Economy takes a breather; return to ‘realistic’ growth seen

By David Parkinson

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Canada’s fast-growing economy stalled in July, snapping an eight-month growth streak, as the recovery in the energy sector took a step backward.

Statistics Canada reported that Canadian real gross domestic product was flat in July, on a seasonally adjusted basis, compared with June – the first time since October, 2016 that the economy failed to show month-over-month growth.

Economists had expected the economy to cool down entering the third quarter, after posting average month-over-month growth of 0.4 per cent in the prior three months, and a stellar 4.5-per-cent annualized growth pace for the second quarter as a whole. But the July result was weaker than the median forecast of a 0.1-per-cent uptick in the month.

Despite the disappointment, economists characterized the July setback as an understandable breather in what has been a faster-than-expected economic expansion this year. Forecasters anticipate a more reasonable but still healthy pace of growth in the second half of the year, and the July pause serves as early evidence that this moderation has begun.

“The flat July GDP result represents a rare misstep for the Canadian economy in 2017. While we would never read too much into any one month, it could also mark a return to a more sustainable and realistic growth rate for the economy, after a year of staggeringly good news,” said Douglas Porter, chief economist at Bank of Montreal, in a research note.

A key contributor to the slowdown was a 1.8-per-cent drop in oil and gas extraction, the second straight monthly drop, as the sector’s rapid resurgence this year from its oil-shock doldrums shows signs of levelling off. But output in the sector was also dented by a small fire at Syncrude’s Mildred Lake, Alta. upgrader in early July, which, together with some maintenance work, left the facility producing at roughly half of its capacity for the month – suggesting the sector likely bounced back in August.

Similarly, manufacturing sector’s 0.4-per-cent decline in the month was substantially tied to longer-than-normal summer maintenance slowdowns in the auto sector, which may have set the stage for an August rebound. Motor vehicle and parts manufacturing fell 9.1 per cent month over month.

Still, those weren’t the only sources of weakness in the July numbers. Several other key industries also pulled back from recent gains, including construction (down 0.5 per cent month over month), and retail trade (down 0.1 per cent).

Goods-producing industries declined 0.5 per cent month over month, their first contraction since February. Services-producing industries grew 0.2 per cent, their 16th straight month of expansion.

The July figures set the tone for what economist expect will be a moderation in the economy in the second half of the year, after real GDP grew at a torrid pace of more than 4 per cent annualized in the first half. Forecasts call for third-quarter growth to be in the range of 2 to 2.5 per cent annualized.

“The message in today’s figures is that Canadian GDP will cool in the back half of the year, with less economic slack leaving less room for the economy to grow above its potential,” said Canadian Imperial Bank of Commerce economist Nick Exarhos in a research report.

The emerging signs of a slower pace for the economy also support the case for the Bank of Canada to take a pause in its interest-rate increases over the next few months, after the growth surge in the first half of the year spurred the Bank of Canada to raise rates twice over the summer. Stephen Poloz, the head of the central bank, hinted as much in a speech in St. John's, Nfld., earlier this week.

Second-half growth is still expected to be well above what the Bank of Canada considers its "potential" – i.e. the rate at which the economy can expand without triggering inflation, which the central bank estimates is less than 1.5 per cent – which certainly keeps further rate increases on the table. But the slower pace will mean that whatever excess capacity there is in the economy will be eaten up less slowly. The size of this so-called output gap, and how quickly it is closing, is a key consideration in the timing of future interest-rate increases.

"The BoC will see no additional GDP releases prior to the next rate decision on Oct. 25, and, alongside Governor Poloz's remarks this week, it seems that the case for yet another quick follow-up rate hike is weak at this point," BMO's Mr. Porter said. "We continue to look for the Bank [of Canada] to take a pause for now, with the next hike pencilled in for January."