Canada’s economy looking a bit softer in H2/19...

Canadian GDP edged up by just 0.1% in August, marking a third consecutive month of sub-trend growth (albeit following three months of above-potential increases). Services output saw a more modest gain but was still up more than 2% from a year earlier. Goods production increased but the oil and gas sector remained soft with temporary production outages adding to weak drilling activity. Output should rebound as shutdowns are reversed, but the sector is facing new challenges with a recent pipeline spill disrupting transportation and pushing Western Canadian oil prices lower. And the familiar egress issues that have weighed on investment remain unresolved—additional pipeline capacity from Enbridge’s Line 3 replacement is still several quarters away, while the Trans Mountain Expansion won’t be in service for years.

...as global headwinds test the household sector’s resilience...

Given a slow start to the quarter, we have trimmed our Q3 GDP call to 1.5%. Growth is forecast to remain below potential (which is closer to 1.8%) heading into 2020 with business investment expected to remain sluggish and exports unlikely to provide much support. Beyond weakness in the energy sector, our view on trade and investment is largely motivated by the global backdrop, which carries both upside and downside risks. Early signs of a bottoming out in manufacturing sentiment and potential for a US-China trade deal suggests key external headwinds could begin to subside. But the global industrial sector remains weak, and even if further tariff hikes are avoided, we could see more spillover into Canada. The BoC’s latest Business Outlook Survey showed investment intentions remain healthy amid rising capacity constraints outside of the energy-producing provinces. But those intentions haven’t translated into actual capital spending so far this year. Low borrowing costs don’t seem to be enough to offset persistent trade uncertainty, or more structural issues like competitiveness and burdensome regulation.

The upshot is that Canada’s household sector is once again being called on to support growth. Consumer spending has stabilized at a more moderate pace amid strong employment gains and rising incomes. The latter has helped some households manage an earlier increase in debt service payments (the overall household debt service ratio remains at a record high despite lower market interest rates this year). But with household savings remaining low and Canadians shying away from non-mortgage debt, consumers don’t exactly have the firepower they once did. Home resales and building activity have picked up amid solid demographic demand and lower mortgage rates (unlike consumer credit, mortgage growth is accelerating). But while we think housing will add to growth in 2020, it can only do so much to offset manufacturing and investment headwinds.

...and the BoC finally gives up on neutrality

The Bank of Canada held rates steady in October but struck a much more dovish tone than in the summer, highlighting a “worsening global situation” as the primary issue. It noted escalating trade tensions and uncertainty are weighing more heavily on global growth, which will have knock-on effects on Canadian business investment and exports. The policy statement emphasized that the domestic economy’s resilience (a key factor keeping the BoC on the sidelines this year) will be “increasingly tested as trade conflicts and uncertainty persist.” Governor Poloz more or less confirmed an easing bias, noting Governing Council considered a rate cut at October’s meeting. But ongoing strength in the services sector, robust job gains, a resurgent housing market (which threatens to add to already-elevated financial vulnerabilities), and indications that the economy is close to capacity in most regions gave the central bank cause for patience. The potential for more stimulative fiscal policy next year also seemed to influence its decision. Our assumption has been that the BoC’s patience will eventually run out, with persistent trade uncertainty and below-trend growth around the turn of the year prompting a rate cut in early-2020. Rising odds of a US-China trade deal has pared back market expectations for a rate cut. But based on its October meeting, the BoC stands ready to act if global headwinds persist or the household sector begins to falter.

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