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Economic Insights

Recent Developments in the Canadian Economy: Fall 2018

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Analytical Studies Branch

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Recent Developments in the Canadian Economy: Fall 2018

by Guy Gellatly and Elizabeth Richards, Analytical Studies Branch

This article in the *Economic Insights* series provides users with an integrated summary of recent changes in output, employment, household demand, international trade and prices. Organized as a statistical summary of major indicators, the report is designed to inform about recent developments in the Canadian economy, highlighting major changes in the economic data during the first half of 2018 and into the summer months. Unless otherwise noted, the tabulations presented in this report are based on seasonally adjusted data available on October 19, 2018.

Overview

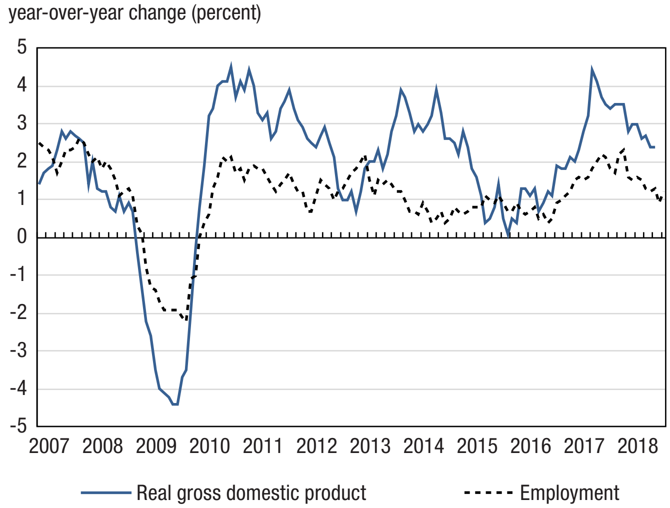
Following a modest gain to start the year, economic growth accelerated in the second quarter of 2018 as exports and household spending strengthened. Non-residential business investment contributed to growth in both quarters, and has trended higher since early 2017. Investment in housing was down in the first half of 2018 owing to lower activity in resale markets.

Higher output in construction and oil and gas extraction supported goods production during the first half of 2018. Oil and gas extraction strengthened in the second quarter, contributing to increases in business productivity and capacity utilization as energy exports, supported by higher prices and volumes, continued to expand.

Employment growth slowed during the first half of 2018 as gains in full-time work were offset by part-time losses. Following sizable gains in the second half of last year, the number of private sector employees declined in the first six months of 2018. Employment among core-age workers was little changed. More recently, employment increased in the third quarter on gains in part-time work and among private-sector employees.

Consumer price inflation continued to increase in the first half, rising to 2.5% in June before accelerating to 3.0% in July, the largest headline rate since 2011. Higher gas prices contributed substantially to the stronger pace of consumer inflation into mid-year. Consumer price inflation decelerated in August and September.

Chart 1
Output and employment

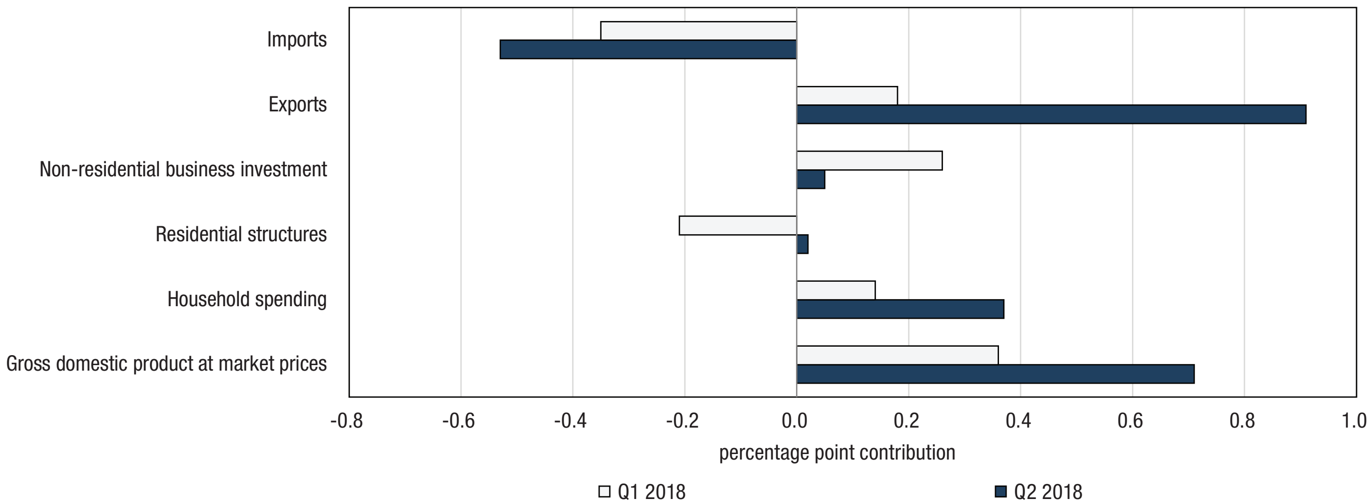


Sources: Statistics Canada, tables 36-10-0434-01 and 14-10-0287-01.

Overall, the pace of real GDP growth, measured year-over-year, has slowed since mid-2017, edging down to 2.4% in June. Annual employment growth also trended lower, slowing to 1.2% at mid-year. The positive gap between output growth and employment growth has remained relatively stable over 2018 to date (Chart 1).[1]

1. For bi-weekly video summaries of recent movements in the major economic indicators published by Statistics Canada, see the Review of *Economic Statistics* at the following link: https://www.statcan.gc.ca/eng/dai/economicstats. Contextual information on major economic and business developments for specific calendar months is available at Canadian Economic News, located at: https://www.statcan.gc.ca/eng/dai/btd/cen/index.

Chart 2
Contributions to real GDP growth, selected components



Notes: Data on gross domestic product (GDP) are quarterly growth rates; all other data are percentage-point contributions to the the quarterly growth in real GDP. For additional data on these contributions, see the table noted below. Non-residential business investment includes spending on non-residential structures and machinery and equipment.
Source: Statistics Canada, table 36-10-0104-01.

Economic growth strengthened as exports advanced

Economic growth accelerated in the second quarter of 2018, as output expanded at the fastest pace since the first half of last year. Real GDP rose 0.7% in the second quarter, following a 0.4% gain in the first.

