THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE MARCH 2005

OVERVIEW

- In the fourth quarter of 2004 real gross domestic product (GDP) grew 1.7%, following a 2.9% increase in the third quarter. For 2004 as a whole, real GDP rose 2.8%.
- Final domestic demand remained strong, rising 4.4% following gains of 3.5% in the third quarter and 2.4% in the second. Stronger consumer spending and business investment in machinery and equipment led the way. In addition, business inventory accumulation increased to $22.4 billion from $18.3 billion in the third quarter and $1.8 billion in the second.
- Much of the increased domestic demand, including inventory investment, was met through an 8.4% jump in real imports. Real exports fell 3.5% following a 3.4% decline in the third quarter.
- The current account registered its 22nd consecutive quarterly surplus despite a drop of $8.2 billion to $25.2 billion, or 1.9% of nominal GDP. For 2004 as a whole, the current account surplus reached a record $33.8 billion, $10 billion higher than in 2003.
- The Canadian economy created over 226,000 net new jobs during 2004, but lost 6,000 in January 2005. The unemployment rate was 7.0% in January, the same as in December.

Real GDP grows 1.7%

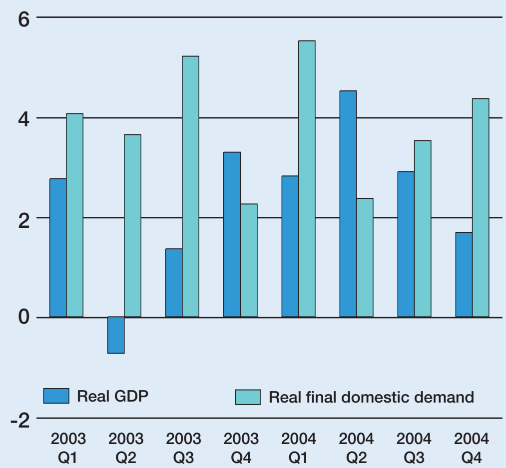
Real GDP rose 1.7% in the fourth quarter following a 2.9% gain in the third. Final domestic demand grew 4.4%, up from 3.5% in the previous quarter (Chart 1).

Consumer spending growth rises

Real consumer expenditure grew 4.1% in the fourth quarter, up from 3.6% in the third quarter and 1.9% in the second. Spending growth was solid for durables and for non-durables such as food. Services spending grew more strongly than in the third quarter.

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 1, 2005.

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)

	2003	2004	2004:Q2	2004:Q3	2004:Q4	Most recent	
Real gross domestic product	2.0	2.8	4.5	2.9	1.7		–
Final domestic demand	3.6	3.8	2.4	3.5	4.4		–
Government expenditure							–
Goods and services	3.8	2.5	1.9	1.5	2.2		–
Gross fixed capital	6.8	1.9	-5.7	-1.7	0.9		–
Consumer expenditure	3.1	3.5	1.9	3.6	4.1		–
Residential investment	7.5	8.4	6.9	5.1	7.0		–
Business fixed investment	3.2	6.1	5.3	7.0	9.3		–
Non-residential construction	1.0	1.0	2.5	3.7	1.7		–
Machinery and equipment	4.5	9.4	7.1	9.1	14.4		–
Business inventory investment ($ billion)	11.9	11.7	1.8	18.3	22.4		–
Exports	-2.4	4.9	17.9	-3.4	-3.5		–
Imports	3.8	8.2	9.6	14.2	8.4		–
Current account balance							
(nominal $ billion)	23.8	33.8	44.1	33.4	25.2		–
(percentage of GDP)	2.0	2.6	3.4	2.6	1.9		–
Nominal personal income	3.0	4.1	5.3	3.6	4.1		–
Nominal personal disposable income	3.0	3.9	5.6	2.6	4.4		–
Real personal disposable income	1.4	2.4	2.4	1.5	3.0		–
Profits before taxes	10.0	17.7	36.6	6.2	6.0		–
Costs and prices (%, y/y)							
GDP price deflator	3.2	3.2	3.4	3.8	4.2		–
Consumer price index	2.8	1.9	2.2	2.0	2.3	2.0	Jan-2005
CPI excluding eight most volatile items	2.2	1.5	1.7	1.7	1.6	1.6	Jan-2005
Unit labour costs	1.6	1.5	1.4	1.3	1.7		
Wage settlements (total)	2.5	1.7	1.3	1.4	2.2	2.5	Dec-2004
Labour market							
Unemployment rate (%)	7.6	7.2	7.2	7.1	7.1	7.0	Jan-2005
Employment growth	2.3	1.8	2.4	1.3	1.7	-0.4	Jan-2005
Financial markets (average)							
Exchange rate (cents U.S.)	71.6	77.0	73.6	76.5	81.9	80.60	1-Mar-05
Prime interest rate (%)	4.7	4.0	3.8	3.8	4.3	4.25	1-Mar-05

