

The wirtschwafwunderkinder turned into a bit of a brat.

Canadian GDP (May) 0.1% m/m

The Canadian economy ground out a mere 0.1% m/m rise in GDP, back of the market median at 0.2% but better than our own pessimistic forecast suggesting the economy laid an egg (0.0%). The outcome was considerably less robust than the monthly average growth rates of 0.46% m/m the came to characterize the first quarter of the current year. Canada, an economic wonder child no more.

A month full of surprises.

On the upside, the big surprise in May was found in the extraction industries that jumped a whopping 3.4% m/m in the same month that saw considerably weaker pricing metrics for commodities (out of the gate prices for producers of petroleum and coal products were down -2.3% m/m, primary metals -2.9). The loss of -11K job in the natural resources sector also tended to argue against such a strong outcome for the sector.

Agriculture, forestry and fishing also generated some significant upside surprise, having risen by 1.3% m/m. Wholesale sales of agricultural supplies plunged 30% m/m in May, again portending a rather less than robust outcome.

The misses. Utilities output disappointed, declining by -0.5% despite that fact that temperatures soared in central Canada towards the end of the month.

Construction and manufacturing were largely as expected. Manufacturing managed to eke out a slight increase rising 0.1% m/m while construction fell -1.6% m/m. Ample evidence going into the GDP number set to suggest that construction was going to take it on the nose. Not to fear. The Canadian real estate market has been a real marvel of science throwing off remarkable strength throughout the economic recession and on into the economic recovery. Recall that at the time the economy was hitting its cycle lows in 2009, the real estate market was printing off new historical highs.

Going forward, the expectation is for construction and real estate activity to taper off given: I) higher interest rates, II) the introduction of a new tax structure in Ontario and BC that hits the new build and home renovation categories, and III) changed funding formulas for mortgages all of which will conspire to raise the bar on affordability and take the edge off the housing market.

Indeed, the all important FIREs sector (financial, insurance and real estate is the largest GDP category) dropped -0.1% m/m in May which is a direct reflection of declining activity in real estate. Outside of the FIREs sector, wholesale trade took a big hit, declining by -1.8% but again this was well telegraphed by earlier released data.

As we close in on the June GDP release, our tendency will be to look at the first half of 2010 in aggregate as a means of smoothing out the massive run up in economic growth in Q1 followed by what ostensibly looks like a massive run down in the pace of growth in Q2. In one sense, Q1 cannibalized Q2 as activity was carried forward.

To be certain, the economic recovery is decelerating to a level consistent with more moderate rates of economic growth. As we enter the second half of 2010 and head off into 2011, continued softness is expected in the construction and real estate markets. We also know that government consumption will go from generating a positive contribution to GDP to becoming an outright drag on growth. And of course there is the expectation that despite the massive employment growth the economy experienced in Q2, the historically high levels of household debt (of which a good deal is made up of variable rate products) combined with rising interest rates, will cause personal consumption to ebb.

On the upside, business and external demand is expected to rise to the fore. Indeed, if Canada is to look forward to a sustainable economic recovery it is going to have to experience a roll over in demand away from its reliance upon consumer spending and government transfusions. At the end of Q1/10, while business demand contributed positively to GDP, suggesting that this was exactly what was taking place, we find that looking below the surface finds business demand focused on residential structures. And of course as mentioned above, this area of the economy is set to soften and with it this contribution to GDP coming out of businesses can reasonably be expected to fade. What we need to see is business investment in plants and equipment, which to date has been anemic to non-existent, begin to grow robustly in keeping with the patterns emerging in the US.

Where as corporate America seems content to invest in capital at the expense of labor and for its efforts spin off productivity, Canadian businesses so far have been content to hire scads of worker (over 225K in Q2) at the expense of seemingly any sort of productivity gain. Despite these new pairs of hands pulling and pushing on the economic levers of the economy in Q2, Canada really has very little to show for all this added effort in terms of GDP growth.

Still, its a bit of a double edged sword. As Canada is not a significant producer of capital goods, if we are at some point going to see Canadian businesses begin to recapitalize themselves, the pick up in GDP associated with this type of business investment would to some extent be offset by a corresponding increase in the import category.

However, that may very well be the story for 2011. For today, what we seem to be left with is this Canadian wirtschaftswunder kinder (economic wonder child) in Q1/10 that seems to have turned into a bit of brat in Q2.

Disclosure appendix

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Issuer of report

HSBC Securities (Canada) Inc.
70 York Street, 8th Floor
Toronto, Ontario M5J 1S9, Canada
Telephone +1 416 868 7523
Fax +1 416 364 2543
Website: www.research.hsbc.com

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