BBVA Research Flash

U.S.

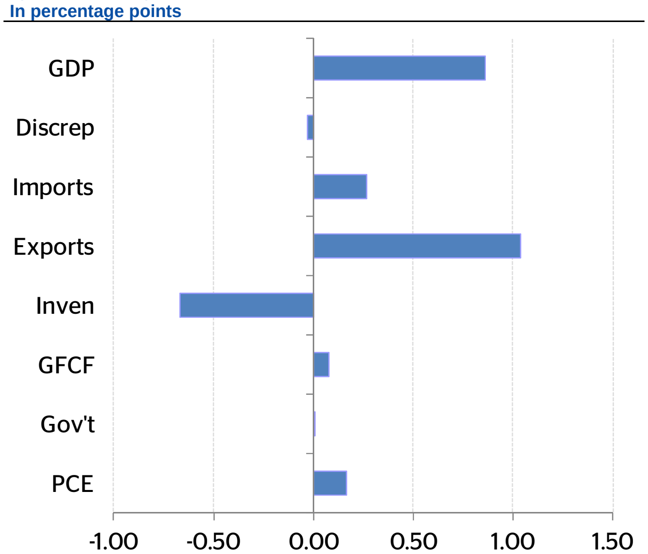
Canada: Final Demand Slows, but Exports Outperform

- **Canada's GDP expands by a 3.5% annualized rate, higher than all estimates**
- **Exports notch a significant gain, but consumption and investment slow**
- **Despite strong result, external uncertainties persist to keep BoC on hold**

Canada's economy grew at a 3.5% annualized rate in 2011Q3, a result faster than all forecasts included in consensus. Exports represented the main driver of this result and increased at a 14.4% annualized rate, the largest since 2004Q2. Final domestic demand, however, slowed to 0.9% as consumer and business spending declined, casting doubt on internal dynamics in Canada. While domestic spending on housing increased 2.6%, given Canada's frothy home price indices this result actually raises further doubts. Canada's housing market has been often flagged as a potential source of financial instability. It cannot be denied, however, that the goods sector showed impressive gains of 4.5% YoY in September on a monthly basis. Mining, oil and gas and utilities both helped boost growth in the goods sector. The services sector largely grew within expectations by 2.3% YoY in September, with retail trade surprising slightly to the upside by growing 1.5% YoY. One problem is the now yawningly-huge discrepancy in the aggregation of the goods sector's components and the total goods sector figure in the monthly GDP by industry data. This discrepancy for the goods sector now stands at 2.0%, but no meaningful discrepancy exists for the service side of the economy. Future revisions are therefore probable.

Today's GDP result is far above the Bank of Canada's (BoC) 2011Q3 forecast and will likely impact their estimation of the output gap and inflation, but not in a severe manner. The driving hypothesis of BoC's rate stance is concerns about external demand stemming from European sovereign debt issues and slowing activity in emerging markets. Given that these risk factors are not completely vanquished, today's GDP report provides Canada only with a better foundation to withstand external shocks, not the certainty of smooth sailing ahead. With slowing final demand, the onus is even greater for being watchful of export conditions. We maintain our expectation of a next rate hike in March of 2013.

Chart 1
Quarter-on-Quarter Contribution to GDP
In percentage points



Source: Haver Analytics / Statistics Canada

BBVA RESEARCH | 2001 Kirby Drive, Suite 310, Houston, TX 77019 USA | http://www.bbvaresearch.com/ | Follow us on Twitter