THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE DECEMBER 2003

OVERVIEW

- In the third quarter of 2003, led by final domestic demand, real gross domestic product (GDP) resumed growth, rising 1.1% following a second-quarter drop of 0.7%. Growth was supported by continued low interest rates but dampened by the August power outage in Ontario and the sharp appreciation of the Canadian dollar.
- Final domestic demand grew 5.7%, a stronger pace than in the second quarter. Consumer spending and residential and business investment all increased robustly, with investment in machinery and equipment jumping 18.8%.
- However, businesses' accumulation of inventories was much smaller than in the second quarter. Further, real exports subtracted from growth for the fourth consecutive quarter, decreasing 0.9%.
- The current account registered its 17th consecutive quarterly surplus, as a third consecutive decrease in import prices boosted the surplus to $29.3 billion, or 2.4% of nominal GDP.
- The Canadian economy created 166,000 net new jobs from September to November. The unemployment rate fell to 7.5% in November after peaking at 8.0% in August.

Real GDP growth resumes

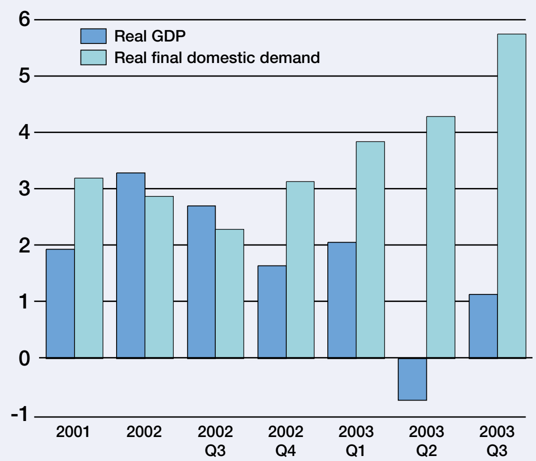
Real GDP increased 1.1% in the third quarter following a 0.7% decrease in the second, as final domestic demand strengthened (Chart 1).

Consumer spending robust

Real consumer expenditure grew a solid 5.1% in the third quarter, its strongest pace in three years. Spending rose in all major categories but was most notable in durables, especially motor vehicles as sales incentives attracted buyers to showrooms. Expenditures on furniture and appliances also rose sharply given continued housing market buoyancy.

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

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



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

	2001	2002	2003:Q1	2003:Q2	2003:Q3	Most recent	
Real gross domestic product	1.9	3.3	2.0	-0.7	1.1		–
Final domestic demand	3.2	2.9	3.8	4.3	5.7		–
Government expenditure							–
Goods and services	3.7	3.0	2.5	6.9	1.3		–
Gross fixed capital	10.3	11.8	10.1	6.4	-2.4		–
Consumer expenditure	2.6	3.4	3.9	3.8	5.1		–
Residential investment	10.3	14.2	1.5	5.1	18.2		–
Business fixed investment	1.0	-6.0	5.6	1.4	13.2		–
Non-residential construction	2.2	-10.4	5.2	-0.1	4.4		–
Machinery and equipment	0.3	-3.2	5.9	2.3	18.8		–
Business inventory investment ($ billion)	-2.1	5.9	18.8	14.6	0.8		–
Exports	-3.1	-0.1	-5.5	-3.7	-0.9		–
Imports	-5.0	0.6	3.8	6.8	-2.1		–
Current account balance							
(nominal $ billion)	26.9	23.4	28.3	20.2	29.3		–
(percentage of GDP)	2.4	2.0	2.3	1.7	2.4		–
Nominal personal income	4.0	3.3	2.7	1.8	3.5		–
Nominal personal disposable income	4.4	4.7	4.0	1.6	3.1		–
Real personal disposable income	2.6	2.7	1.4	2.3	1.4		–
Profits before taxes	-6.0	4.3	39.8	-34.8	21.2		–
Costs and prices (%, y/y)							
GDP price deflator	1.1	0.9	5.3	3.1	3.3		–
Consumer price index	2.6	2.2	4.5	2.8	2.1	1.6	Oct-2003
CPI excluding eight most volatile items	2.0	2.4	3.1	2.2	1.7	1.8	Oct-2003
Unit labour costs	2.6	1.5	2.2	2.6	2.4		
Wage settlements (total)	3.2	2.8	2.8	2.6	3.2	3.0	Sep-2003
Labour market							
Unemployment rate (%)	7.2	7.7	7.4	7.7	7.9	7.5	Nov-2003
Employment growth	1.1	2.2	2.2	0.4	0.4	4.2	Nov-2003
Financial markets (average)							
Exchange rate (cents U.S.)	64.6	63.7	66.3	71.6	72.5	76.62	05-Dec-03
Prime interest rate (%)	5.8	4.2	4.6	5.0	4.7	4.50	05-Dec-03