Higher exports were the main contributor to stronger growth in the second quarter of 2018, as export volumes expanded at their fastest pace in four years (Chart 2). Household spending also accelerated, though the pace of spending remained well below levels observed during the first half of last year. Non-residential business investment slowed in the second quarter, after a notable gain to start the year as investment outlays continued to recover from lower levels in 2015 and 2016. Residential structures edged up in the second quarter, after weighing on growth in the first.

In the United States, real GDP rose 1.0% in the second quarter of 2018, up from 0.5% earlier in the year, as household spending and exports strengthened. Economic growth in the United States has outpaced growth in Canada since mid-2017.

The volume of goods exported from Canada rose 3.6% in the second quarter, after edging up 0.3% in the first. Energy volumes increased by 5.6% in the second, following a similar gain to start the year, as exports of crude oil and crude bitumen, natural gas, and refined petroleum products all advanced. Higher volumes of consumer goods and aircraft also contributed to stronger exports in the second quarter (Chart 3).

Imports rose 1.6% in the second quarter, following a 1.0% gain in the first. Import volumes have increased for six consecutive quarters. Refined petroleum products led the growth in the second quarter, as imports rose to offset lower volumes at domestic petroleum refineries due to maintenance activities. Imports of basic and industrial chemicals and other transportation equipment and parts also contributed to growth in the second quarter.

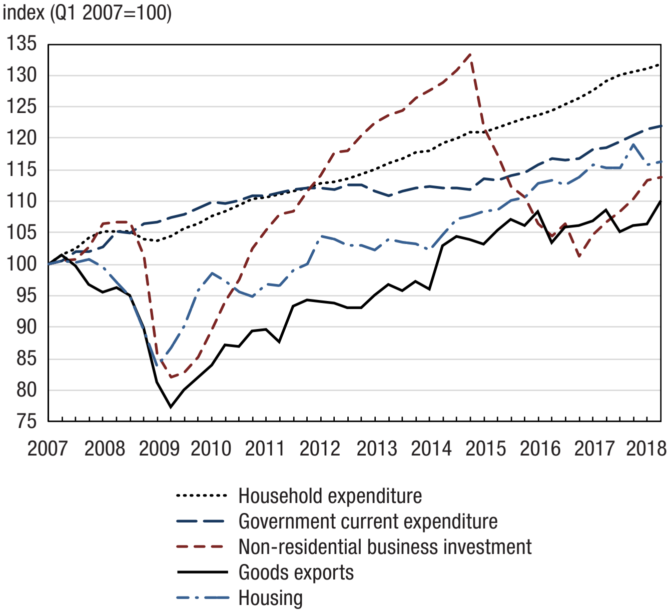
Household spending accelerated following slower growth

Household spending rose 0.6% in the second quarter, following a 0.3% gain in the first. Stronger spending in the second followed three consecutive quarters during which the pace of household spending had slowed. Higher outlays on insurance and financial services, household furnishings, and recreation and culture supported growth in the second quarter.

Business investment advanced at a slower pace

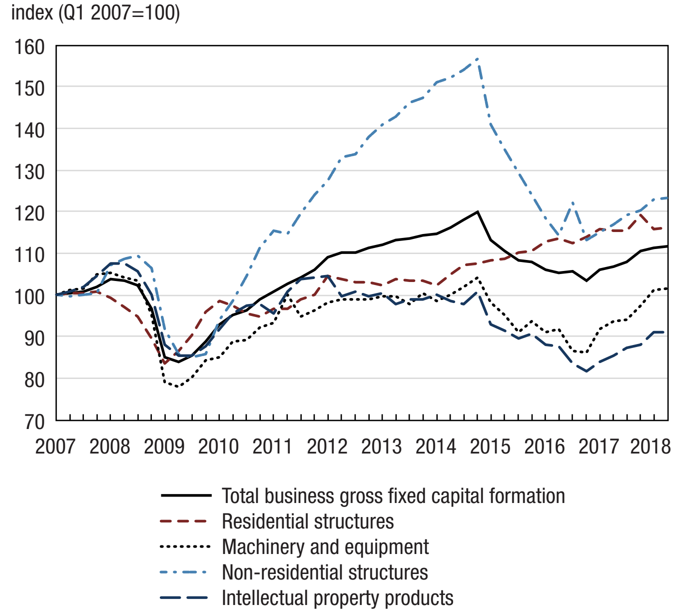
Business spending on non-residential structures and machinery and equipment (M&E) rose 0.5% in the second quarter, following a 2.7% gain in the first. Combined business outlays on structures and machinery and equipment have increased for six consecutive quarters, after trending lower in 2015 and 2016 as oil prices declined. Combined outlays on structures and M&E in the second quarter remain 15% below peak levels at the end of 2014 (Chart 4).

Chart 3
Real gross domestic product, selected aggregates



Note: Q1=first quarter.
Source: Statistics Canada, table 36-10-0104-01.

Chart 4
Business gross fixed capital formation



Note: Q1=first quarter.
Source: Statistics Canada, table 36-10-0108-01.

Business investment in non-residential structures edged up 0.5% in the second quarter, following a 2.0% gain in the first. Spending on engineering structures was flat in the second quarter, after advancing to start the year. Outlays on non-residential buildings contributed to growth in both quarters, and have strengthened over the last year. Total business outlays on non-residential structures in the second quarter remain about 20% below levels at the end of 2014.

Business investment in machinery and equipment slowed in the second quarter (+0.3%), after a sizable gain to start the year. Investments in aircraft and other transportation equipment contributed to the gain in the second, supported by spending on computers and industrial machinery. Business spending on machinery and equipment has strengthened since early 2017 after trending lower in 2015 and 2016. However, outlays in the second quarter of this year are still down about 3% from levels at the end of 2014.

Business outlays on intellectual property products edged up 0.2% in the second quarter, following a sizable increase in the first. Gains in the first quarter were broad-based, as expenditures on software, mineral exploration, and research and development all increased. Spending on research and development continued to rise in the second quarter, while outlays on mineral exploration declined. Total business investment in intellectual property assets has trended higher since early 2017 but remain about 10% lower than levels at the end of 2014. Spending on mineral exploration is down about 50% from levels in late 2014.

