The Economy in Brief

DEPARTMENT OF FINANCE MARCH 2004

Overview

- In the fourth quarter of 2003 real gross domestic product (GDP) growth strengthened to 3.8% following the more modest 1.3% increase in the third. Fourth-quarter growth was the fastest since early 2002. Rebounding exports and stronger inventory investment more than offset slower final domestic demand growth. For 2003 as a whole, GDP increased 1.7%, down from 3.3% in 2002.
- Strong U.S. growth in the second half of 2003, improved conditions in other major trading partners and a bounce-back from the effects of severe acute respiratory syndrome (SARS) and the August power outage in Ontario produced a 13.5% jump in real exports following four quarterly declines.
- Final domestic demand growth slowed to 1.2% from 5.8% in the previous quarter. Consumer spending showed almost no growth following a solid increase in the third quarter, and business investment increased more modestly than in the previous quarter.
- The current account registered its 18th consecutive quarterly surplus. However, it dipped to $26.6 billion, or 2.2% of nominal GDP, from $31.4 billion, or 2.6% of GDP, in the third quarter. For 2003 in its entirety, the surplus rose to $25.8 billion from $23.4 billion in 2002.
- The Canadian economy created 220,000 net new jobs in the five-month period ending in January 2004. The unemployment rate fell to 7.4% in December and remained there in January.

Real GDP growth strengthens

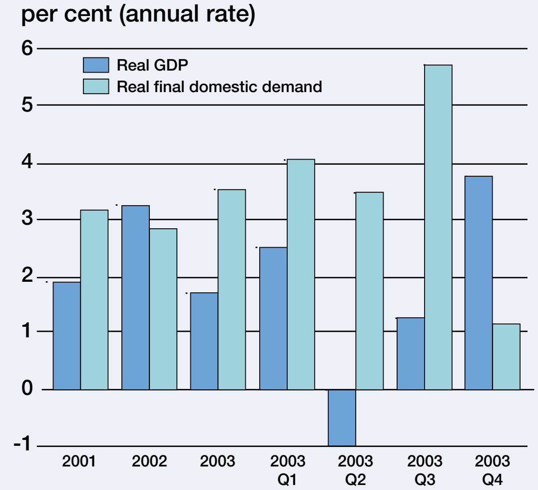
Real GDP rose 3.8% in the fourth quarter following a 1.3% increase in the third, as exports rebounded and businesses added to inventories (Chart 1).

Exports add to growth

Real exports rose 13.5% after four consecutive declines. Strong U.S. growth in the second half of the year and a bounce-back from the Ontario blackout boosted Canadian exports, especially of high-tech machinery and equipment, and automotive, energy and industrial products. The travel industry's recovery accelerated following the depressing effects of SARS and the Iraq war. However, the approximately 20% dollar appreciation in 2003 dampened export growth for 2003 as a whole.

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of day, March 2, 2004.

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)

	2002	2003	2003:Q2	2003:Q3	2003:Q4	Most recent	
Real gross domestic product	3.3	1.7	-1.0	1.3	3.8		–
Final domestic demand	2.9	3.6	3.5	5.8	1.2		–
Government expenditure							–
Goods and services	3.0	3.0	4.7	1.4	0.6		–
Gross fixed capital	11.8	5.8	6.3	0.5	3.8		–
Consumer expenditure	3.4	3.3	3.5	4.6	0.1		–
Residential investment	14.2	7.5	1.2	18.6	10.0		–
Business fixed investment	-6.0	3.4	2.2	14.4	2.2		–
Non-residential construction	-10.4	0.7	1.4	6.9	4.0		–
Machinery and equipment	-3.2	5.0	2.7	19.2	1.1		–
Business inventory investment ($ billion)	5.9	12.2	15.6	2.9	11.0		–
Exports	-0.1	-2.1	-3.1	-1.7	13.5		–
Imports	0.6	4.0	5.4	-4.0	17.8		–
Current account balance							
(nominal $ billion)	23.4	25.8	20.4	31.4	26.6		–
(percentage of GDP)	2.0	2.1	1.7	2.6	2.2		–
Nominal personal income	3.3	2.7	1.6	3.2	2.6		–
Nominal personal disposable income	4.7	2.8	2.1	1.5	1.1		–
Real personal disposable income	2.7	1.1	2.8	-0.3	1.1		–
Profits before taxes	4.3	10.1	-35.9	21.4	14.7		–
Costs and prices (%, y/y)							
GDP price deflator	0.9	3.4	3.0	3.3	2.3		–
Consumer price index	2.2	2.8	2.8	2.1	1.7	1.2	Jan-2004
CPI excluding eight most volatile items	2.4	2.2	2.2	1.7	1.9	1.5	Jan-2004
Unit labour costs	1.5	1.6	2.3	1.9	0.5		
Wage settlements (total)	2.8	2.6	2.5	3.1	2.1	2.6	Dec-2003
Labour market							
Unemployment rate (%)	7.7	7.6	7.7	7.9	7.5	7.4	Jan-2004
Employment growth	2.2	2.2	0.7	0.8	3.6	1.1	Jan-2004
Financial markets (average)							
Exchange rate (cents U.S.)	63.7	71.6	71.6	72.5	76.0	74.48	02-Mar-04
Prime interest rate (%)	4.2	4.7	5.0	4.7	4.5	4.00	02-Mar-04

