Canada: Domestic demand still very solid in Q1

By Matthieu Arseneau / Alexandra Ducharme

Canada’s GDP grew below consensus expectations in the first quarter of 2022, which should not come as a concern. The consensus had been upwardly revised in recent months due to the monthly GDP by industry, which was once again misleading. Nevertheless, a 3.1% growth in GDP remains respectable, especially with the first month of the year being held back by health measures. While international trade negatively impacted growth in Q1, domestic demand was very solid. Consumers benefited from strong wage growth in a context of tight labor market, as evidenced by the compensation of employees, which rose an annualized 16.1%, its largest quarterly increase since 1981 excluding the third quarter of 2020. In real terms (adjusted for the deflator in consumption), compensation was up a whopping 9.1%. This development that allowed a rise in the savings rate should alleviate the fears of some about a payment shock due to higher interest rates and high inflation that is still eating into purchasing power in Q2. Since the start of the pandemic, excess savings reached 13.4% of GDP, an interesting cushion for consumers juggling inflation and interest rate hikes. All in all, there is nothing in this report to slow down the central bank’s vigor in the short term. Economic growth is in line with its forecast in the last Monetary Policy Report for the first quarter (3.0%) and significant wage pressures are cause for concern. This should reinforce the central bank’s conviction to have a neutral monetary policy as soon as possible to calm down the housing market and brake consumption. Corporate profits are up sharply thanks to record high terms of trade that could encourage investment particularly in the resource sector. As for governments, with surging nominal GDP, we don’t expect austere budgets anytime soon. In other words, there are many reasons to remain positive about the Canadian economy despite the global concerns.

**HIGHLIGHTS:**

- The Canadian economy reportedly expanded an annualized 3.1% in the quarter, a result below consensus expectations (+5.2%). Following in the footsteps of a 6.6% expansion in Q4, this gain hoisted economic output 0.8% above its pre-crisis level.
- Final demand remained strong in the first quarter of the year, expanding at a 4.8% annualized rate.
- Residential investment (+18.1%), business investment in non-residential structures, machinery and equipment (+9.0%), government investment (+5.0%) and household consumption (+3.4%) all contributed to the increase. Spending on services continued to recover (+3.0% q/q annualized), while consumption on goods expanded 3.8%. Relative to their pre-crisis levels, services consumption was still down 2.1% while spending on goods was up 5.3%.
- Trade had a negative impact on growth as a decline in exports (-9.4% q/q annualized) was not cancelled out by lower imports (-2.8%). The buildup in inventory, meanwhile, added 0.6 percentage points to the headline growth figure (right chart).
- Nominal GDP grew by 15.7% on an annualized basis, following a 15.2% increase in Q3. This is good news for the fiscal health of Canadian governments and businesses. Disposable income grew an annualized 14.1% despite most of the federal support being discontinued at this point. The household savings rate consequently bounced back from 6.9% to 8.1% (left chart). This was comfortably above this indicator’s pre-crisis level (roughly 2.5%).
- Finally, industry data showed a 0.7% GDP growth reading in March, with increases in the goods sector (+0.9%) and in services-producing industries (+0.6%). Statistics Canada also released an advance estimate for April showing an increase of 0.2% m/m.

Canada: Surging compensation in Q1

**Compensation, disposable income and savings rate**

Canada: Final domestic demand contributes positively to growth in Q1

**Contribution (%)**

<table>
<thead>
<tr>
<th>Component</th>
<th>Contribution (%)</th>
<th>Q/Q annualized growth (%)</th>
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<tbody>
<tr>
<td>GDP</td>
<td>3.1</td>
<td>3.1</td>
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<tr>
<td>Consumption</td>
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<td>Business Investment</td>
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<td>Nonprofit Sector</td>
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<tr>
<td>Residential Investment</td>
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<td>18.1</td>
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<tr>
<td>Government</td>
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<td>5.0</td>
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<tr>
<td>Final Domestic Demand</td>
<td>4.7</td>
<td>4.8</td>
</tr>
<tr>
<td>Exports</td>
<td>-3.1</td>
<td>-9.4</td>
</tr>
<tr>
<td>Imports</td>
<td>0.9</td>
<td>-2.8</td>
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<tr>
<td>Trade</td>
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<td>-</td>
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<tr>
<td>Inventories</td>
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<td>Statistical discrepancy</td>
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<td>-21.2</td>
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