THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 2004

OVERVIEW

- In the second quarter of 2004 real gross domestic product (GDP) grew a solid 4.3%, the most rapid pace in two years, following an increase of 3.0% in the first quarter.
- Strong foreign demand pushed real exports up 21.6% following a 6.1% first-quarter gain. Canadian final domestic demand growth slowed to 1.7% in the second quarter from 5.9% in the first. Growth in all major categories of domestic demand eased relative to the first quarter.
- Part of the increased demand was met through a 13.3% jump in imports.
- The current account surplus rose $8.7 billion to $41.7 billion or 3.2% of nominal GDP, the 20th consecutive quarterly surplus.
- The Canadian economy created over 112,000 net new jobs in the first eight months of 2004. The unemployment rate remained at 7.2% in August.

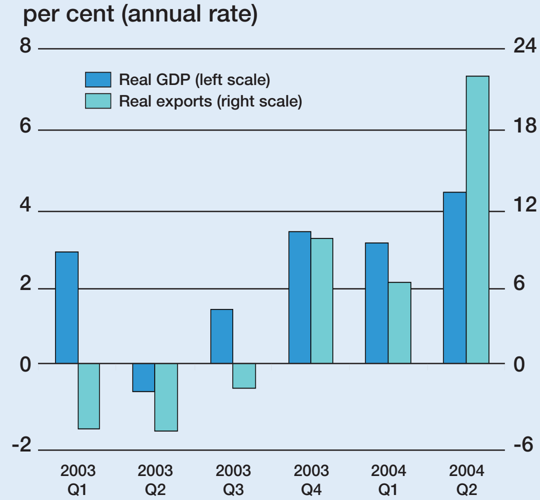
Real GDP growth steps higher

Real GDP rose 4.3% in the second quarter, the most rapid growth rate since the beginning of 2002, following a 3.0% first-quarter gain, as exports jumped to meet strong foreign demand (Chart 1). Final domestic demand advanced more modestly than in the first quarter.

Exports surge

Real exports rose a very strong 21.6%. Exports to the United States and other major trading partners grew strongly, as did exports of all major goods categories. Exports of automotive products, machinery and equipment, and industrial goods, the three largest components, all advanced more than 25%. Exports of forest products, benefiting

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 end of day, September 10, 2004.

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

	2002	2003	2003:Q4	2004:Q1	2004:Q2		Most recent
Real gross domestic product	3.4	2.0	3.3	3.0	4.3		–
Final domestic demand	3.1	3.6	2.3	5.9	1.7		–
Government expenditure							–
Goods and services	2.8	3.8	3.9	3.2	1.2		–
Gross fixed capital	9.1	6.8	5.9	6.0	-5.1		–
Consumer expenditure	3.4	3.1	0.7	6.4	1.3		–
Residential investment	14.5	7.5	8.6	12.0	5.8		–
Business fixed investment	-4.0	3.2	3.3	4.8	4.1		–
Non-residential construction	-8.3	1.0	3.5	-2.3	3.4		–
Machinery and equipment	-1.2	4.5	3.2	9.6	4.5		–
Business inventory investment ($ billion)	2.1	11.9	12.2	1.0	0.1		–
Exports	1.1	-2.4	9.4	6.1	21.6		–
Imports	1.4	3.8	17.8	3.8	13.3		–
Current account balance							
(nominal $ billion)	22.7	23.8	26.6	33.0	41.7		–
(percentage of GDP)	2.0	2.0	2.2	2.6	3.2		–
Nominal personal income	2.7	3.0	2.7	5.6	5.2		–
Nominal personal disposable income	3.8	3.0	2.8	6.6	8.0		–
Real personal disposable income	1.7	1.4	3.1	4.2	4.8		–
Profits before taxes	8.6	10.0	14.6	35.8	28.6		–
Costs and prices (%, y/y)							
GDP price deflator	1.0	3.2	2.2	1.6	3.5		–
Consumer price index	2.2	2.8	1.7	0.9	2.2	2.3	Jul-2004
CPI excluding eight most volatile items	2.4	2.2	1.9	1.3	1.7	1.9	Jul-2004
Unit labour costs	0.5	1.5	1.2	1.3	1.2		
Wage settlements (total)	2.8	2.6	2.0	2.8	1.3	2.6	Jun-2004
Labour market							
Unemployment rate (%)	7.7	7.6	7.5	7.4	7.2	7.2	Aug-2004
Employment growth	2.2	2.2	3.6	1.1	2.0	-0.2	Aug-2004
Financial markets (average)							
Exchange rate (cents U.S.)	63.7	71.6	76.0	75.9	73.6	77.45	10-Sep-04
Prime interest rate (%)	4.2	4.7	4.5	4.2	3.8	4.00	10-Sep-04

