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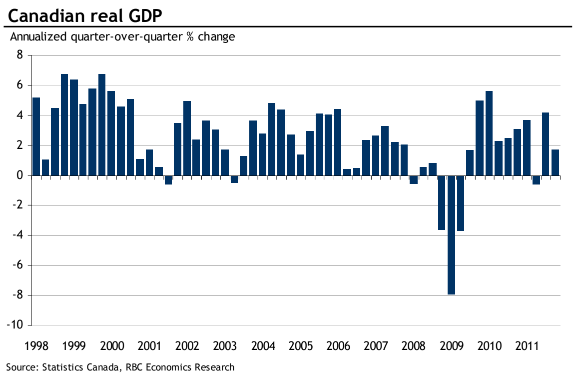
CANADIAN NATIONAL GDP ACCOUNTS
MARCH 2, 2012



Canadian Q4 GDP annualized growth slows to an expected 1.8% following an upwardly revised 4.2% in Q3

- Q4 GDP annualized growth slowed as expected to 1.8% though from an upwardly revised gain in the third quarter of 4.2% that was originally reported as up 3.5%. With the final quarter's data, growth in 2011 was 2.5% and compares to a 3.2% gain in 2010.
- Support to Q4 growth came from a stronger-than-expected 2.1% gain in final domestic demand along with an improvement in net exports. Some offset was provided by a drawdown in inventories.
- In a separate report, December GDP rose a stronger-than-expected 0.4% which more than offset the disappointing 0.1% decline in November.
- The slowing in Q4 GDP growth relative to the third quarter is disappointing. However, the monthly detail indicate the most of the slowing resulted from a drop in activity in the November that was more than reversed in December. This recovery augurs well for growth in the first quarter of 2012 to recover to our current projection of a 2.5% annualized gain. Despite the projected rebound in the current quarter, this pace of activity will likely result in only modest downward pressure on the unemployment rate. The persistence of continuing slack in labour markets implies little urgency for the Bank of Canada to start tightening. Our forecast assumes that the current overnight rate of 1.00% will be maintained through this year with a return to tightening mode not expected until 2013.

Implications

Expectations of a slowing in Q4 growth were largely based on indications that overall production in the economy was moderating based on flat to declining monthly GDP data for November and October. The slowing was expected despite indications of net exports adding to growth in the final quarter of 2011 with the implication that some of the foreign demand was being met out of inventories. Today's report confirmed an add from the net export component though it was a more modest-than-expected 0.7 percentage points. The monthly merchandise trade data had implied a boost to growth closer to 2 pp. A smaller build in inventories did result in that component subtracting 1.0 pp from overall annualized Q4 GDP growth.

The report encouragingly indicated a stronger-than-expected 2.1% increase in final domestic demand. This mainly reflected business investment rising an impressive 8.1% versus our expectation of a gain closer to 2%. The increase in the non-residential structures component jumped a much stronger-than-expected 13.3%. This may in part be the result of a mild winter in most of the country facilitating more construction activity though this component rose an even stronger 17.4% in Q3. Consumer spending rose a solid, though generally expected, 2.9% in the quarter.

A key offset to these areas of strength was a 19.0% drop in government investment that likely reflected a winding down of the federal government's infrastructure spending program introduced in the height of the last reces-

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sion. The drop represented the third consecutive quarter of double digit declines and provides a strong indication that the winding down of much of the fiscal stimulus may have played out through 2011 with less downside risk in 2012.

Also released this morning was the December GDP report which rose a stronger-than-expected 0.4%. This optimistically indicated activity ending the fourth quarter on a strong note following a 0.1% decline in November and unchanged activity in October. The decline in November was in large part a reflection of maintenance shutdowns that contributed to the mining and oil and gas extraction sector dropping 2.1% in the month. With the cessation of these maintenance shutdowns, activity in this component rebounded by 1.4%. The bounceback was limited by weakness in drilling activity that was reportedly hampered by the mild winter weather hampering movement of equipment. Mild weather was also a factor sending utilities output down a third consecutive month dropping 1.0% in December. Manufacturing rose 0.9% while service-producing industries rose a solid 0.3% reflecting relatively broad-based strength.

The slowing in Q4 GDP growth relative to the third quarter is disappointing. However, the monthly detail indicate the most of the slowing resulted from a drop in activity in November that was more than reversed in December. This augurs well for growth in the first quarter of 2012 to bounce back to our current projection of a 2.5% annualized gain.
Despite the projected rebound in the current quarter, this pace of activity will likely result in only modest downward pressure on the unemployment rate. The persistence of continuing slack implies little urgency for the Bank of Canada to start tightening. Our forecast assumes that the current overnight rate of 1.00% will be maintained through this year with a return to tightening mode not expected until 2013.

Q3 national accounts

Annualized % change (millions of chained 2002 dollars) from previous quarter

	Q4-10	Q1-11	Q2-11	Q3-11	Q4-11
Consumer Spending	4.4	0.6	2.0	1.8	2.9
Durables	11.0	-5.6	2.3	-0.6	8.6
Semi-Durable	2.9	0.5	0.0	3.5	3.6
Non-Durables	0.9	-0.5	0.3	3.6	-0.1
Services	4.8	2.4	2.9	1.3	3.1
Business Fixed Investment	7.8	12.2	8.9	5.2	6.3
Residential	-0.9	6.5	0.3	10.6	3.3
Non-residential	13.5	15.7	14.4	2.1	8.1
Machinery & equipment	5.0	15.5	30.2	-11.8	2.7
Government Spending	2.7	-0.6	1.7	2.3	0.1
Government fixed investment	7.1	-5.3	-10.5	-17.0	-19.0
Final domestic demand	4.8	2.1	2.6	1.7	2.1
Exports	8.8	4.7	-6.0	16.0	4.6
Imports	-0.5	7.7	13.5	-1.5	2.2
Change in inventories ($b)	0.2	10.0	21.5	10.5	6.5
Real GDP	**3.1**	**3.7**	**-0.6**	**4.2**	**1.8**