Lower resale activity weighed on housing

Spending on residential structures edged up 0.3% in the second quarter of 2018, following a 2.7% decline in the first. Outlays on residential structures had risen 3.2% in late 2017 prior to the introduction of new mortgage regulations in January of this year. Lower spending on ownership transfer costs, a measure of the volume of activity in resale markets, accounted for the first-quarter decline, partly offset by increases in new construction and renovations. Ownership transfer costs continued to decline in the second quarter, and are down about 20% from levels in the fourth quarter of 2017. New construction also declined in second quarter, following six consecutive quarterly gains. Higher renovations in the second quarter (+2.9%) supported the overall increase in housing investment.

Productivity and industrial capacity strengthened on gains in oil extraction

Following a 0.3% decline to start the year, business sector labour productivity rose 0.7% in the second quarter. Higher productivity in mining and oil and gas extraction led the increase, as output in the sector rose 3.6% while hours worked were unchanged. Productivity in the construction sector also rose for the eighth consecutive quarter.

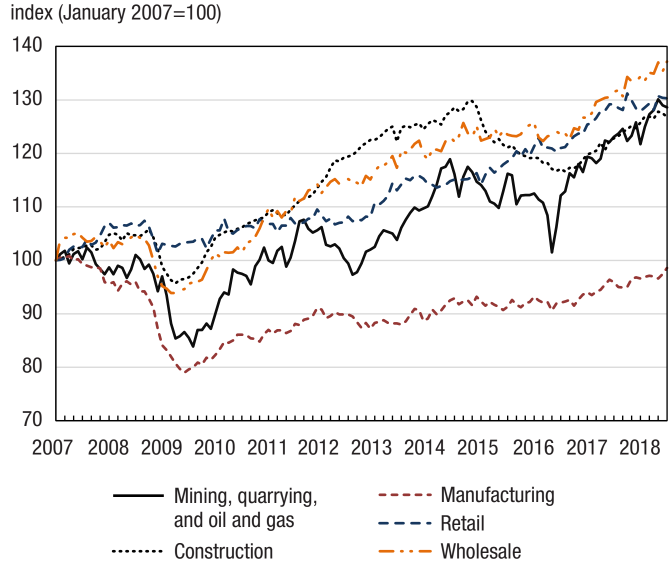
Industrial capacity utilization rose to 85.5% in the second quarter, the highest level since the second quarter of 2007. Higher capacity utilization in the energy sector led the gain. After remaining stable since mid-2017, capacity utilization in oil and gas extraction rose 4.4 percentage points in the second quarter, to 87.1%. Capacity utilization also strengthened in forestry and manufacturing.

The contribution of the terms of trade to income growth moderated during the first half of 2018, after making a sizable contribution in the fourth quarter of last year. Following a 0.8% increase to start the year, nominal GDP rose 1.3% in the second quarter as corporate earnings strengthened.

Resource extraction and construction bolstered output

Following a decline to start the year, the output of goods-producing industries rose steadily from February to May before slowing in June. Increased construction activity contributed to higher goods production in the first quarter, while increased activity in mining, quarrying and oil and gas extraction bolstered output in the second. Manufacturing output rose in both quarters (Chart 5).

Chart 5
Real gross domestic product, selected industries



Source: Statistics Canada, table 36-10-0434-01.

Construction output strengthened in early 2018 as residential, non-residential and engineering activity all increased in January and February. Construction activity rose sharply in May on higher residential activity, before edging down in June. At mid-year, output in the construction sector was 2.3% higher than at year-end 2017, supported by increases in both residential and non-residential activity. Non-residential building construction increased from January to April, before edging lower into mid-year.

Manufacturing output expanded in three of the first six months of 2018 as durables strengthened. The output of fabricated metal manufacturers was 7.2% higher at mid-year than at year-end 2017, while primary metal manufacturing, which includes steel and aluminum producers, was up 4.4%. Transportation equipment manufacturing edged lower in the first half of 2018. Auto manufacturing in June was down 3.2% from levels at year-end 2017, and down 8.2% on a year-over-year basis. The output of petroleum refineries was down in the first half of the year, as maintenance shutdowns affected production levels in April and May. Refinery output ramped up in June as facilities came back on line. Refinery output in June was 5.6% lower than levels at year-end, and down about 11% on a year-over-year basis.

The output of service industries edged higher early in the year, and advanced sharply in May (+0.5%) on increases in retail and wholesale trade. Professional, scientific and technical services supported growth in both quarters, as output in computer systems design and architectural and engineering services continued to trend higher. Retail trade strengthened in the second quarter, after weighing on growth in the first.

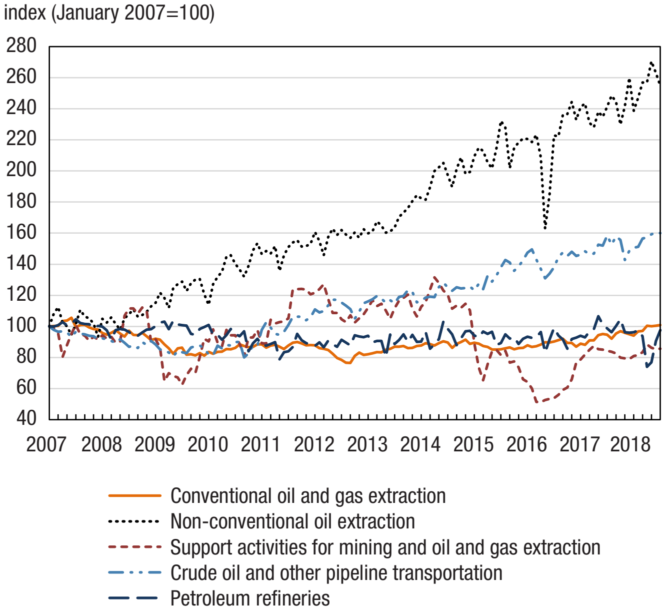
The output of real estate agents and brokers declined sharply in January and February as new mortgage lending requirements took effect at the start of the year. Activity in this sector was relatively stable from March to June. As of June, the output of real estate agents and brokers was down nearly 20% from levels at year-end 2017.

Oil extraction and support services strengthened

Oil extraction contracted substantially at the start of 2018 as shutdowns in the oil sands weighed on non-conventional output. Non-conventional extraction rose from February to May, before edging lower at mid-year. Output rose sharply in May following maintenance and expansion-related activities. Non-conventional output in June was 1.3% higher than levels at year-end, and 12% higher on a year-over-year basis, following sizable gains in late 2017 (Chart 6).