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

Personal income increased 3.5% in the quarter, as employment grew at a pace similar to that in the second quarter while the average wage rate increased. Real personal disposable income rose 1.4% while real personal disposable income per capita edged higher to a record level, nearly 14% above its most recent low in the second quarter of 1996. The personal savings rate fell to 1.3% from 2.2% in the second quarter.

Strong residential investment growth

Low interest rates continued to support the housing market. Residential investment soared 18.2% in the third quarter, returning to the double-digit increases regularly seen from mid-2000 to the end of 2002. This strong third-quarter increase followed gains of 1.5% and 5.1% in the first two quarters of 2003. Spending rose in all major categories, with real estate transfer costs on sales of existing homes surging. New construction activity jumped as housing starts reached their highest level since the late 1980s. Renovations also grew solidly.

Robust business fixed investment

Business spending on plant and equipment increased 13.2% in the third quarter, its sharpest increase since 1997. Investment in machinery and equipment soared 18.8%, with strong spending gains on computers and other office equipment, transportation equipment (especially trucks) and telecommunications equipment.

Non-residential construction increased a solid 4.4% following a dip of 0.1% in the second quarter. Spending on building construction and engineering projects both contributed to the overall gain.

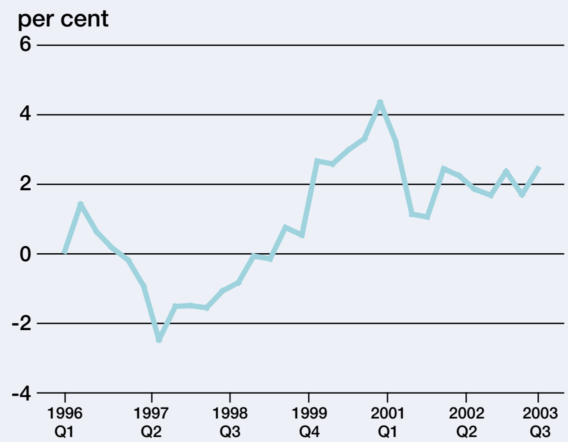
Businesses add less to inventories

Businesses boosted inventories by $0.8 billion in the third quarter, down from the $14.6-billion inventory accumulation in the second. This deceleration in inventory investment, which reduced GDP growth, was concentrated in the drawdown of lumber inventories to meet the strong demand from the housing market and the clearance of motor vehicles at both the wholesale and retail trade levels. On the other hand, farm inventories jumped as grain inventories rose and the holding of livestock ballooned given the continued export ban caused by the single case of mad cow disease. The slow pace of inventory accumulation reduced the economy-wide inventory-to-sales ratio.

Exports subtract from growth

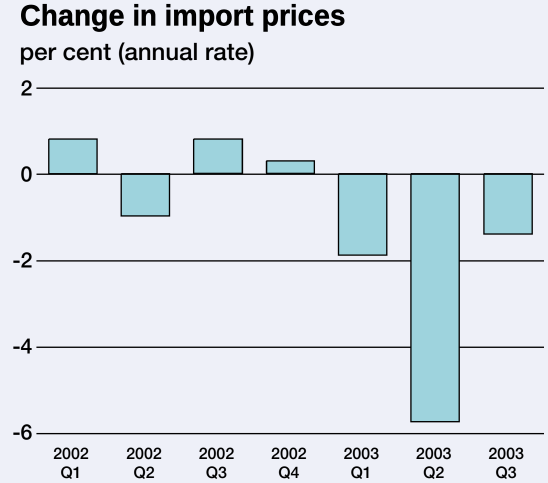
Real exports subtracted from growth for the fourth consecutive quarter, dipping 0.9%. Despite strong U.S. growth in the quarter, Canadian goods exports dropped, especially of machinery and equipment and automotive products. The sharp appreciation of the Canadian dollar in 2003 (up 17% over the first nine months) dampened exports. However, service exports soared as travel and tourism recovered from the effects of severe acute respiratory syndrome and the war in Iraq.

