

Canada: A GDP nugget mined in February.

GDP up 0.3% m/m. Mining, manufacturing and Olympic gold.

For Canada, Olympians were mining gold on the playing field and minting cash at the registers. 1/3 of the rise in GDP related to the impact of Olympic related activity. Goods producing sectors having led the economy into recession are as expected, leading the charge down the path to recovery.

The Canadian economy pushed out a decent nugget of growth in February, with the economy growing by 0.3% m/m, in line with the market median, and just ahead of our own forecast looking for 0.2% m/m.

The broader story for Canada is unfolding as would be expected with the goods producing sectors leading the recovery. In February, the goods sector expanded robustly, growing by 0.7% m/m, although at half the rate of January's 1.4% m/m. Manufacturing was quite strong, expanding by a whopping 1.2% m/m despite some evidence in the run up to today's report to suggest that the sector was being weighed down by some temporary shutdowns in the auto sector. In that the sector performed as well as it did tends to suggest that the manufacturing sector may continue to print strong numbers in March as the temporary shutdowns in capacity come back on line in March.

Activity in the agricultural sectors was stronger than we had expected running at 0.7% m/m as opposed to our forecast for 0.4% m/m. Industries involved in oil and gas extraction disappointed, dropping by -1.8%. The real gem found in the mining, and support services sectors which rose by 7.6%. Overall, mining, oil and gas extraction was up 0.4% m/m.

Service sector growth was just about bang on our expectations. We had been forecasting services up (unrounded) 0.14% m/m, with the actual number coming in at 0.13% m/m. A couple points of divergence though. The FIREs sector (financial) continues to disappoint, posting a growth rate of 0.0% m/m, we had been looking for growth to return to trend in the area of 0.3% m/m. It would be unsettling, given the size of the category, that if the new trend for the FIREs sector was no growth at all. Throughout much of the recession, this sector had proved to be one of the rare pillars of growth.

Where FIREs disappointed, the arts, entertainment, and accommodation categories provided significant upside courtesy of the frenzy associated with the Olympics. Capturing the value associated with the Olympics was the tricky part. All and sundry expected them to be up significantly, just the orders of magnitude were up for grabs. In the report, for February, arts and entertainment rose by a whopping 6.1% m/m, while accommodation rose by 2.1% m/m.

These are of course transitory events that will begin to unwind in March and fully be unwound by April. Recall that while the Olympics ended in February, while the Para-Olympics continued in March and by all accounts, they were very well attended events albeit not nearly as broad as the Olympic games. As such, while these two categories will see significant declines in March, they will not fully unwind until April. Still if the FIREs category can manage to squeak out even some marginal growth in March, given its overall size, it will act as a decent offset to the declines in the entertainment categories. And there is some reason to believe that the FIREs category will be supported by the pick up in housing market activity to followed the distraction provided for by the Olympics. Of total GDP in February, 35% of the growth came out of the entertainment and accommodation categories, contributing 0.1ppt of the total 0.3% m/m gain.

Given the trajectory of the economy over the first two months of the quarter, it appears that the BoC forecast for a growth rate of 5.8%q/q ann. is looking just slightly optimistic but very much in keeping with the general thrust of another strong quarter for the Canadian economy. Although we suspect that given the what February's numbers look like and in keeping with how the lay of the land may shape up in March, that the economy is set to print another strong quarter in Q1/10. Indeed, if the BoC forecast is correct, Canada's GDP rate would be running well ahead of the initial peak at the US economic performance for the same quarter.

Beyond the comparable headlines, the story is even better.

For the US economy, much of the last two quarters of growth have been reliant upon inventory corrections. In Q4/09, 3.8ppt of the 5.6%q/q ann growth rate came out the inventory component. In Q1/10, changes in inventories accounted for another 1.6pp or fully half of the 3.2%q/q increase. As many are aware, this is a transitory contribution to the economic recovery story.

By contrast, Canada's recovery has been comparably more broad and balanced with growth being generated from still strong consumer demand and an important growing recovery in external demand rather than a reliance upon an inventory correction. Rather, in Q4/09, an accelerated pace of destocking in Canada actually dragged 0.9ppt out of the Canadian economy which still managed to print a growth rate of 5.0%q/q ann.

If there is to be a chink in the Canadian armour it is that business investment is continuing to decline. Expenditures on capital equipment and plants declined by 2.3%q/q in the fourth quarter. For Canada to truly embark upon a balanced self-sustaining economic recovery, it is necessary to see the successful hand off of the economic football from the consumer and government spending on over to external demand and business investment. So far one leg of the trade is working - external demand.

To be certain, the onset of higher interest rates (we are forecasting a BoC rate hike on June 1) is going to curb consumer consumption given high debt levels and an abundance of variable rate debt products on household balance sheets. While there are still another couple of quarters in which business investment can turn around, it is clear that in the absence of continued growth in external demand and a yet to be seen recovery in business investment, that the stellar growth rates generated by the Canadian economy in the last couple of quarter, will fall precipitously as the country moves into 2011. Not the least of which the government of Canada has been clear in that the fiscal lubrication comes to an end in Q1/11.

And of course while Canada's economic recovery story is currently tracking better than perhaps the US story, the country remains inextricably linked to the prospects of US economic recovery. You largely can't have one (recovery in Canada) without the other (economic recovery in the US).

Disclosure appendix

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