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

from the U.S. housing boom, jumped nearly 24%, the strongest gain in almost eight years.

Imports jump with exports

Real imports jumped 13.3%. Imports of machinery and equipment, industrial goods and automotive products all registered double-digit gains. Export growth likely helped boost imports as Canadian automotive and machinery and equipment production make extensive use of imported inputs.

Consumer spending growth slows

Real consumer expenditure grew 1.3% in the second quarter, down from 6.4% in the first. Spending growth on durables slowed to 3.7% from 9.2% in the first quarter. Dealer incentives aided household expenditure on motor vehicles while the robust housing market boosted furniture and appliance sales. Expenditure growth on semi-durables and services also slowed while spending on non-durables actually dropped after healthy growth in the first quarter.

Personal income registered another solid gain in the second quarter, rising 5.2% following a 5.6% increase in the first quarter. With a stronger advance in compensation per employee than in the first quarter, labour income registered a solid 5.5% gain. Real personal disposable income rose 4.8% while real personal disposable income per capita advanced 3.8%. The personal savings rate increased to 1.5% from 0.8% in the first quarter.

Residential investment growth strong

Low interest rates continued to support the housing market. Residential investment increased a solid 5.8% in the second quarter, down from 12.0% in the first. House resales and real estate transfer costs jumped, but growth in new construction activity slowed to 4.6% from 12.9% in the previous quarter, as housing starts showed only a modest increase in the second quarter from already high levels. Renovations showed little gain following a spike up in the first quarter.

Business fixed investment rises

Business spending on plant and equipment rose for the sixth consecutive quarter, growing 4.1% in the second quarter. Investment in machinery and equipment rose 4.5%, less than half the pace in the first quarter. Spending soared on other transportation equipment and increased for computers and office furniture, but it declined for agricultural and industrial machinery, motor vehicles, software, and telecommunications equipment.

Non-residential construction rose 3.4% after a drop of 2.3% in the first quarter. Spending on engineering projects increased for a sixth consecutive quarter, but expenditures on building construction, such as office towers and shopping malls, fell for a third consecutive quarter.

Business inventories little changed

Businesses held their inventories almost unchanged in the second quarter following an inventory investment of $1.0 billion in the first quarter. An accumulation of farm inventories offset depletions by manufacturers, retailers and wholesalers.

Current account surplus widens

In the second quarter, the current account registered a 20th consecutive surplus, in contrast with deficits throughout most of the 1980s and 1990s. The surplus rose $8.7 billion to $41.7 billion or 3.2% of nominal GDP (Chart 2). The goods trade surplus improved $14.3 billion as higher export prices (Chart 3), especially for primary products, added to the positive impact of real trade movements. A $5.8-billion deterioration in the investment income deficit partly offset that gain, as stronger profits earned by foreign direct investors in Canada boosted dividends and retained earnings assigned to non-residents.

