THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 2003

OVERVIEW

- In the second quarter of 2003 real gross domestic product (GDP) dipped 0.3% at an annual rate, the first decrease since the third quarter of 2001. Growth was restrained by the SARS outbreak, the BSE-related beef export ban and a sharp appreciation of the Canadian dollar.
- Final domestic demand grew solidly, albeit at a slower pace than in the first quarter. Inventory accumulation was smaller in the second quarter than in the first.
- Real exports added to growth, increasing 2.2% following two consecutive declines. Canadian service exports dropped, as travel and transportation-related industries suffered from the SARS fallout and exports of live animals and meat products decreased due to the mad cow scare.
- The current account registered its 16th consecutive quarterly surplus. However, a 5.6% increase in real imports reduced GDP growth and contributed to a $7.4-billion narrowing in the current account to $20.3 billion or 1.7% of nominal GDP.
- With job losses of over 32,000 in July and August, net job creation in the Canadian economy sat at about 52,000 for the period from the end of 2002 to August 2003. The unemployment rate in August was 8.0%.

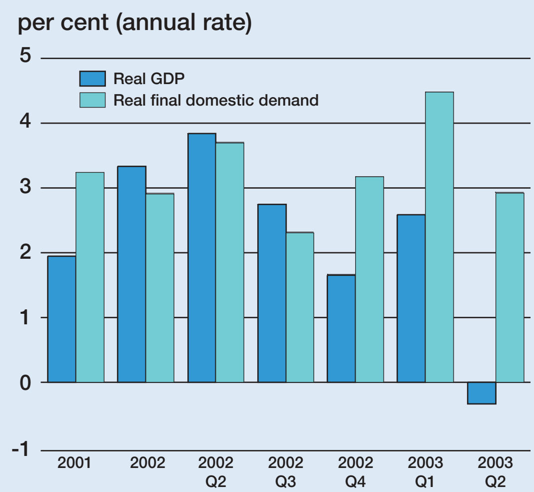
Real GDP dips

Real GDP declined 0.3% in the second quarter following a 2.6% increase in the first, as inventory investment fell and real imports increased (Chart 1).

Consumer spending is solid

Real consumer expenditure grew a solid 2.7% in the second quarter, somewhat slower than the 4.4% pace of the two previous quarters. Spending rose in all major categories but was most notable in durables, especially furniture and appliances given continued buoyancy in the housing market.

Chart 1
Growth in real GDP and real final domestic demand



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, September 5, 2003.

Main economic indicators
(per cent change at annual rates unless otherwise indicated)

	2001	2002	2002:Q4	2003:Q1	2003:Q2		Most recent
Real gross domestic product	1.9	3.3	1.6	2.6	-0.3		–
Final domestic demand	3.2	2.9	3.1	4.4	2.9		–
Government expenditure							–
Goods and services	3.7	3.0	2.4	2.4	3.6		–
Gross fixed capital	10.3	11.8	-0.2	11.6	6.6		–
Consumer expenditure	2.6	3.4	4.4	4.4	2.7		–
Residential investment	10.3	14.2	11.1	4.0	3.0		–
Business fixed investment	1.0	-6.0	-5.0	6.7	1.6		–
Non-residential construction	2.2	-10.4	-6.5	3.6	0.2		–
Machinery and equipment	0.3	-3.2	-4.1	8.6	2.4		–
Business inventory investment ($ billion)	-2.1	5.9	11.6	20.2	13.1		–
Exports	-3.1	-0.1	-8.7	-6.7	2.2		–
Imports	-5.0	0.6	-1.4	3.8	5.6		–
Current account balance							
(nominal $ billion)	26.9	23.4	19.5	27.7	20.3		–
(percentage of GDP)	2.4	2.0	1.7	2.3	1.7		–
Nominal personal income	4.0	3.3	4.2	3.4	1.6		–
Nominal personal disposable income	4.4	4.7	3.7	3.1	2.6		–
Real personal disposable income	2.6	2.7	1.9	0.4	3.4		–
Profits before taxes	-6.0	4.3	6.1	36.1	-28.9		–
Costs and prices (%, y/y)							
GDP price deflator	1.1	0.9	4.1	5.2	3.2		–
Consumer price index	2.6	2.2	3.8	4.5	2.8	2.2	Jul-2003
CPI excluding eight most volatile items	2.0	2.4	2.8	3.1	2.2	1.8	Jul-2003
Unit labour costs	2.6	1.5	2.2	2.1	2.5		
Wage settlements (total)	3.2	2.8	3.3	2.8	2.6	2.2	Jun-2003
Labour market							
Unemployment rate (%)	7.2	7.7	7.6	7.4	7.7	8.0	Aug-2003
Employment growth	1.1	2.2	3.2	2.2	0.4	-1.4	Aug-2003
Financial markets (average)							
Exchange rate (cents U.S.)	64.6	63.7	63.7	66.3	71.6	72.98	04-Sep-03
Prime interest rate (%)	5.8	4.2	4.5	4.6	5.0	4.50	04-Sep-03

Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

Personal income increased 1.6% in the quarter, as more moderate employment growth than in the first quarter slowed labour income gains. Real personal disposable income increased 3.4% while real personal disposable income per capita reached a record level and stood 14% above its most recent low in the second quarter of 1996. The personal savings rate edged up to 2.4% from 2.3% in the first quarter.

Residential investment growth continues

Low interest rates continued to support the housing market. Residential investment increased 3.0% in the second quarter, following a gain of 4.0% in the first. While still solid, growth slowed from double-digit gains in the second half of 2002. Spending on house resales and renovations grew, more than offsetting a 3.9% decrease in new construction.

Business fixed investment rises again

Business spending on plant and equipment increased 1.6% in the second quarter, following a 6.7% gain in the first. Investment in machinery and equipment rose 2.4% as increased expenditures on industrial machinery and computers were partly offset by reduced spending on other high technology products, such as software and telecommunications equipment, and on transportation equipment.

Non-residential construction edged up, the second consecutive gain after six declines. Spending on building construction increased more than enough to offset reduced expenditure on engineering projects.

Businesses add less to inventories

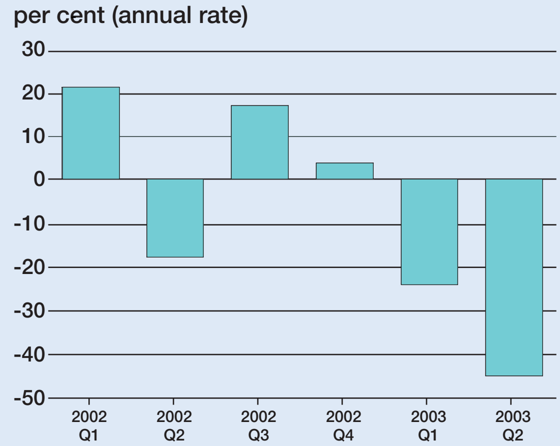
Businesses boosted inventories by $13.1 billion in the second quarter, down from the $20.2-billion inventory accumulation in the first. This deceleration in inventory investment, a major factor behind the decline in GDP, was centred entirely in the wholesale and retail trade industries, with motor vehicles accounting for over half of the slowdown. On the other hand, farmers accumulated cattle inventory due to the ban on exports caused by the single case of mad cow disease.

Exports add to growth

Real exports added to growth, rising 2.2% following two consecutive declines. Canadian service exports dropped, as travel and transportation-related industries suffered from the fallout of SARS and the appreciation of the Canadian dollar in the first half of the year (Chart 2).

Real imports rose 5.6%, outpacing the 2.9% gain in final domestic demand and the 2.2% rise in exports. Imports of machinery and equipment, automotive products and other consumer goods registered noticeable jumps.