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

Personal income registered a healthy 4.1% gain in the fourth quarter following a 3.6% increase in the third. Labour income increased with compensation per hour worked. Real personal disposable income rose 3.0%, double the third-quarter pace. Real personal disposable income per capita increased 1.8%. After saving 0.3% of disposable income in the third quarter, consumers spent virtually all of their disposable income in the fourth quarter.

Residential investment growth continues

Low interest rates continued to support housing activity. Residential investment increased 7.0% in the fourth quarter. Continued robust housing starts supported a 7.7% gain in new construction activity after a third-quarter rise of 7.2%. Renovations rose 15.0% following growth of 12.8% in the third quarter. House resales, however, fell in the fourth quarter as in the third, lowering real estate transfer costs by 11.5% and moderating growth in residential investment.

Business fixed investment strengthens

Business spending on plant and equipment grew 9.3% in the fourth quarter, the eighth consecutive increase. Investment in machinery and equipment jumped 14.4%, up from 9.1% in the third quarter and 7.1% in the second (Chart 2). Spending soared in the two largest categories: investment in computers and other office equipment climbed 39.2% while that on industrial machinery rose 19.2%. Investment in automobiles and non-automotive transportation equipment declined.

Non-residential construction increased 1.7% after a third-quarter 3.7% gain. As in the second and third quarters, reduced spending on building construction, such as office towers and shopping malls, partly offset increased spending on engineering projects.

Business inventories build up

Businesses increased inventories by $22.4 billion in the fourth quarter following an increase of $18.3 billion in the third quarter. The fourth-quarter buildup was concentrated in manufacturing and wholesale industries, especially for durable goods. The inventory-to-sales ratio remained well below its historical average.

Exports fall

Exports declined 3.5% in the fourth quarter, the second consecutive drop of over 3% and the sixth decrease in the last nine quarters. Within goods exports, declines were widespread, with the exceptions of industrial and automotive products. Exports of services rose 3.2%, as exports of commercial services rebounded from five consecutive quarterly declines.

Imports climb

Real imports registered a fifth consecutive increase and the seventh in the last eight quarters, climbing 8.4% with gains in all major categories except automotive products. Reflecting growth in investment, machinery and equipment imports increased 12.9%, the fourth consecutive double-digit increase, and reflecting consumer spending growth, imports of non-automotive consumer goods recorded a second consecutive double-digit gain. Imports of services increased 14.9% as spending on foreign travel soared 36.2%.

Current account surplus narrows

In the fourth quarter, the current account registered its 22nd consecutive surplus, in contrast with deficits throughout most of the 1980s and 1990s. The surplus, however, fell to $25.2 billion, or 1.9% of nominal GDP, from $33.4 billion in the previous quarter (Chart 3). With real imports rising and real exports falling, the goods trade surplus dropped $4.3 billion despite a larger decline in import than export prices. A decline in investment income receipts, concentrated in lower retained earnings from direct investment abroad, yielded a $2.9-billion deterioration in the investment income balance