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

Consumer spending flattens

Real consumer expenditure grew 0.1% in the fourth quarter following a 4.6% rise in the third. Sharply reduced spending on durables offset a solid 4.0% gain in services. Motor vehicle sales plunged as incentive programs had shifted sales to the third quarter.

Solid employment growth boosted personal income 2.6% in the fourth quarter. Labour income climbed with employment, but a drop in investment income moderated overall growth. Real personal disposable income rose 1.1% while real personal disposable income per capita was largely unchanged. The personal savings rate edged up to 1.5% from 1.3% in the third quarter.

Strong residential investment growth

Low interest rates continued to support the housing market. Residential investment increased a robust 10.0% in the fourth quarter, following growth of about 19% in the third. New construction activity jumped, as housing starts remained at a high level in the fourth quarter. Renovations also grew solidly. However, while remaining at a healthy level, sales of existing homes declined, reducing real estate transfer costs.

Modest business fixed investment growth

Business spending on plant and equipment grew a modest 2.2% in the fourth quarter, a marked slowdown from the 14.4% jump in the previous quarter. Investment in machinery and equipment rose a weaker 1.1% after increasing 19.2% in the third quarter. While purchases of cars inched up, those of trucks and other transportation equipment, especially aircraft, fell. Investment in information and communications technology, however, appears to be on a sharp rebound from its depressed activity of recent years. It climbed 17.9% in software and soared 47.4% in telecommunications equipment.

Non-residential construction increased a solid 4.0% following a gain of 6.9% in the third quarter. Spending on engineering projects accounted for the gain, as spending on building construction fell.

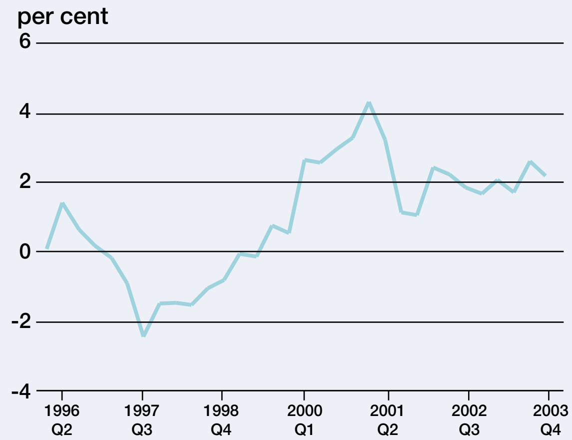
Businesses add more to inventories

Businesses boosted inventories $11.0 billion in the fourth quarter, up sharply from the $2.9-billion inventory accumulation in the third. Retail inventories drove this investment, partly reflecting an increase in motor vehicle inventories as imports rose while sales declined. Inventories of livestock continued to accumulate due to the ban on beef exports, while stocks of grains increased following a good harvest.

Imports increase more than exports

Boosted by the appreciation of the dollar and higher inventory investment, real imports increased more than exports in the fourth quarter, rising 17.8%. Imports of high-tech equipment and automotive and energy products led the way in the goods category. Spending on travel abroad also surged as the fear of SARS and the war in Iraq subsided while the appreciation of the dollar made foreign travel less expensive.

