THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 2002

OVERVIEW

- In the first quarter of 2002 real gross domestic product (GDP) increased a robust 6.0%, following a 2.9% gain in the fourth quarter. This was the strongest growth rate since the fourth quarter of 1999.
- Final domestic demand rose 3.5%, driven by a 35.9% increase in residential investment and a 2.5% gain in consumer expenditure. Investment in machinery and equipment rose 2.6%.
- Part of increased demand was satisfied by a 5.2% rise in imports and a $6.7-billion rundown in inventories.
- Higher foreign demand boosted real exports by 5.9%. This ended a string of four consecutive quarterly declines.
- Rising world energy prices combined with higher real exports raised the current account surplus $5.9 billion to $23.6 billion.
- The Canadian economy created 237,000 net new jobs in the first five months of the year. In May the unemployment rate was 7.7%, compared to 8.0% in December.

Strong real GDP growth

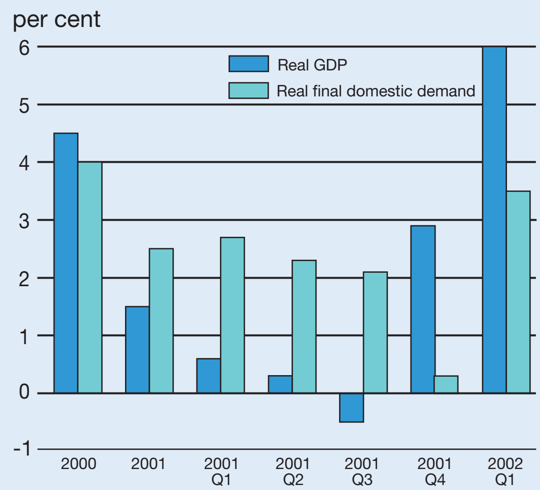
Real GDP rose strongly in the first quarter, the second consecutive increase (Chart 1). Domestic and foreign demand growth boosted Canadian production.

Consumers increase spending

Real consumer expenditure rose 2.5% in the first quarter, with increases in all major categories. The gain was strongest for durable goods, especially for household furnishings, and weakest for services. Growth in consumer spending moderated from the 4.1% rate of the previous quarter.

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, June 7, 2002.

Chart 1
Growth in real GDP and real final domestic demand



Department of Finance Canada Ministère des Finances Canada

Canada

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

	2000	2001	2001:Q3	2001:Q4	2002:Q1	Most recent	
Real gross domestic product	4.5	1.5	-0.5	2.9	6.0		–
Final domestic demand	4.0	2.5	2.1	0.3	3.5		–
Government expenditure							–
Goods and services	2.3	3.3	1.9	0.9	2.0		–
Gross fixed capital	3.0	11.5	14.1	18.5	2.3		–
Consumer expenditure	3.7	2.6	-0.3	4.1	2.5		–
Residential investment	3.5	4.7	8.3	23.9	35.9		–
Business fixed investment	8.2	-1.1	8.9	-25.3	-1.2		–
Non-residential construction	6.4	0.8	-3.9	-7.5	-6.9		–
Machinery and equipment	9.3	-2.2	17.3	-34.5	2.6		–
Business inventory investment ($ billion)	9.9	-3.5	-4.0	-12.7	-6.7		–
Exports	8.0	-3.8	-7.0	-0.6	5.9		–
Imports	8.2	-5.8	-7.0	-16.9	5.2		–
Current account balance							
(nominal $ billion)	27.8	30.0	17.6	17.7	23.6		–
(percentage of GDP)	2.6	2.8	1.6	1.6	2.1		–
Nominal personal income	7.1	4.0	1.8	3.2	4.2		–
Nominal personal disposable income	6.9	4.4	3.1	5.2	4.5		–
Real personal disposable income	4.7	2.5	2.3	6.4	1.8		–
Profits before taxes	19.4	-8.9	-41.0	-31.9	67.6		–
Costs and prices (%, y/y)							
GDP price deflator	3.9	1.1	0.1	-1.2	-1.6		–
Consumer price index	2.7	2.6	2.7	1.1	1.5	1.7	Apr-2002
CPI excluding eight most volatile items	1.3	2.0	2.4	1.8	2.1	2.2	Apr-2002
Unit labour costs	3.7	2.8	2.7	2.2	0.5		
Wage settlements (total)	2.5	3.2	3.4	3.0	2.9	3.2	Mar-2002
Labour market							
Unemployment rate (%)	6.8	7.2	7.2	7.7	7.8	7.7	May-2002
Employment growth	2.6	1.1	-0.2	0.5	2.8	2.4	May-2002
Financial markets (average)							
Exchange rate (cents U.S.)	67.3	64.6	64.7	63.3	62.7	65.21	6-Jun-02
Prime interest rate (%)	7.3	5.8	5.7	4.2	3.8	4.25	6-Jun-02

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

This largely reflected a slowdown in spending growth on motor vehicles from the 39% pace in the fourth quarter, when manufacturers offered incentives to buyers.

Consumer expenditure growth was supported by higher incomes, aided by sharp increases in employment and the average number of hours worked per week, and lower interest rates. Nominal personal disposable income rose 4.5%. The personal savings rate dipped to 4.7% from 4.8% in the fourth quarter.

