THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE | DECEMBER 1998

KEY MESSAGES

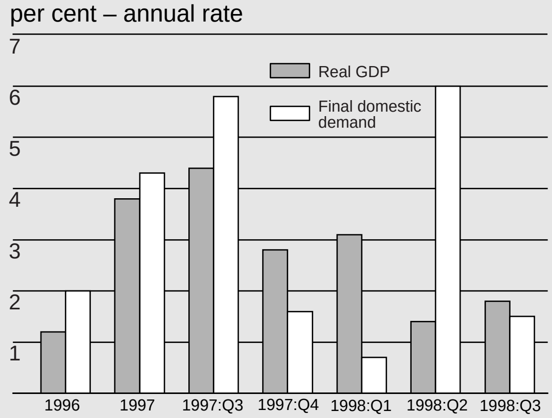
- In the third quarter of 1998, real GDP grew at an annual rate of 1.8%, a second consecutive quarter of moderate growth following seven quarters of robust growth averaging 3.7%.
- Foreign demand, especially from the United States, was the primary impetus for growth in the quarter, boosting real exports and Canadian production.
- Growth in demand by Canadian households, businesses and governments for goods, services, housing, and plant and equipment tailed off noticeably in almost every major spending category.
- Total domestic demand was also negatively affected by a reduction in inventory investment, from a substantial accumulation in the previous quarter to a decumulation in the third quarter, dampening the production gain. Excluding inventories, real GDP rose 6.4%, double the second quarter pace.
- With Canadian demand weakening, real imports of goods and services declined significantly and, given the increase in exports, the current account deficit improved. However, the degree of improvement was moderated by a sharp deterioration in the investment income deficit.
- The robust employment growth seen since June continued in November. A jump of 103,000 in the month, the largest rise in four years, brought the cumulative gain in net new jobs to 425,000 since the end of 1997. The unemployment rate in November was 8.0%, its lowest level in over eight years.

SUMMARY[1]

Canadian exports were the major force behind real GDP growth in the third quarter. But slower final domestic demand gains and declining inventories kept overall economic growth at a moderate pace (Chart 1). The drop in inventories and slower Canadian demand resulted in falling imports and a larger trade surplus in goods and services.

Domestic cost and inflation pressures remained subdued.

Chart 1
Growth in real GDP and real final domestic demand



1 Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, December 4, 1998.

Strong export growth boosts production

Strong foreign demand for Canadian products boosted real exports 5.7% in the third quarter, up sharply from the pace in the previous quarter, despite continuing problems in Asia, Russia and Latin America. The increase in exports was largely confined to machinery and equipment and to trade with the United States. Stronger growth in that country and increased Canadian cost competitiveness were two of the factors explaining this strength.

Consumer spending growth moderates

Real consumer expenditure growth eased to 2.2% in the third quarter from 5.6% in the second. Spending gains on durables, in particular on motor vehicles, softened. Demand growth for services also eased.

Personal income growth, at 0.4%, was weak. Labour income rose only modestly, hampered by labour strikes in Canada and the United States.

Main economic indicators

(per cent change at annual rates unless otherwise indicated)