Chart 2
Current account as a percentage of nominal GDP



Real imports declined more than exports in the third quarter, dropping 2.1% despite the rise in final domestic demand and the appreciation of the dollar. This partly reflected much lower business inventory investment, which typically has a large import content. The drop in imports was largely in automotive products, consistent with an inventory decumulation to meet motor vehicle sales. Imports of machinery and equipment increased to meet the stronger investment demand.

Chart 3
Change in import prices



Current account surplus widens

The current account registered a 17th consecutive quarterly surplus, in contrast to deficits over most of the 1980s and 1990s. The surplus increased $9 billion to $29.3 billion, or 2.4% of nominal GDP (Chart 2). Adding to the positive impact of movements in trade volumes, markedly lower import prices accompanied an appreciating Canadian dollar, reducing the value of imports and boosting the trade surplus (Chart 3).

Inflation remains low

The GDP deflator, a comprehensive measure of domestic prices, rose 3.3% in the third quarter of 2003 following a 2% drop in the second. Relative to the third quarter of 2002, prices stood 3.3% higher.

Year-over-year consumer price inflation dropped to 1.6% in October, down from a recent high of 4.6% in February. Core CPI inflation, which excludes the eight most volatile items, was 1.8%, slightly below the mid-point of the target band of 1% to 3%.

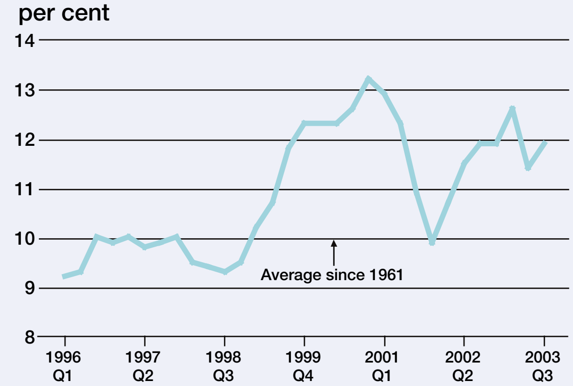
Corporate profits increase

Corporate profits increased 21.2% in the third quarter, following a 34.8% drop in the second. At an 11.9% share of GDP, profits continued to stand well above their 10.0% historical average (Chart 4). Manufacturers, especially of automotive products, saw profits increase with sales, while the retail industry benefited from strong consumer spending. Mining profits jumped as strong demand reduced inventories and raised prices. Exporters who price in U.S. dollars saw their Canadian-dollar revenue negatively affected by the appreciation of the Canadian dollar while importers gained a cost advantage.

Solid employment growth resumes

Employment grew a cumulative 166,000 in September, October and November. The participation rate sat at 67.6% in November, equal to its record high, while the unemployment rate stood at 7.5%, down from 8.0% in August and September.

Chart 4
Profits before taxes as a share of nominal GDP



Hourly labour productivity increased as hours worked fell while output rose. Growth in labour costs per unit of output of 1.6% matched its pace in the second quarter to stand 2.4% higher than a year earlier.

Bank of Canada holds interest rates steady

On December 2 the Bank of Canada left its key policy rate—the Target for the Overnight Rate—unchanged at 2¾ per cent, noting that while “core and total CPI inflation have fallen below the 2 per cent inflation target… the Bank expects Canada’s economic growth in the fourth quarter to rebound strongly.”

Since the end of August Canadian and U.S. short-term interest rates have remained largely unchanged. Long-term rates have dipped by similar amounts in both countries.

The Canadian dollar continued to appreciate against the U.S. dollar, although at a slower pace than in the first half of the year. It closed at 76.62 cents U.S. on December 5, off the 77.04 cents U.S. level of December 2, which represented its highest closing value in over 10 years.

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. Also available on the Internet at www.fin.gc.ca
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