS:

- Canada's real GDP expanded at an annualized pace of 2% in Q3, as contributions from trade more than offset a small drag from domestic demand. The latter was hampered by soft business investment and residential construction, which dwarfed contributions from government spending and consumption (left chart).
- Sinking imports meant that inventories subtracted from growth in Q3.
- Nominal GDP (+5% annualized) grew for an eleventh consecutive quarter, which will pad government coffers further.
- Revisions to past data, including those stemming from a change in base year to 2012 (from 2007), translated to lower annual growth rates than initially estimated for 2016 (1.1% instead of 1.4%), 2015 (0.7% versus 1.0%), and 2013 (2.3% versus 2.5%).
- The savings rate was also revised down over the period 2016-2018. It fell near all-time lows of 0.8% in Q3, while real disposable incomes grew just 1% annualized.
- Industry data showed GDP falling 0.1% in September. For Q3 as a whole, industry output was up 1.7% annualized thanks to the services sector (right chart). It's the first time in 7 quarters that industry data shows a lower quarterly growth rate than expenditures data.

Canada: Economy decelerated in the third quarter



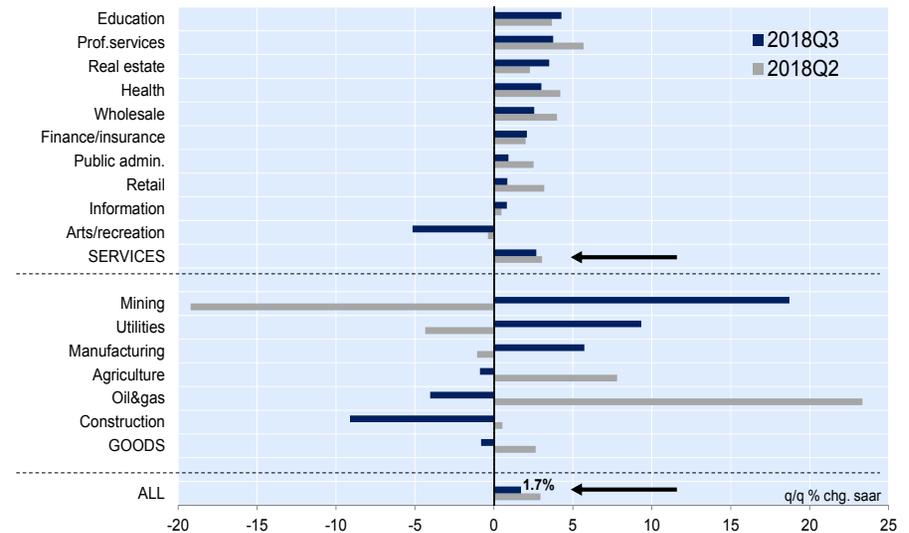
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Contributions to real GDP

	2018Q3	2018Q2	2018Q1
GDP	2.0%	2.9%	1.7%
Consumption	0.7%	1.3%	0.8%
Business investm.	-0.8%	0.1%	1.5%
Nonprofit sector	0.0%	0.1%	0.0%
Residential investm.	-0.5%	0.0%	-0.6%
Government	0.5%	0.3%	0.6%
Domestic Demand	-0.1%	1.8%	2.3%
Exports	0.3%	3.9%	0.7%
Imports	2.8%	-1.9%	-1.5%
Trade	3.1%	2.0%	-0.8%
Inventories	-1.3%	-0.6%	0.1%
Stat discrepancy	0.3%	-0.3%	0.1%

Canada: Services sector lifts Q3 GDP

GDP by industry



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