Conventional oil and gas extraction rose in four of the first six months of 2018. Conventional output in June was 5.6% higher than levels at year-end 2017, after edging lower during the second half of last year.

Chart 6
Real gross domestic product, selected industries



Source: Statistics Canada, table 36-10-0434-01.

Businesses that provide support activities for mining and oil and gas extraction, including rigging and drilling services, expanded output in the first half of 2018, as production rose from January to April prior to declines into mid-year. The output of these businesses in June was 8.1% higher than at year-end 2017, and about 60% higher than levels reported two years ago when activity in this industry was near recent lows. Output in June 2018 was similar to levels reported in mid-2015.

The output of crude oil pipelines increased steadily over the first half of 2018, posting six consecutive gains to start the year. Output in June was 7.9% higher than levels at year-end. Monthly exports of crude oil and equivalent products by pipeline averaged 95.6 million barrels during the first half of 2018, compared to 90.3 million barrels during the last half of 2017.

More recently, real GDP rose 0.2% in July, led by gains in manufacturing and wholesale trade. Non-durable manufacturing increased 2.4% in July, the largest monthly gain in four years, as the output of chemical manufacturers and petroleum refineries rose sharply following maintenance and retooling activities at some facilities earlier in the year.

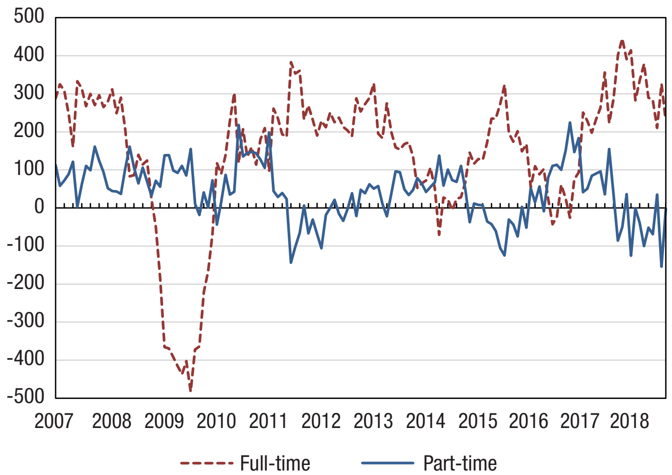
Employment growth slowed on part-time losses

The pace of employment growth, measured year-over-year, slowed during the first half of 2018, edging down to 1.2% in June. Total employment was little changed over the first six months of the year, as gains in full-time work (+85,000) were offset by lower part-time employment (-102,000) (Chart 7). The number of private sector employees declined by 48,000 in the first half, while employment among core-aged workers was little changed. Employment in manufacturing was down 32,000 during the first six months of 2018.

Employment in Ontario was little changed over the first six months of the year (+21,000) as increases in full-time work were offset by part-time losses. In January 2018, the minimum wage in Ontario increased from $11.60 per hour to $14.00 per hour. Employment levels in the province were relatively stable in several sectors that employ large numbers of lower-wage workers, including accommodation and food services, agriculture, and other services, while employment in wholesale and retail edged lower in the first half following gains late last year. The pace of employment growth in British Columbia continued to slow in the first half of 2018, as employment in June was little changed from levels in mid-2017. Following gains in late 2017, employment growth in Quebec also slowed in the first half of 2018 (Chart 8).

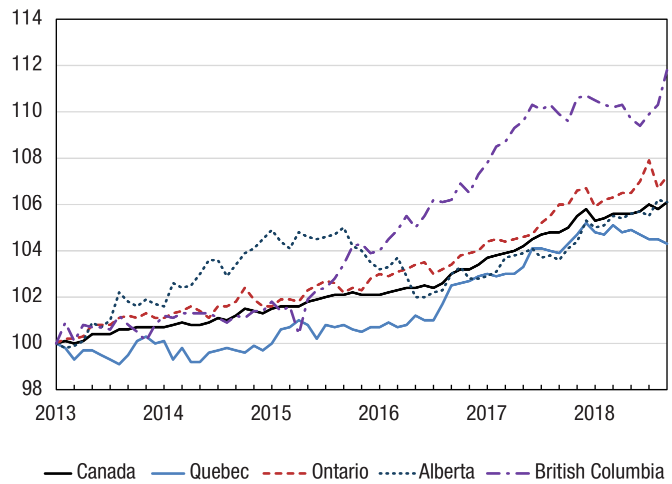
The national unemployment rate remained below 6% from January to May, before edging up to 6% in June. The unemployment rate in Ontario and Quebec averaged 5.6% and 5.5% respectively over the first six months of the year. Alberta's rate edged below 7% in February for the first time since October 2015, and averaged 6.6% during the first half of the year. Unemployment in British Columbia averaged 4.9% from January to June.

Chart 7
Type of employment



Source: Statistics Canada, table 14-10-0287-01.

Chart 8
Employment, Canada and selected provinces



Source: Statistics Canada, table 14-10-0287-01.

The employment rate, the number of persons employed as a percentage of the working-age population, edged down slightly in the first half of 2018, to 61.5% in June. Among core-age workers, the employment rate was relatively stable, averaging 82.5% during this period. The core-age employment rate in Ontario averaged 81.2% from January to June, compared to 83.3% and 82.9% in Alberta and British Columbia. In Quebec, the rate of core-age employment averaged 84.6% during the first half, highest among the provinces, as the share of persons aged 25 to 54 in the province that are working trended higher from mid 2014 to early 2018 (Chart 9).[2]

More recently, employment rose 66,000 in the third quarter on gains in part-time work and among private sector employees. Overall employment gains in the quarter were concentrated in British Columbia. The national unemployment rate was 5.9% in September.

Faster earnings growth in central Canada

After accelerating in the second half of 2017, earnings growth, measured year-over-year, averaged 2.9% over the first six months of the year. Earnings growth accelerated to 3.4% in February, the largest year-over-year gain since mid-2014, on broad-based increases. The pace of earnings growth declined below 3% from April to June as gains among professional services moderated, and earnings declined among administrative and support services. Earnings growth in the goods sector edged higher towards mid-year, bolstered by increases in construction.

