ECONOMIC RESEARCH AND STRATEGY

LAURENTIAN BANK SECURITIES

Sébastien Lavoie,
Chief Economist
LavoieS@vmbl.ca
514 350-2931

Dominique Lapointe, CFA,
Senior Economist
LapointeD@vmbl.ca
514 350-2924

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Canadian 2021Q2 GDP – Surprise contraction from supply disruptions and the 3rd wave but the medium-term outlook remains positive

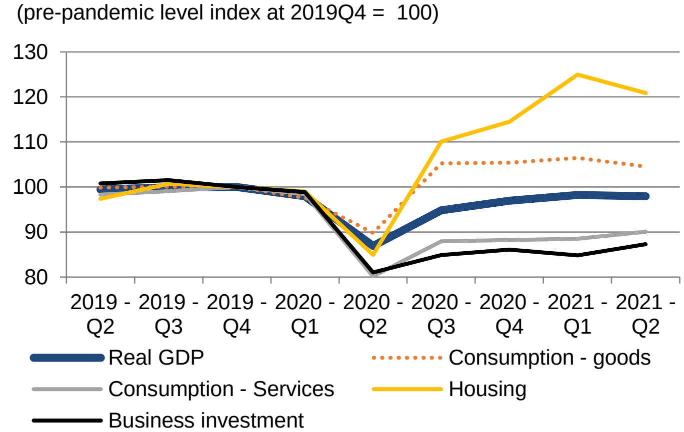
Statistics Canada released real GDP data for 2021Q2 and for the month of June this morning.

Last spring's third pandemic wave caused a setback in the economic recovery. Canadian real GDP edged down 1.1% Q/Q AR during the second quarter, a disappointing result relative to the Bank of Canada's 2.0% July MPR projection, the 2.5% market consensus and our own 2.2% estimate. In comparison, U.S. real GDP soared by 6.6% in 2021Q2 due to the broader easing in restrictions across states, boosting confidence. The U.S. economy reached its pre-pandemic level of activity in 2021Q2 while Canadian activity now sits 2% below it.

The most striking feature from this morning's release relates to global supply chain bottlenecks and shortages: they restrained the purchase of motor vehicles for consumers, prevented businesses from adding trucks to their fleets and dragged down exports. Without these disruptions, the Canadian economy would have actually expanded instead of contracting, according to our calculations. For instance, household goods consumption fell 7% Q/Q AR in 2021Q2, after outsized gains in 2020 when spending options were limited to goods. The ongoing shortage of cars and trucks supply led to a 7% decline in the purchase of motor vehicles by consumers.

The re-orientation of consumer spending is also underway. Household consumption of services jumped 7% Q/Q AR in 2021Q2. The summer respite, before the ongoing fourth wave of infections, allowed Canada's GDP to advance at a fast clip of 0.7% m/m in June, led by a 15% jump in food and accommodation services and a 4% increase in retail trade. Overall, consumption of services remained 10% below their pre-pandemic level of activity in 2021Q2 while consumption of goods stood 5% above (see chart). Total household consumption was flat during the quarter at 96% of its pre-pandemic level of activity.

Canadian Real GDP and Expenditure Components
(pre-pandemic level index at 2019Q4 = 100)



Source: Statistics Canada, LBS Econ. Res. and Strategy.

Last quarter also marked the beginning of a setback in an otherwise extremely elevated level of housing activity. Residential investment declined 12.4% in 2021Q2, the strongest pullback since 2009Q1, excluding 2020Q2. The cooling in MLS resale transactions more than offset continuous gains in new construction and renovation spending tied to the popularity of teleworking. However, residential investment was still up 20% from pre-pandemic levels in 2021Q2 and continued to represent an important 9% share of nominal GDP, versus its 6.5% historical average. Further softening is in the cards in 2021Q3 as construction declined in July according to Statistics Canada, and MLS transactions fell according to CREA .

This morning's quarterly GDP result supports recent surveys indicating that vaccination progress fosters business confidence. M&E gross fixed capital formation rose by 24.9% Q/Q AR in 2021Q2, mainly caused by a rebound in aircraft following a major disinvestment in 2021Q1. Industrial machinery and equipment rose 20.4% but investment in passenger cars declined 74.2% and trucks, buses and other motor vehicles collapsed 81.3%. Investment in motor vehicle is now only half of what it was prior to the pandemic. Problems in the motor vehicle industry also explains the 15.1% drop in total exports. Excluding these glitches, total exports only edged down 3%.

In summary, global supply disruptions and the housing slowdown prevented the Canadian economy from continuously growing in the second quarter. These factors also impacted 2021Q3 growth: Statistics Canada's preliminary monthly GDP growth estimate for July is -0.4% m/m. Accordingly, we substantially revise down our 2021Q3 real GDP growth forecast to 3% Q/Q AR and our 2021 annual forecast to 5.1% (from 5.9%). Fortunately, we see some signs of resilience. The delta variant led to a rapid deterioration in U.S. consumer confidence, but recent data does not suggest it is also happening in Canada. Also, the number of new confirmed cases has started to decline in key U.S. States, an indicator that the economic impact of the fourth wave of infections will be limited.

Sébastien Lavoie | Chief Economist
514 350-2931 | lavoies@vmbl.ca

Dominique Lapointe, CFA | Senior Economist
514 350-2924 | lapointed@vmbl.ca