Chart 2
Current account as a percentage of nominal GDP



Current account surplus widens

The current account registered its 18th consecutive quarterly surplus, in contrast to deficits over most of the 1980s and 1990s. However, the surplus decreased $4.8 billion to $26.6 billion, or 2.2% of nominal GDP (Chart 2). Lower dividends received from non-residents plus smaller retained earnings by Canadian-owned corporations abroad compounded the decline in the nominal trade balance in the fourth quarter.

For 2003 as a whole, the appreciation of the Canadian dollar reduced interest payments on foreign currency deposits and U.S. dollar denominated Canadian securities held in foreign portfolios. This improved the investment income deficit by $4.0 billion. The current account surplus thus increased to $25.8 billion in 2003 from $23.4 billion in 2002.

Inflation remains low

The GDP deflator, a comprehensive measure of domestic prices, inched 0.4% higher in the fourth quarter following a 3.7% increase in the third. Relative to the fourth quarter of 2002, prices stood 2.3% higher.

Year-over-year consumer price inflation dropped to 1.2% in January 2004, down from a recent high of 4.6% in February 2003. At 1.5% in January, core CPI inflation, which excludes the eight most volatile items, was below the 2% target, which is the mid-point of the official 1% to 3% band.

Corporate profits increase

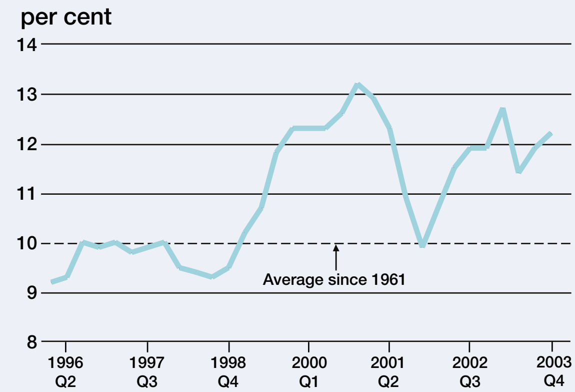
Corporate profits rose 14.7% in the fourth quarter, following a 21.4% jump in the third. Profits of depository financial institutions and transportation and mining industries rose significantly. Mining profits climbed, driven by increased demand from the U.S. and Asian markets and tight supplies. In the manufacturing sector, profits recovered marginally in the fourth quarter after a turbulent year, but remained well below the year-earlier level. Manufacturers of automotive products saw profits decrease with sales. Exporters saw their Canadian dollar revenue negatively affected by the currency appreciation while importers gained a cost advantage. At 12.2% of GDP, overall profits remained above their 10.0% historical average (Chart 3).

Solid employment growth

Employment grew 3.6% in the fourth quarter, more than four times the pace in the previous quarter. The nearly 15,000 net new jobs added in January 2004 brought the increase in employment since December 2002 to 293,000. The participation rate sat at 67.6% in January, slightly below its record high of 67.7% set in the previous month. The unemployment rate remained at December's level of 7.4%, the same rate as in March 2003, but down from 8.0% in August.

Hourly labour productivity edged only 0.3% higher in the fourth quarter as hours worked jumped with employment and closely matched output growth. Labour costs per unit of output dipped 0.3% to stand 0.5% higher than a year earlier.

Chart 3
Profits before taxes as a share of nominal GDP



Bank of Canada lowers its policy rate

On March 2, the Bank of Canada lowered its key policy rate—the Target for the Overnight Rate—to 2.25 per cent, stating that with CPI inflation significantly below 2% this decision would "provide some additional monetary stimulus… to support aggregate demand and to return inflation to the target by the end of 2005."

Since the end of November, Canadian short-term interest rates have decreased while U.S. rates have remained steady, narrowing the gap between the two. The same is true of long-term rates, but to a lesser degree.

In recent weeks, the Canadian dollar has given back a portion of its appreciation in 2003 and very early 2004 against the U.S. dollar. It closed at 74.48 cents U.S. on March 2, off the 78.67 cents U.S. level of January 9, 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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