Canada's economy steamrolls ahead, sets stage for rate hike

By Michael Babad
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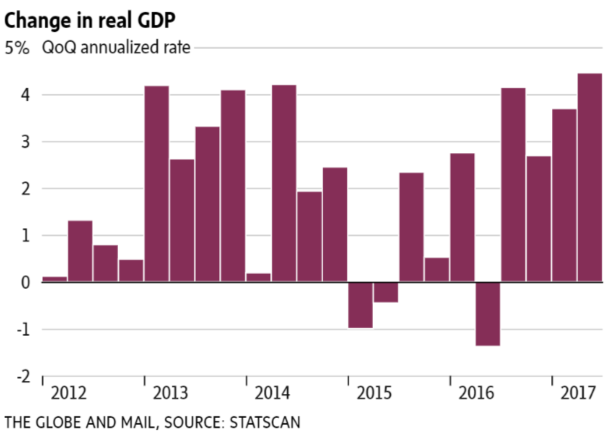
Canada's economy is steamrolling ahead, expanding in the second quarter at an annual pace of 4.5 per cent and reinforcing the probability of a fall hike in interest rates.

Canada is moving from a laggard to a leader among its Group of Seven peers as the impact of the oil shock fades and consumers continue to buoy the economy with what economists warn are unsustainable spending and borrowing habits.

Thursday's reading of gross domestic product by Statistics Canada was far greater than economists had projected.

In the first two quarters of the year, the economy has now expanded at its strongest clip since 2002, the federal agency added.

What's more, "with today's report, average growth has been more than double the economy's potential rate for four consecutive quarters," said Royal Bank of Canada assistant chief economist Paul Ferley.



"Activity is being supported by low interest rates and solid job gains that have been sustaining consumer spending growth of almost 4 per cent over the past year. However, an additional supportive factor has been the cessation of sizable declines in energy investment as oil prices moved modestly higher."

Consumers are pumping up growth, as are goods exports and construction.

But observers say this can't last, and that growth will slow along with household consumption as interest rates rise while debt burdens remain high. Having said that, the savings rate still managed to rise.

Or, as economist David Madani of Capital Economics put it, Canadians are "still living the high life."

Household spending rose 1.9 per cent in the quarter, on everything from durable to non-durable goods. That's the fastest pace since mid-2007.

Household consumption thus climbed 1.1 per cent, almost matching the first quarter's 1.2 per cent.

There was also strong news on the export front, which the Bank of Canada will welcome as it hopes to shift from a consumer-driven economy.

Having gained just 0.4 per cent in the first quarter, volumes rose by 2.3 per cent in the second.

"Canada's second quarter let the good times roll, so much so that the country's national humility has almost everyone assuming that this can't last," said CIBC World Markets chief Avery Shenfeld, noting that the savings rate actually rose to 4.6 per cent from 4.3 per cent, leaving "more room" for consumers to stay on track in the current quarter.

Not only that, disposable income gained 1.6 per cent, eclipsing the 1.1-per-cent rise in consumption.

The Canadian dollar spiked on the report.

The latest number also plays into the Bank of Canada’s next decision.

“In light of today’s upside surprises in both Q2 and June GDP, we’re bringing forward our forecast for another quarter-point hike by the Bank of Canada this year, as we now see September as a bit more likely than October,” said Mr. Shenfeld

“The bank can clearly argue that the economy simply doesn’t need rates as low as they have been to generate decent economic growth.”

Be it September or October, “another interest rate hike this fall is almost certainly a done deal,” said Toronto-Dominion Bank senior economist Brian DePratto.

While growth is expected to slow somewhat in the third quarter, Bank of Montreal still boosted its forecast for the current three-month period to 2.5 per cent, and for the year to 3.1 per cent.