	1996	1997	1998Q1	1998Q2	1998Q3	Most Recent	
Real gross domestic product	1.2	3.8	3.1	1.4	1.8	–	
GDP excluding inventories	2.0	3.0	3.6	3.1	6.4	–	
Final domestic demand	2.0	4.3	0.7	6.0	1.5	–	
Government expenditure	-2.5	-1.5	0.8	3.8	1.5	–	
Consumer expenditure	2.3	4.1	0.3	5.6	2.2	–	
Residential investment	10.2	12.4	-0.7	-4.0	-10.1	–	
Business fixed investment	7.4	15.0	2.7	16.8	2.9	–	
Non-residential construction	4.7	8.4	13.5	6.1	3.9	–	
Machinery and equipment	9.3	19.6	-3.6	24.2	2.3	–	
Business inventory change[1]	-0.8	0.8	-0.5	-1.6	-4.4	–	
Trade balance[1]	0.3	-1.5	3.3	-2.4	5.3	–	
Exports	5.9	8.0	9.1	1.9	5.7	–	
Imports	5.4	13.3	0.0	8.9	-8.1	–	
Current account balance							
(BOP basis, nominal $ billion)	4.5	-12.8	-15.0	-20.9	-17.6	–	
(percentage of GDP)	0.5	-1.5	-1.7	-2.4	-2.0	–	
Real personal disposable income	0.0	0.2	6.2	-2.2	-2.0	–	
Profits before taxes	-2.5	13.3	-34.8	-7.0	4.5	–	
Costs and prices (%, y/y)							
GDP price deflator	1.5	0.7	-0.5	-0.3	-0.6	–	
Consumer Price Index	1.6	1.6	1.0	1.0	0.9	1.0	Oct-98
CPI – excluding food and energy	1.4	1.6	1.4	1.2	1.4	1.4	Oct-98
Unit labour costs	1.2	0.9	0.5	0.7	0.6		
Wage settlements (total)	0.9	1.6	1.8	1.6	1.3	1.8	Sep-98
Labour market							
Unemployment rate (%)	9.7	9.2	8.6	8.4	8.3	8.0	Nov-98
Employment growth	1.3	1.9	3.0	2.7	1.4	8.9	Nov-98
Financial markets (average)							
Exchange rates (¢ U.S.)	73.34	72.24	69.92	69.13	66.03	65.01	Dec-3-98
Prime interest rates (%)	6.06	4.96	6.33	6.50	6.75	6.75	Dec-3-98

[1] Annualized change expressed as a percentage of GDP in the previous period.

Source: Statistics Canada, Bank of Canada and Human Resources Development Canada.

A strike at General Motors in the United States produced layoffs in Canada, while disputes in the construction and education industries in Ontario also limited earnings. Further, income growth was restrained because employment gains in the quarter were almost exclusively in part-time work. Also, net farm income plunged, partly due to lower prices given increased world output and reduced demand from Asia.

Despite a slowing in the rise of income taxes paid, the growth in transfers to governments outpaced that of personal income and so disposable income fell slightly.

As growth in nominal personal spending exceeded that in nominal disposable income, the personal savings rate fell to -0.8% (Chart 2), its first-ever negative value (as revisions boosted the previously negative second quarter rate above zero).

The negative savings rate (also observed in the United States) partly reflects measurement problems. The strong capital gains earned by the personal sector in bond and equity markets in recent years represented income to households and likely boosted spending. However, since these gains are not derived from current production, they are not counted as income in the national economic and financial accounts. Moreover, they add to the tax liabilities of the personal sector, lowering measured disposable income.

Business investment growth eases

Business investment in plant and equipment rose 2.9% in the third quarter, well off the pace of the second quarter. The slowdown in import-intensive machinery and equipment investment was particularly sharp. In non-residential construction, which is satisfied much less by imports than is machinery and equipment, the slowdown resulted from a drop in engineering projects, as spending on building construction grew more than in the second quarter.

Residential investment, another category with high domestic content, fell 10.1%. Fewer housing starts in recent quarters yielded a sharp 23.2% decline in new construction. A modest drop in spending on renovations also contributed to the overall decline. Partly offsetting this were much stronger transfer costs (mostly real estate commissions), the consequence of rising house resales.

Chart 2
The personal savings rate (national accounts)

Inventories fall off

Businesses reduced their inventories by $1.1 billion in the third quarter following an accumulation of $8 billion in the previous quarter. Most of the decline came in the retail sector, especially at motor vehicle dealers, as the strike at General Motors in the United States pared dealers' stock. With only modest growth in overall demand, this left the economy-wide inventory-to-sales ratio nearly unchanged at a level modestly above its all-time low but well below levels in the early 1990s.