The pace of earnings growth varied markedly across the country in the first half of 2018. Quebec posted the largest increase among the provinces, averaging 4.0% over the first six months of the year. Gains in Ontario averaged 3.0% during the first half. Among the western provinces, average earnings growth ranged from 2.8% in Alberta and Manitoba to 0.8% in Saskatchewan. In Atlantic Canada, earnings growth ranged from 3.0% in New Brunswick to 0.7% in Nova Scotia.

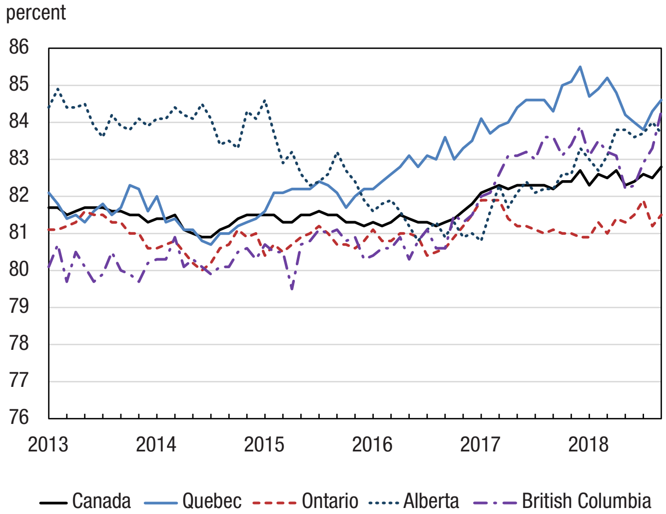
In July, average weekly earnings, measured year-over-year, accelerated to 3.0%, led by gains in retail trade, accommodation and food services, and construction. Earnings growth was at or above 3% in New Brunswick, Manitoba, Ontario, British Columbia and Quebec.

Merchandise trade deficits narrowed as energy surplus expanded

Canada posted a cumulative merchandise trade deficit of $13.5 billion over the first six months of 2018, down from a deficit of $16.2 billion during the last half of 2017. A larger net surplus in energy products during the first half was partly offset by higher deficits in several non-energy products, including basic and industrial chemicals, and motor vehicles and parts. In addition, a larger surplus in forestry and building products also contributed to a smaller overall trade deficit (Chart 10).

2. For more information on labour market developments during the first half of 2018, see Hardy et al. (2018).

Chart 9
Employment rates of individuals aged 25 to 54, Canada and selected provinces



Source: Statistics Canada, table 14-10-0287-01.

Total energy exports during the first six months of 2018 totalled $54.9 billion, an increase of about 20% from the second half of last year. Exports of non-energy products rose 4.6% in the first half of 2018, reflecting widespread gains across commodities. Higher shipments of metal and non-metallic mineral products, consumer goods and forestry products supported the increase in non-energy exports (Chart 11). Higher prices were mainly responsible for increased exports of metals and non-metallic minerals, a category which includes steel and aluminium exports, as volumes were relatively stable.

Non-energy imports strengthened during the first half of the year, advancing 4.9% from the second half of 2017. Imports of basic and industrial chemicals and motor vehicles and parts contributed to the gains, supported by higher shipments of aircraft and consumer goods. Notably, imports of aircraft and other transportation equipment were 20% higher than in the second half of 2017. Imports of energy products also rose about 20% in the first half as higher imports of refined petroleum products offset lower production at Canadian refineries.

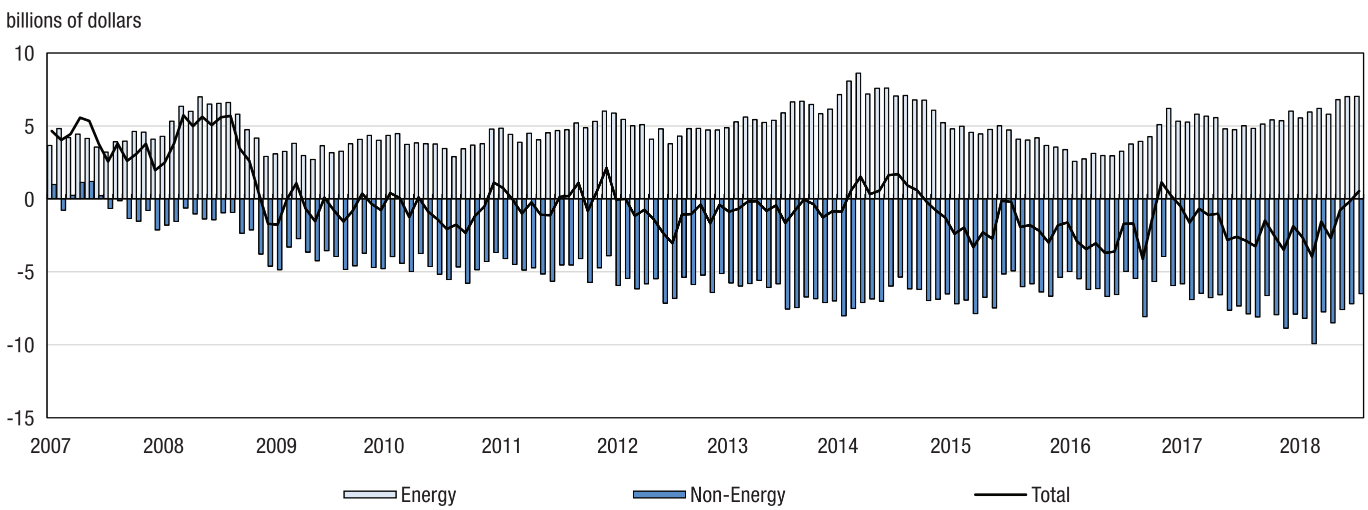
More recently, the trade deficit narrowed to just under $200 million in July, as energy exports rose on higher crude oil prices and imports declined. In August, Canada posted the first merchandise trade surplus since December 2016 as both exports and imports declined.

Steel and aluminum exports to the United States accelerated in advance of tariffs

As of June 2018, exports of steel and aluminum products to the United States were subject to tariffs of 25% and 10%, respectively. Exports of both steel and aluminum products to the United States rose sharply over several months in advance of the tariffs, before declining sharply in June. As of August, exports of steel products to the United States remained about 3% higher on a year-over-year basis, while exports of aluminium products were down about 3%.

