THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JULY 1999

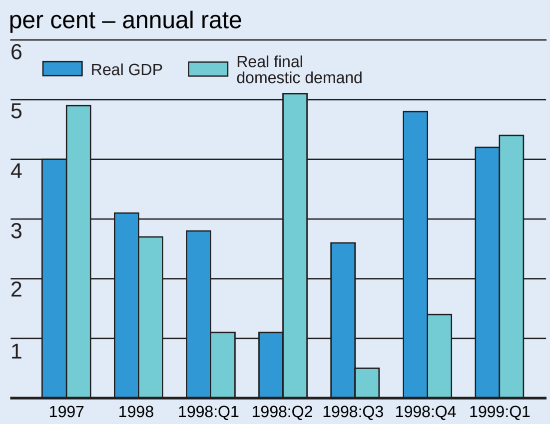
KEY MESSAGES

- In the first quarter of 1999, real gross domestic product (GDP) grew a solid 4.2% following a robust 4.8% gain in the fourth quarter of 1998.
- Unlike the previous quarter when demand growth was more narrowly concentrated, the strength in the first quarter was widespread. Growth in demand by Canadians for consumer goods and services, housing and business investment rose sharply. This increased demand led to imports rising at a similar pace.
- Stronger foreign demand also contributed to growth through an 8.5% increase in real exports in the quarter, boosting Canadian production.
- A smaller accumulation in business inventories than in the fourth quarter of last year limited the first quarter growth rate. Excluding inventories, real GDP rose 5.4%, up from 1.3% in the previous quarter.
- With stronger export growth than import growth, the increase in the trade surplus resulted in an impressive reduction in the current account deficit from $16.5 billion to $5.4 billion.
- Despite a modest loss on balance since February, the employment gain from the end of 1998 to May exceeded 73,000, with the gain entirely in full-time jobs. This brought the number of net new jobs created since June 1998 to nearly 400,000. The unemployment rate in May was 8.1%, down from 8.3% in April but slightly above the 7.8% seen during the first three months of 1999.

SUMMARY[1]

In the first quarter of 1999, the strength in demand was widespread. Final domestic demand (spending by consumers, business and government on goods, services, housing and plant and equipment) and foreign demand boosted Canadian production (Chart 1). A negative swing in inventory investment, however, moderated overall growth so that it was somewhat slower than in the fourth quarter. 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 end of the day, July 5, 1999.

Consumers return to the stores

Real consumer expenditure increased 5.1% in the first quarter following a very weak performance in the fourth quarter of 1998. Spending on goods, particularly on durables such as motor vehicles, furniture and appliances, rose sharply.

Personal income grew 2.7% in the first quarter, a more modest advance than in the previous quarter, as the pace of increase for most major forms of income eased. Labour income growth slowed in conjunction with a less robust gain in employment than in the fourth quarter.

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

	1997	1998	1998:Q3	1998:Q4	1999:Q1	Most recent	
Real gross domestic product	4.0	3.1	2.6	4.8	4.2	–	
GDP excluding inventories	3.2	3.6	7.4	1.3	5.4	–	
Final domestic demand	4.9	2.7	0.5	1.4	4.4	–	
Government expenditure	-1.0	2.0	1.0	2.2	-0.3	–	
Consumer expenditure	4.2	2.8	0.9	0.0	5.1	–	
Residential investment	12.6	-1.9	-9.4	0.3	16.6	–	
Business fixed investment	18.8	5.7	2.1	6.8	5.2	–	
Non-residential construction	14.0	0.1	-3.8	-2.4	-1.1	–	
Machinery and equipment	22.2	9.5	5.9	12.7	8.9	–	
Business inventory change[1]	0.7	-0.4	-4.5	3.4	-1.1	–	
Trade balance[1]	-1.7	1.0	6.6	-0.2	1.8	–	
Exports	8.5	8.2	11.2	14.2	8.5	–	
Imports	14.6	5.8	-6.2	15.9	4.2	–	
Current account balance							
(nominal $ billion)	-14.3	-16.4	-15.3	-16.5	-5.4	–	
(percentage of GDP)	-1.6	-1.8	-1.7	-1.8	-0.6	–	
Real personal disposable income	1.3	2.4	-0.6	2.7	1.7	–	
Profits before taxes	8.5	-6.0	3.5	13.0	25.6	–	
Costs and prices (%, y/y)							
GDP price deflator	0.8	-0.6	-0.7	-0.7	0.0	–	
Consumer Price Index	1.6	0.9	0.9	1.1	0.8	1.7	99-Apr
CPI – excluding food and energy	1.6	1.3	1.4	1.5	1.0	1.4	99-Apr
Unit labour costs	1.8	0.9	0.6	0.7	-0.5		
Wage settlements (total)	1.4	1.7	1.4	1.7	1.5	1.4	99-Mar
Labour market							
Unemployment rate (%)	9.2	8.3	8.3	8.0	7.8	8.1	99-May
Employment growth	1.9	2.8	1.9	5.1	3.7	-1.1	99-May
Financial markets (average)							
Exchange rates (¢ U.S.)	72.24	67.48	66.03	64.84	66.17	68.11	5-Jul-99
Prime interest rates (%)	4.96	6.60	6.75	6.83	6.75	6.25	5-Jul-99

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

Sources: Statistics Canada, the Bank of Canada and Human Resources Development Canada.

With personal taxes rising faster than in the previous quarter and faster than personal income, real personal disposable income growth moderated to 1.7%.

As growth in nominal disposable income fell short of that in nominal personal spending, the personal savings rate fell to 1.4% from 2.2% in the fourth quarter.

