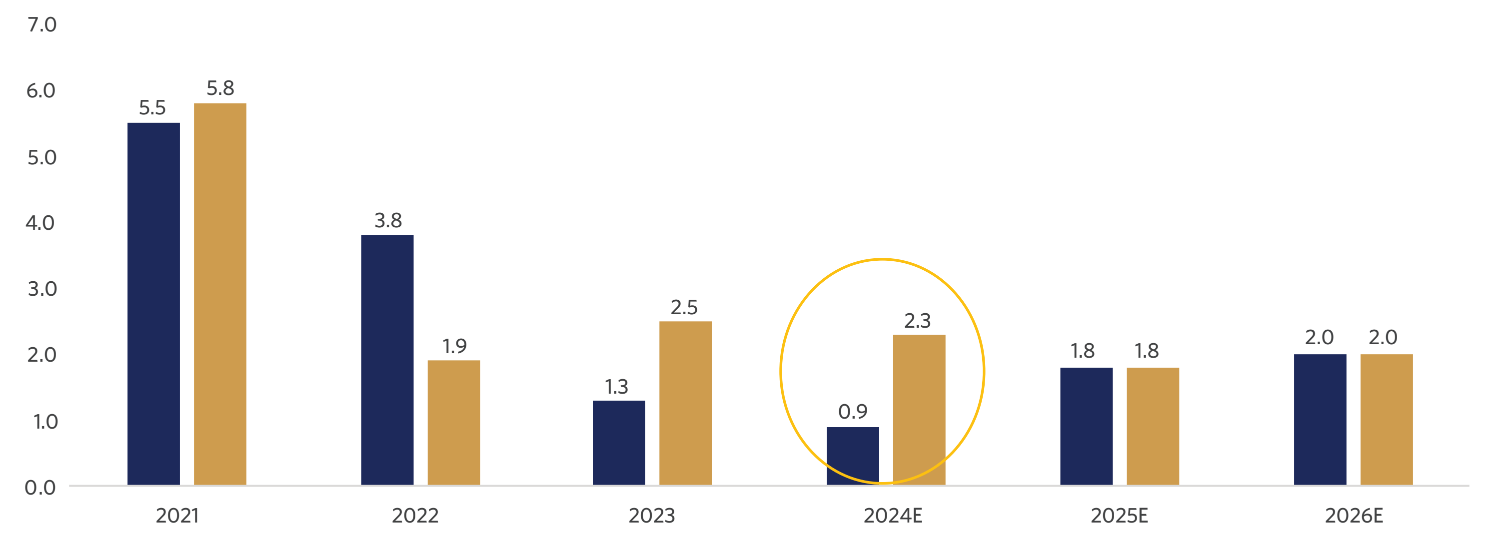
Canadian real GDP growth is expected to lag the U.S. in 2024, before rebounding (Real GDP, YoY%)



Source: Bloomberg

Economic outlook

The Canadian economy has emerged from a soft patch in the back-half of 2023 but continues to remain at or slightly below trend levels. In the first quarter, real GDP growth was 1.7% annualized, supported by solid household consumption of 3%. However, this may slow in Q2 and the second half of the year as consumption is expected to moderate to below 2%.

Labour market shows early signs of cooling - The Canadian labour market went through a period strength in the post-pandemic period, with the unemployment rate falling to a low of 5.0% in June 2022. However, the labour market since cooled, with the unemployment rate now at 6.4%, the highest since January 2022. Leading indicators point to further softening, as job vacancies (job openings in the economy) have fallen to recent lows. Meanwhile, the labour supply continues to increase, supported by immigration as well.

The labour market's supply-and-demand dynamics could lead to further pickup in the unemployment rate and put some downward pressure on wage growth, in our view. If job uncertainty is elevated, consumer sentiment and some consumption may be negatively impacted. However, we would view this as a deceleration rather than a deep or prolonged downturn.

Inflation may continue its bumpy path lower - The Canadian consumer price index (CPI) has moved steadily lower, despite fluctuating May results. The CPI inflation rate in Canada stands at 2.9%, versus 3.3% in the U.S., and we believe these inflation rates could head lower, albeit perhaps not in a straight line, for two key reasons:

1. Shelter and rent components of inflation moderates, especially given real-time data for Canadian home price appreciation has already slowed
2. Services inflation cools as wage growth potentially slows

If inflation continues to moderate, and the Canadian economy softens, we believe the Bank of Canada will continue to cut interest rates, perhaps two or three more times in 2024, which support a rebound in economic growth as we head towards 2025.

▶ Action for investors

In this backdrop, we continue to favour U.S. large-cap and mid-cap stocks over Canadian large-cap stocks, which we believe will benefit from both central bank rate cuts and more exposure to growth sectors of the market.