Chart 2
Current account as a percentage of nominal GDP

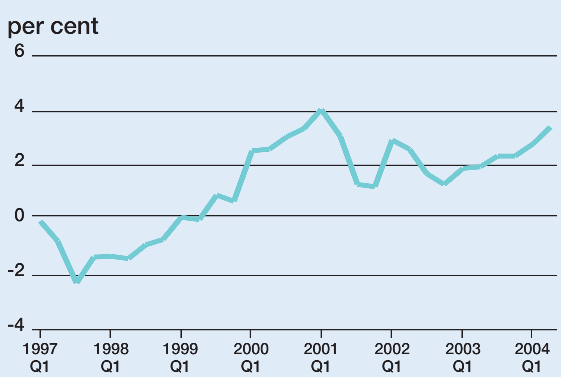
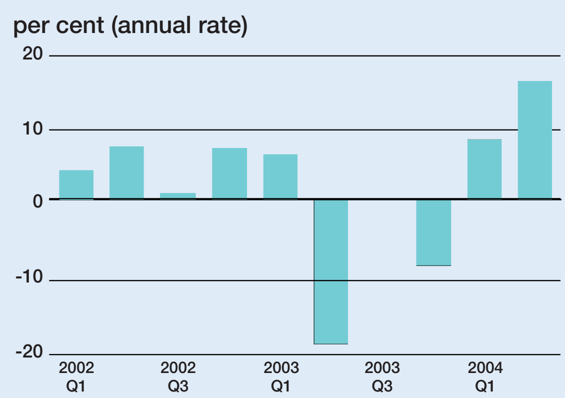


Chart 3
Change in export prices



Corporate profits jump

Corporate profits rose 28.6% in the second quarter, following a 35.8% jump in the first quarter. Manufacturers, oil and gas producers and retailers all made noticeable gains. Four consecutive double-digit increases have raised corporate profits as a share of GDP to 13.8%, well above the 10.1% historical average (Chart 4).

Consumer price inflation remains low

The GDP deflator, a comprehensive measure of domestic prices, increased 5.7% in the second quarter following a 4.5% increase in the first, as rising commodity prices boosted export prices (Chart 3). The GDP deflator stood 3.5% higher than a year earlier.

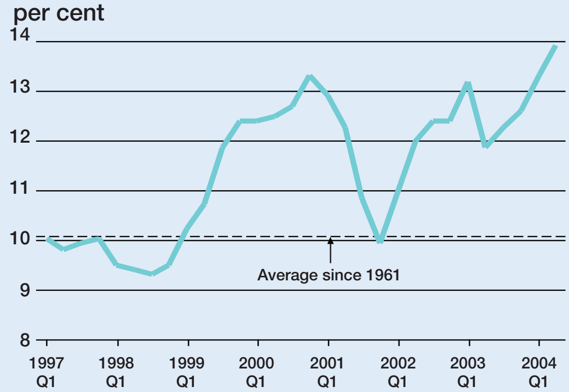
Year-over-year consumer price inflation dipped to 2.3% in July from 2.5% in June as the pace of increase in energy prices slowed in July. Nonetheless, higher energy prices have boosted CPI inflation above the 2% target, the mid-point of the official 1% to 3% band, and well above the recent low of 0.7% in February and March. However, at 1.9% in July, core CPI inflation, which excludes the eight most volatile items, sat just below the target level.

Employment grows in second quarter

Employment grew 2.0% in the second quarter. In the first eight months of 2004 the Canadian economy created 112,500 net new jobs. The participation rate sat at 67.4% in August, the same as in July and below its record high of 67.7% set in December 2003. The unemployment rate remained at 7.2%, the same rate as in July and May, when it hit its lowest level since July 2001.

Hourly labour productivity jumped a robust 2.9%, as output increased more than hours worked. Labour costs per unit of output rose 1.2% to stand 1.2% higher than a year earlier.

Chart 4
Profits before taxes as a share of nominal GDP



Bank of Canada raises its policy rate

On September 8, the Bank of Canada raised its key policy rate—the target for the overnight rate—by one-quarter of one percentage point to 2.25 per cent. As background for this decision, the Bank stated that it expects "aggregate demand to grow at, or marginally above, the rate of growth of production capacity. With the economy operating close to its capacity, monetary stimulus needs to be reduced to avoid a buildup of inflationary pressures."

With the U.S. Federal Reserve having raised its target rate 25 basis points on August 10, the gap between Canadian and U.S. short-term interest rates narrowed to under 70 from over 90 basis points in May. Long rates have fallen in the United States over the last three months, widening the gap in the two countries.

The Canadian dollar closed at 77.45 cents U.S. on September 10, 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 Steven James at (613) 992-4321. Also available on the Internet at www.fin.gc.ca

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