Slower growth drops imports

Canadian imports dropped sharply in the third quarter owing to slower domestic demand growth, particularly the negative investment in inventories, and a depreciation in the Canadian dollar. Given the gain in exports, both the real and nominal trade surpluses doubled.

Current account deficit improves

With more exports and fewer imports, the nominal trade surplus in goods and services rose by $6.7 billion. But the current account deficit improved by only $3.4 billion to $17.6 billion, or 2% of nominal GDP, as the investment income deficit widened. This resulted from lower dividends being paid to Canadians because of the negative impact of the spreading Asian crisis on profits in the affected countries, and because of higher payments to non-residents in dividends from rising profits and interest paid on their portfolio investments in Canada.

Inflation subdued while profits climb

With the economy operating below potential, underlying price and cost pressures remained subdued in the third quarter. Both the implicit price index and the chain price index for GDP fell 0.7% in the quarter, leaving both price indices down from their levels a year earlier.

Labour costs per unit of output fell modestly from their second quarter level and were up only 0.6% from their level a year earlier. Both the average wage rate per employee and output per employed person have shown moderate growth over the last year.

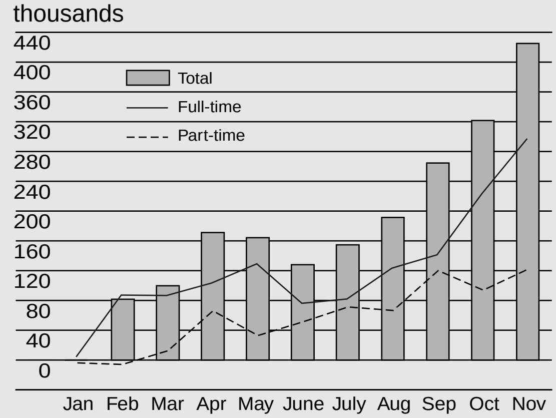
Pre-tax corporate profits climbed 4.5% to an 8.8% share of nominal GDP. Gains were most notable in the high technology sectors of electronic equipment, computers and telecommunication carriers. As well, the natural gas sector made excellent gains. These were partly offset by losses elsewhere, notably in the motor vehicle industry where the General Motors strike in the United States negatively impacted profits in Canada. This overall rise in profits followed contractions in the first half of the year, such that the third quarter level was still below its year-earlier level.

Robust job creation resumed

Employment growth resumed in July after two months of retrenchment. A robust gain of 103,000 in November, the largest monthly gain in four years, brought net job creation to 425,000 so far during 1998 (Chart 3), a stronger performance than that recorded in the first 11 months of 1997. And on an even more positive note, recent gains show stronger growth in full-time employment, a switch from the second and third quarters when the majority of net new jobs were part time in nature.

But as employment gains were largely matched by a jump in labour force participation, the unemployment rate only declined from 8.1% in October to 8.0% in November, its lowest level in over eight years. As well, the employment-to-population ratio reached an eight-year high.

Chart 3
Cumulative employment growth during 1998



The Canadian dollar rebounds

The Canadian dollar has remained relatively stable over the past two months, trading around 65 cents U.S., after having closed at an all-time low of 63.31 cents U.S. on August 27.

A 1-percentage-point hike in the Bank Rate on August 27 helped stabilize the dollar which was being negatively affected by the Asian, Russian and Latin American crises, the fallout on commodity prices and a market preference for U.S. dollar assets. With the dollar stabilizing, that rate hike has subsequently been largely reversed as the Bank of Canada quickly mirrored three 25-basis-point cuts by the U.S. Federal Reserve Board.

As a result, short-term interest rates are down somewhat more than 1 percentage point from their peak following the 1-percentage-point rise in the Bank Rate on August 27. Long-term rates have also moved down since early November, following a period of modest increases that began in October.

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 Cliff Halliwell at (613) 992-4321.
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