Investment remains vibrant

Real business investment in plant and equipment climbed a solid 5.2% in the first quarter, a slower pace than in the previous quarter, however. Growth in machinery and equipment investment was again very strong, with computers and other office equipment contributing a significant share of the gain. Part of this may have been a response to tax incentives for small and medium-sized businesses to update hardware to be year 2000 compliant. Investment in non-residential construction declined somewhat. Both engineering projects and building construction contributed to this weakening.

Real residential investment jumped 16.6% following almost no change in the previous quarter. Increased housing starts boosted new house construction activity in the quarter while increased house resales boosted real estate commissions. Alterations and improvements also rose sharply.

Strong export growth boosts production

Strong foreign demand for Canadian products continued to boost real exports in the first quarter. However, real exports grew at a slower pace than in the fourth quarter, when automotive exports soared to replenish stocks depleted by the strike at General Motors in the United States in the summer of 1998. The increase in exports in the first quarter was concentrated in trade with the United States. Strong economic growth in that country and greater overall Canadian competitiveness have been the major factors behind rising Canadian exports.

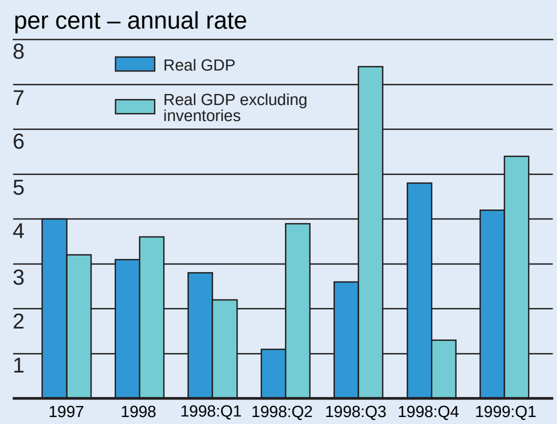
Imports grow with domestic demand

In the first quarter, real imports rose at about the same pace as final domestic demand. The gain was highly correlated with the need to satisfy stronger Canadian demand for import-intensive machinery and equipment.

Inventory accumulation slows

Businesses increased their non-farm inventories by $0.7 billion in the first quarter following a much larger accumulation of $3.1 billion in the fourth quarter. Retail and wholesale inventories of motor vehicles declined after having surged in the previous quarter. With less output required for restocking, production growth slowed despite the surge in demand (Chart 2).

Chart 2
Real GDP growth with and without inventories



With strong domestic and foreign demand boosting sales, the economy-wide inventory-to-sales ratio declined and is again approaching its lowest recorded level.

Current account deficit improves

Stronger real export than import growth sharply boosted the real trade surplus. This was reinforced by a gain in the terms of trade (export prices declined less than import prices), and together these factors nearly doubled the nominal trade surplus relative to its fourth quarter level. When combined with a modest deterioration in the investment income deficit due to lower receipts from profits on Canadian direct investment abroad, the current account deficit sharply improved from $16.5 billion to $5.4 billion, or 0.6% of nominal GDP – its lowest level in two years.

Inflation subdued while profits soar

With the economy operating at a level of production below potential, underlying price and cost pressures remained subdued in the first quarter. The implicit price index was unchanged from its year-earlier level while the chain price index was up only 0.3%. The 12-month rate of increase for consumer prices rose to 1.7% in April, owing in part to the temporary impact of higher energy prices.

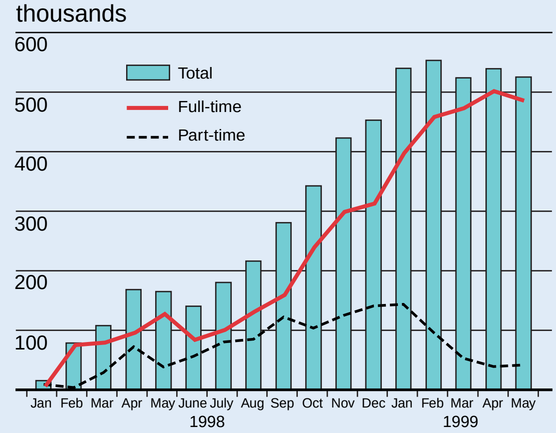
Labour productivity, when measured as output per employed person, rose somewhat in the first quarter. Labour costs per unit of output fell from their fourth quarter level and were 0.5% below that of a year earlier.

Pre-tax corporate profits surged 25.6% after having risen 13.0% in the fourth quarter. These gains raised profits to 8.3% above their level of a year earlier and almost restored the previous losses that occurred after the peak in profits in the fourth quarter of 1997. Gains in the quarter were most notable in non-financial industries such as motor vehicle and other transportation industries, primary industries (given some rebound in commodity prices in the quarter), general services to business, and consumer goods and services.

Job creation has been impressive

First quarter employment increased 3.7%, slower than the 5.1% pace of the fourth quarter when it was at its strongest since the last quarter of 1987. Employment gains, however, have paused in recent months, with a small net loss since February (Chart 3).

Chart 3
Cumulative employment growth since December 1997



The unemployment rate was 8.1% in May, down from 8.3% in April but up from 7.8% in the three previous months.

Canadian dollar strengthens

After having traded around 65 cents U.S. for most of the last four months of 1998, the Canadian dollar has strengthened in 1999 in line with firming world commodity prices, peaking near 69 cents U.S. in early May. On July 5, the dollar closed at 68.11 cents U.S.

After having risen from December to early March due to upward pressure on market interest rates in the United States coming from the continuing strong performance of that economy, short- and long-term Canadian interest rates then eased back until early May. The Bank of Canada reduced its official Bank Rate in late March and again in early May. Market interest rates increased modestly again after an unfavourable inflation report in the United States raised expectations of a policy tightening by the Federal Reserve. This proved to be correct as the Federal Funds Rate was raised by 25 basis points on June 30. Market interest rates in Canada were thus largely unaffected.

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.
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