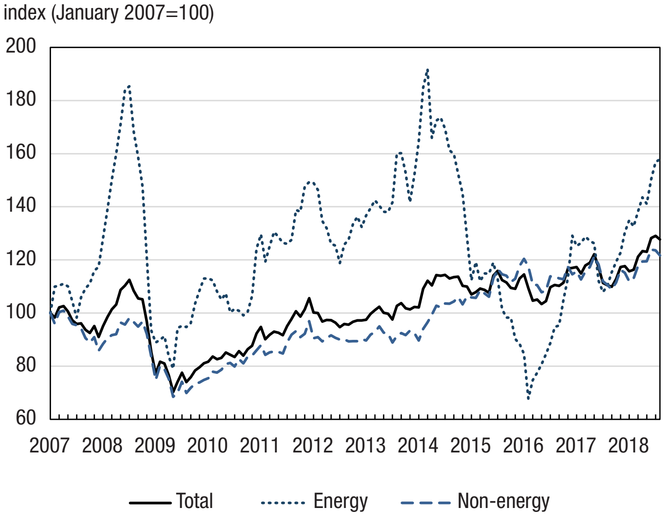
Retaliatory tariffs on imports of steel and aluminum products from the United States took effect in July 2018. Imports of steel products from the United States rose sharply in June prior to a sizable decline in July. As of August, imports of steel products from the United States were down almost 30% on a year-over-year basis, while imports of aluminum products were 14% higher.

Chart 10
Merchandise trade balance, energy and non-energy commodities



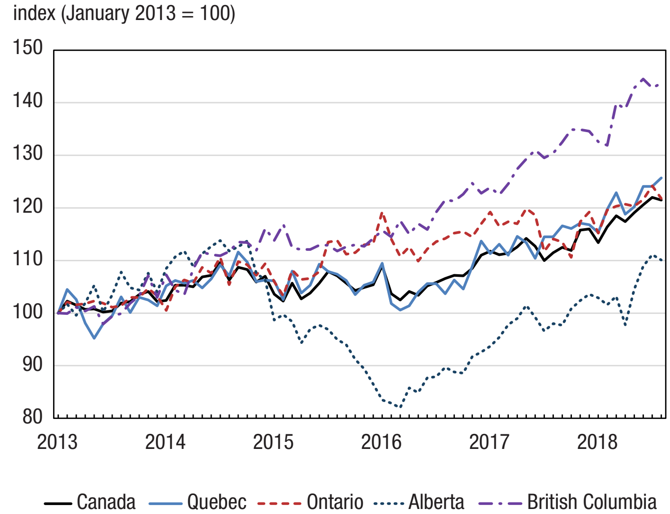
Source: Statistics Canada, table 12-10-0001-01.

Chart 11
Merchandise exports by commodity group



Source: Statistics Canada, table 12-10-0001-01.

Chart 12
Manufacturing sales, Canada and selected provinces



Sources: Statistics Canada, tables 16-10-0047-01 and 16-10-0048-01.

Manufacturing sales advanced on broad-based gains

Total manufacturing sales were 4.1% higher in the first six months of 2018 than in the second half of last year. Higher sales of transportation equipment, petroleum products, and primary and fabricated metals contributed to the overall increase in the first half. Sales of transportation equipment increased 4.4% as motor vehicles and aerospace advanced. Sales of petroleum and coal products rose 6.9% as higher prices offset lower volumes in the first half.

Higher sales in Ontario and Quebec were mainly responsible for the growth in the first half of 2018. Total manufacturing sales in Ontario rose 4.5% led by higher sales of petroleum and coal products and motor vehicles and parts. Higher auto sales in the first half followed declines in the second half of 2017 which reflected shutdowns at assembly plants. Sales of primary and fabricated metals also supported gains in Ontario. Manufacturing sales in Quebec rose 3.6% in the first half on widespread gains, led by primary metals, paper products and fabricated metals. Manufacturing sales in Alberta rose 3.3%, as petroleum and coal products contributed to over half of the increase. Sales in British Columbia advanced 4.2% supported by higher sales of paper products and fabricated metals (Chart 12).

In July, manufacturing sales rose 1.2% on increases in transportation equipment, petroleum and coal products, and chemicals. Sales declined 0.4% in August, following three consecutive monthly gains.

Retail spending moderated across most provinces

Total retail sales were 1.1% higher in the first half of 2018 than in the second half of last year. The overall pace of retail spending slowed as sales at auto dealers over the first six months of 2018 were little changed from levels in the second half of last year. Higher sales at gasoline stations were responsible for about 60% of the overall gain in the first half, advancing on higher prices. Excluding sales at gas stations, retail spending rose 0.5% during the first half.

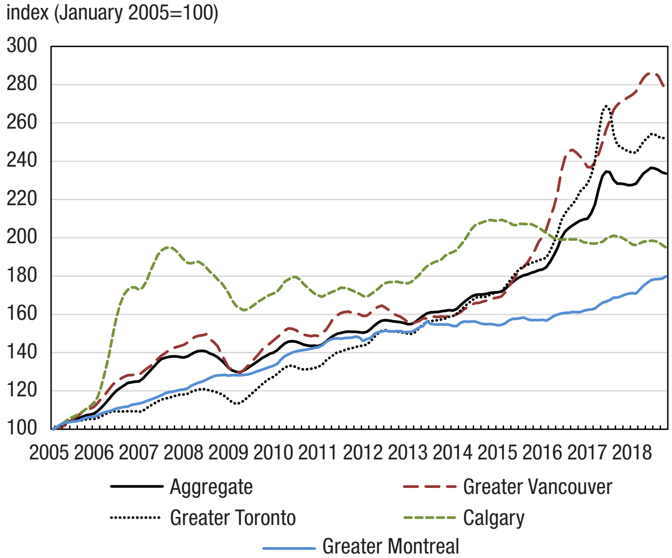
The pace of retail spending slowed in most provinces during the first six months of 2018. Sales in Ontario were 1.2% higher in the first half, about half the pace of growth reported in the second half of last year. Spending also slowed in British Columbia following notable gains in 2017. Gains in Quebec were similar over both six-month periods, while spending in Alberta picked up slightly in the first half of 2018.

In July, retail sales rose modestly (+0.2%) before edging down 0.1% in August.