Chart 2
Growth in real machinery and equipment investment

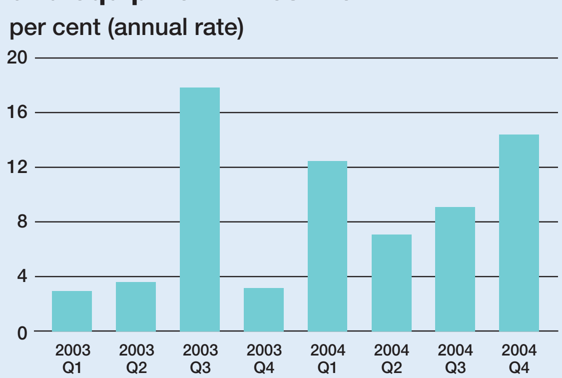
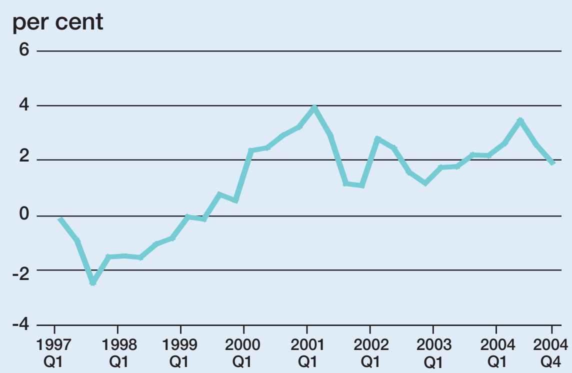


Chart 3
Current account as a percentage of nominal GDP

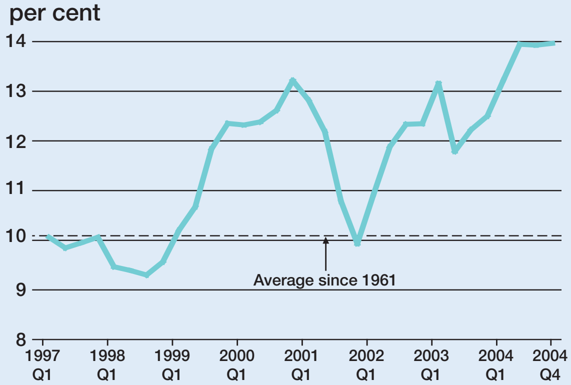


and contributed to the weaker current account surplus. For the year as a whole, the current account registered a surplus of $33.8 billion or 2.6% of nominal GDP, up $10 billion from 2003.

Corporate profits continue to grow

Corporate profits rose 6.0% in the fourth quarter, similar to the third quarter's 6.2% increase that followed four consecutive double-digit gains. Corporate profits as a share of GDP have climbed to 14.0%, well above the 10.1% historical average (Chart 4). The transportation industry's profits rose sharply, but weaker exports and the strong dollar restricted manufacturers' gains. The wood, paper and chemical industries showed increases, but the motor vehicle, primary metals, and petroleum and coal industries saw earnings weaken.

Chart 4
Profits before taxes as a share of nominal GDP



Consumer price inflation remains low

The increase in the GDP deflator, a comprehensive measure of domestic prices, slowed to 3.2% in the fourth quarter from 3.9% in the third to stand 4.2% higher than a year earlier.

Year-over-year consumer price inflation stood at 2.0% in January, down from 2.1% in December, as the pace of the rise in food and energy prices slowed. And at 1.6% in January, core CPI inflation, which excludes the eight most volatile items, sat below the 2% mid-point of the 1% to 3% target band.

Employment growth pauses in January

Employment grew 1.7% in the fourth quarter. During 2004 the Canadian economy created over 226,000 net new jobs, all of them full-time. However, employment dipped 6,000 in January 2005. The participation rate sat at 67.4% in January, down from December and from its record high of 67.7% first set in late 2003 and matched several times since. The unemployment rate remained at 7.0%, its lowest level since mid-2001.

Hourly labour productivity rebounded 3.7% following a third-quarter drop, as output rose despite fewer hours worked. Labour costs per unit of output rose 2.5% to stand 1.7% higher than a year earlier.

Bank of Canada holds policy rate steady

On March 1, as in December and January, the Bank of Canada maintained its key policy rate—the target for the overnight rate—at 2.50 per cent. The Bank stated that since January's announcement, "the outlook for the Canadian economy and inflation…are essentially unchanged."

With the U.S. Federal Reserve having raised its target rate 25 basis points five times from August 2004 to February 2005, U.S. short-term interest rates are now higher than those in Canada.

Since closing at 85.04 cents U.S. on November 26, 2004, its highest value in nearly 13 years, the Canadian dollar has eased back to close at 80.60 cents U.S. on March 1, 2005.

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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