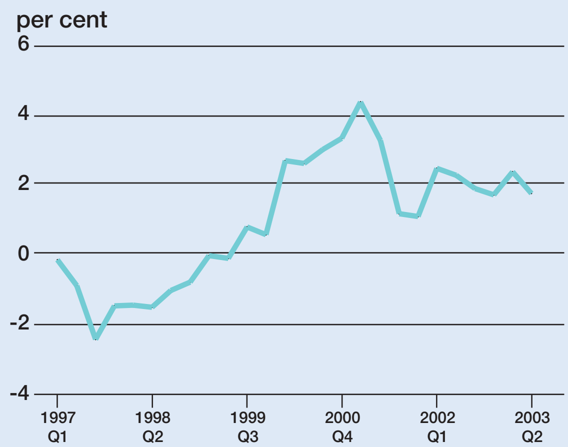
Chart 2
Growth of real exports of travel services



Current account surplus narrows

The current account registered its 16th consecutive quarterly surplus, a contrast to the deficits over most of the 1980s and 1990s. However, the surplus shrank by $7.4 billion to $20.3 billion or 1.7% of nominal GDP (Chart 3). The marked increase in real imports, together with a sharp jump in dividends paid to non-residents, depressed the current account surplus.

Chart 3
Current account as a percentage of nominal GDP



GDP deflator declines

The GDP deflator, a comprehensive measure of domestic prices, fell 1.4% relative to the first quarter to sit 3.2% above its level of a year earlier. Falling export prices, especially for energy products, drove the decrease.

Year-over-year consumer price inflation dropped to 2.2% in July, down from a recent high of 4.6% in February. Core CPI inflation, which excludes the eight most volatile items, was 1.8% in July, slightly below the mid-point of the target band of 1% to 3%. Part of the downward pressure on CPI inflation came from the negative impact of SARS on the cost of travellers' accommodations.

Corporate profits drop

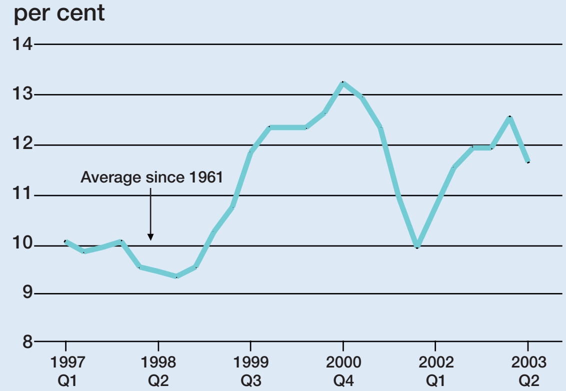
Corporate profits decreased 28.9% in the second quarter, following a 36.1% gain in the first. While this lowered profits as a share of GDP to 11.6%, it remained well above the 10.0% historical average (Chart 4). Falling energy prices following a run-up in the first quarter reduced profits in the oil and gas industry and led the overall decline. Also, exporters who price in U.S. dollars saw their Canadian dollar revenue reduced by the sharp appreciation of the Canadian currency relative to its American counterpart.

Employment gains slow in Q2

Employment rose 0.4% in the second quarter, compared with 2.2% in the first. Gains were concentrated in full-time work.

With job losses totalling more than 32,000 in July and August, net job creation stood at about 52,000 for the period from the end of 2002 to August 2003. Given that the participation rate has remained at its record high level of 67.5% for most of the year, the unemployment rate was 8.0% in August, up from 7.3% in March 2003.

Chart 4
Profits before taxes as a share of nominal GDP



Hourly labour productivity increased as hours worked fell more than output. Growth in labour costs per unit of output increased to 1.7% in the second quarter from 0.8% in the first to stand 2.5% higher than a year earlier.

Bank of Canada lowers target interest rate

On September 3, the Bank of Canada announced a 25-basis-point reduction in its key policy rate, stating that "core inflation has declined below the 2 per cent inflation target earlier than the Bank anticipated, and it appears that lower inflation will persist over the coming months."

In recent months, Canadian short-term rates have declined with the key policy rate while U.S. short rates have remained largely unchanged. U.S. long-term rates have risen more than Canadian rates.

The value of the Canadian dollar relative to its U.S. counterpart has eased off the recent high close of 74.91 cents U.S. on June 13. It closed at 72.98 cents U.S. on September 4.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre at (613) 995-2855. For other inquiries about this publication, contact Mostafa Askari at (613) 992-3055.
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