Slower growth in home prices in Toronto and Vancouver

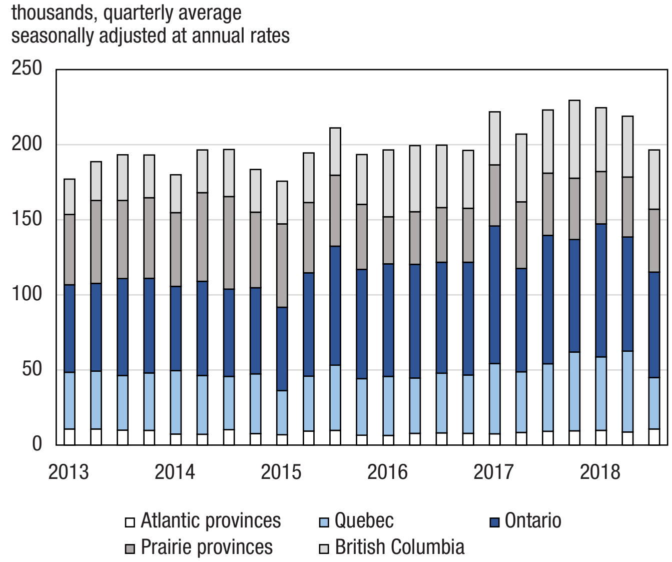
Increases in home prices, measured on a year-over-year basis, moderated towards mid-2018, as price growth slowed in Greater Toronto and Greater Vancouver. Based on estimates from the MLS Home Price Index, home prices rose 0.9% in the twelve months to June 2018, down from 8.4% in December 2017 (Chart 13).

Chart 13
Multiple listing service home price index, selected cities



Source: The Canadian Real Estate Association.

Chart 14
Housing starts, by region



Source: Statistics Canada, table 34-10-0158-01.

In the first half of 2018, home prices in Greater Toronto declined on a year-over-year basis for the first time in almost a decade. Prices in Greater Toronto were 4.8% lower in June from levels in mid-2017. Price growth in Toronto has slowed since the second half of last year, following the introduction of the Fair Housing Plan in April 2017. Home price increases in Greater Vancouver also slowed into mid-2018. Prices in Greater Vancouver were 9.5% higher on a year-over-year basis in June, down from 15.9% at year-end 2017.

By contrast, home price increases in Greater Montreal, measured on a year-over-year basis, accelerated slightly in the first half of 2018. Prices in Greater Montreal were up 6.4% in June and have been on an upward trend since early 2017.

More recently, increases in home prices edged above 2.0% throughout the third quarter. Prices in Greater Toronto, measured on a year-over-over basis, increased in August and September, following five consecutive monthly declines.

Homebuilding moderated on slower starts in British Columbia

Monthly housing starts averaged 222,000 units (seasonally adjusted at annual rates) in the first half of 2018, down from 226,000 units in the second half of 2017. Lower starts in British Columbia were mainly responsible for the decline, partly offset by continued strength in Quebec and Ontario. Housing starts in British Columbia have generally trended lower in the first half of 2018, following higher levels in the second half of last year. Lower multi-unit urban starts in the province contributed to the slower pace of homebuilding in the first half, after notable gains in late 2017.

More recently, housing starts slowed in the third quarter, edging below 200,000 annualized units in August and September. Average starts in Quebec slowed to 34,000 in the third quarter, down from 54,000 in the second as multi-unit starts in urban areas moderated.

Investment in new housing construction, measured year-over-year, slowed during the first half of 2018. Total spending was 6.3% higher in June, down from 10.0% in December 2017. Outlays on single units declined on a year-over-year basis from March to June on lower spending in Ontario. Investment in single units for Canada as a whole was down 5.6% on a year-over-year basis in June. Higher spending on apartments offset lower spending on single units in the first half of 2018. Outlays on apartments rose 27.5% in the twelve months to June 2018 led by gains in Quebec. Total spending in British Columbia slowed in the first half, reflecting lower spending on single units. More recently, outlays on new housing construction continued to slow in July, edging down to 1.7% as spending on single units declined.

Residential building permits edged higher in the first half of 2018. Permits in the first half totalled $31.8 billion, up from $29.8 billion in the last half of 2017.

Consumer inflation accelerated as energy prices strengthened

Consumer price inflation continued to accelerate gradually during the first half of 2018, supported by higher energy prices. The headline rate rose above 2.0% in February, and, after fluctuating between 2.2% and 2.3% from February to May, accelerated to 2.5% in June as energy prices were up over 12% on a year-over-year basis. Gasoline prices in June were 24.6% higher than in June of 2017. Excluding gas prices, consumer inflation was more moderate during the first half, averaging 1.7% from January to June.

Price increases for shelter, measured year-over-year, also edged higher in the first half. Mortgage interest costs rose above 3% in April, and accelerated to 4.5% in June. Conversely, the homeowners' replacement cost index, which partly reflects changes in new home prices, decelerated on a year-over-year basis during the first half, slowing from 3.5% in December 2017 to 1.4% in June.

Food price inflation moderated during the first half, slowing from 2.3% in January to 1.0% in May, before edging up to 1.4% at mid-year. Following declines during much of 2017, prices for clothing and footwear were higher on a year-over-year basis over much of the first half.

The Bank of Canada's preferred measures of core inflation all edged higher early in 2018. Two of the core measures (CPI-median and CPI-trim) averaged 2.0% from February to June, while the remaining measure (CPI-common) averaged 1.9% during this period.[3]

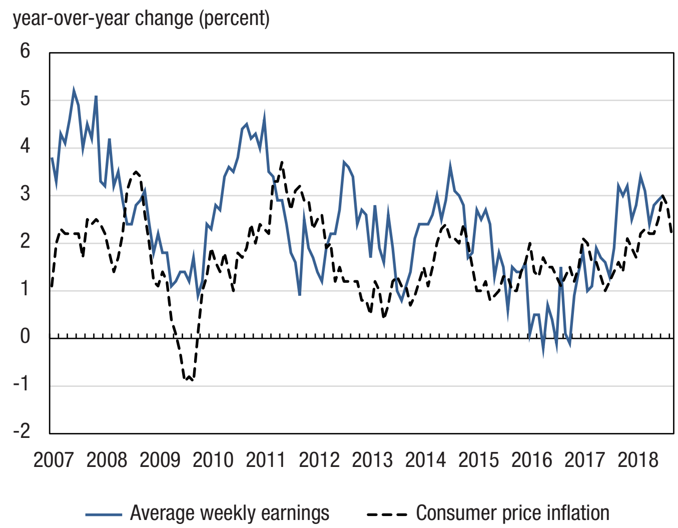
The gap between earnings growth and consumer inflation narrowed in first half, as consumer prices have gradually accelerated since mid-2017 (Chart 15).

More recently, consumer inflation accelerated in July, reaching 3.0% for the first time since 2011. Gas prices in July were 25.4% higher on year-over-year basis, while price increases for air transportation and travel tours also supported the acceleration. Consumer inflation moderated slightly in August, and decelerated in September as the headline rate edged down to 2.2%.

Equities rebounded in second quarter

After strengthening during the second half of 2017, the S&P/TSX composite index fell during the first quarter before rebounding in the second. The index closed at 16,278 in June, little changed from levels at year end (+0.4%). The energy index rose 6.8% in the first half, after advancing from March to June. Information technology, industrials, materials, and the consumer discretionary index all rallied in the second quarter to post gains in the first half. The financial index was down 3.3% from levels at year-end, posting losses in four out of six months. Telecommunications, utilities and gold also registered declines in the first half.

Chart 15
Earnings and inflation



Sources: Statistics Canada, tables 14-10-0223-01 and 18-10-0004-01.

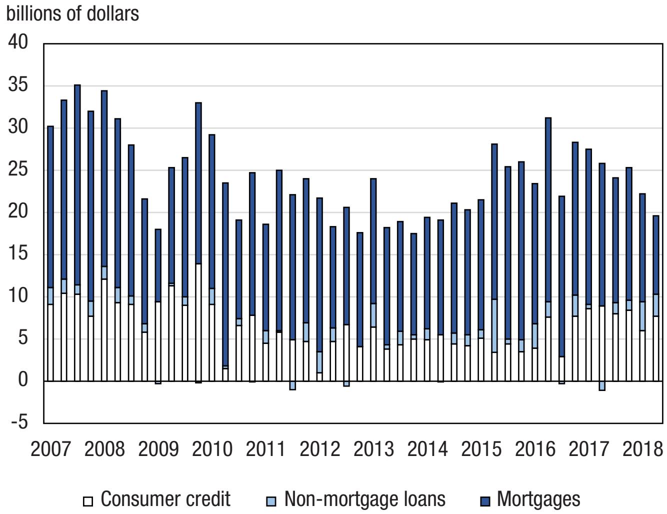
The S&P/TSX composite index edged higher in July before an offsetting loss in August. Financials and industrials posted consecutive gains through the summer months while gold and materials declined. Energy edged higher in June before contracting 4.9% in August.

After trading above 81 cents U.S. in late January, the value of the Canadian dollar trended down in February and March, trading at a low of 76.4 cents U.S. before strengthening to 79.7 cents in mid-April. The dollar then trended lower, trading at 75.1 cents in late June, before edging higher during the third quarter, closing at 77.2 cents U.S. at the end of September.

Measured on a trade- and competition-weighted basis, the Canadian dollar depreciated against the currencies of its major non-U.S. trading partners in January and February, before strengthening in subsequent months. By August, the value of Canada's effective exchange rate, excluding the U.S. dollar, was similar to levels at the start of the year. The effective exchange rate continued to strengthen in September.[4]

3. For more information on these measures, see Bank of Canada's Preferred Measures of Core Inflation General Information document.
4. For more information on the Canadian Effective Exchange Rate developed by the Bank of Canada, see Barnett et al. (2016).

Chart 16
Household credit market borrowing, seasonally adjusted flows



Source: Statistics Canada, table 38-10-0238-01.

Bond yields rose in the first half of 2018 as the spread between short- and long-term yields narrowed. Yields on Government of Canada five-year bonds rose above 2% at the start of the year, and remained at or above the 2% mark from February to May. After edging down to 1.93% in June, five-year yields rose to 2.19% in July, their highest level since mid-2011. Ten-year bond yields were at 2.28% in July as the spread between long- and short-term yields continued to narrow. Yields on both five- and ten-year bonds continued to rise in August and September. Conventional five-year mortgage rates rose above 5% at the start of 2018 for the first time since early 2014. Rates were at 5.14% from January to April, and increased to 5.34% from May to September.

The Bank of Canada raised the policy rate to 1.25% in January 2018, and then to 1.5% in July. More recently, the Bank of Canada increased the policy rate to 1.75% in October 2018, marking the fifth 25 basis point increase in the overnight target since June 2017.

Commodities prices buoyed by gains in energy, forestry and metals

Following gains in the second half of 2017, commodity prices continued to trend higher through the first half. Overall commodity prices were up 14.6% from year-end 2017, led by gains in energy, forestry and metals. Energy prices rose 19.9% from December to June, and were up 34% from levels in mid-2017. Excluding energy, commodity prices increased 8.7% in the first half. Prices for forestry products rose 22.3% during this period, while prices for metals and minerals were up 5.9%

Overall commodity prices declined during the third quarter on broad-based losses. Energy prices were down 4.2% in the quarter, while prices for non-energy commodities declined 10.3%.

Household net worth edged higher while mortgage borrowing continued to slow

The net worth of households rose 1.1% in the second quarter, following a 0.3% gain in the first. Stronger equity prices in the second quarter bolstered the value of household financial assets, as domestic markets rebounded from losses during the first quarter. The value of household real estate assets continued to increase at a slower pace in the second quarter, as home resale prices continued to moderate. Total household assets in the second quarter were valued at $13.25 trillion, while total financial liabilities amounted to $2.19 trillion.

The pace of household credit market borrowing slowed in the second quarter on lower mortgage borrowing (Chart 16). Measured on a seasonally-adjusted basis, household mortgage borrowing was $9.3 billion in the second quarter, down from $12.8 billion in the first, and from $15.7 billion in the fourth quarter of 2017. Overall credit market borrowing by households in the second quarter, based on mortgage loans, non-mortgage loans, and lines of credit, was $19.6 billion, down about 20% from levels in the fourth quarter of 2017.

The ratio of household credit market debt to disposable income rose to 169.1% in the second quarter, up from 168.3% in the first. Despite the increase, the ratio of household debt to income remained slightly below levels reported through much of 2017. The household debt service ratio, which includes obligated principal payments and interest owing, edged up to 14.2% in the second quarter as interest payments rose. The ratio of household debt to household assets edged up to 16.6% in the quarter, but has generally trended lower since the 2008-2009 recession.

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