Residential investment very strong

Residential investment surged 35.9% in the first quarter, fuelled by reductions in interest rates throughout 2001 and early 2002, rising incomes and milder-than-usual weather conditions. All three major categories participated in the increase, as housing starts jumped 67% to their highest quarterly level in 12 years, sales of existing homes soared and renovations rose.

Business fixed investment stabilizes

Business spending on plant and equipment declined 1.2% in the first quarter, following a drop of 25.3% in the fourth. Non-residential construction decreased 6.9%, the third consecutive decline. This reflected reduced spending on both building and engineering projects.

Investment in import-intensive machinery and equipment rose a modest 2.6% after plummeting 34.5% in the previous quarter. Investment in transportation equipment, software and telecommunications equipment rose.

Inventory liquidation slows

Businesses lowered their inventories by $6.7 billion in the first quarter compared with $12.7 billion in the fourth quarter. The slower pace of inventory reduction added about 2 percentage points to growth (Chart 2). Given strong sales, the inventory-to-sales ratio fell to its lowest level on record.

Exports and imports rise

Foreign demand for Canadian goods and services increased in the first quarter. Real exports rose 5.9%, following four consecutive declines, with notable gains in energy products, telecommunications equipment and consumer goods.

After five successive quarterly declines, real imports rose 5.2%. Strength was particularly evident in industrial and automotive products and other consumer goods.

Current account surplus grows

Higher world energy prices and the stronger gain in real exports than imports boosted the nominal trade surplus nearly $5 billion from its fourth-quarter level. Combined with an improvement in the investment income deficit, this raised the current account surplus by $5.9 billion to $23.6 billion or 2.1% of GDP (Chart 3).

Chart 2
Contributions to real GDP growth

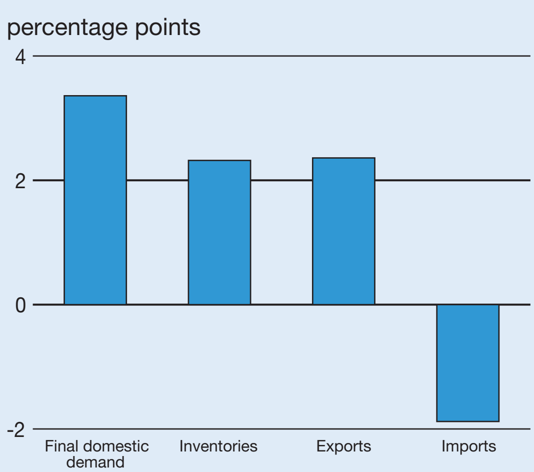
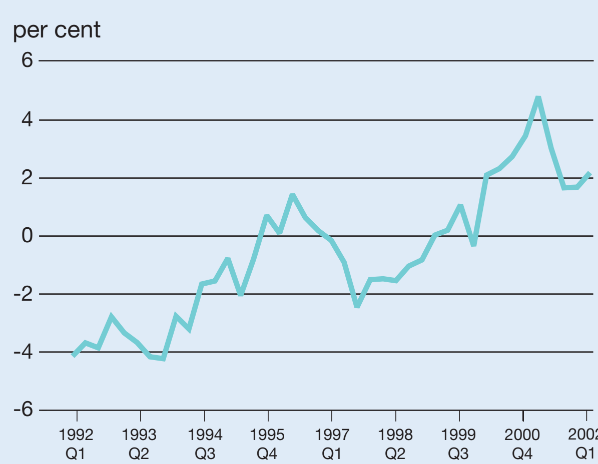


Chart 3
Current account as a percentage of nominal GDP

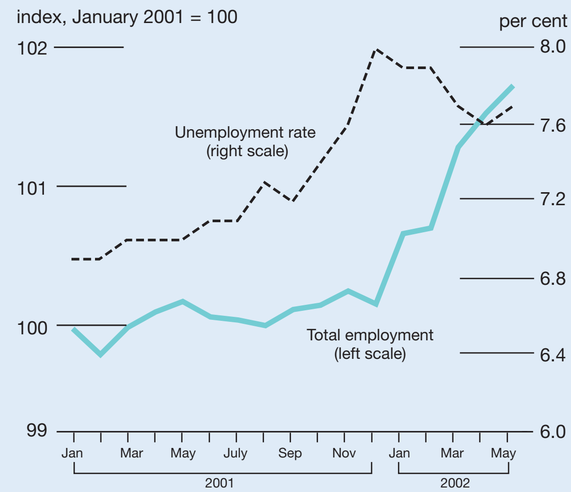


Inflation remains subdued

Underlying price and cost pressures remained subdued in the first quarter. Rising world energy prices helped to boost the GDP deflator after three consecutive declines. This comprehensive measure of inflation rose 3.3% in the first quarter, but it remained 1.6% below its level of a year earlier. Consumer price inflation also remained subdued at 1.7% in April. Core CPI inflation, which excludes the eight most volatile items, was 2.2% in that month.

Total economy labour productivity rose in the first quarter: output per employed person jumped 3.1% while output per hour worked rose 0.7%. Labour costs per unit of output were 0.5% higher than a year earlier, compared to 2.2% in the fourth quarter.

Chart 4
Employment and the unemployment rate



Corporate profits jump

Corporate profits soared 67.6% in the first quarter after three consecutive drops. This brought profits to 13.3% below the level of a year earlier. Higher profits were particularly notable among manufacturing and construction firms. The rebound in profits partly resulted from the clearance of inventories at higher prices than in the previous quarter. This was most evident for refined petroleum, wood products and primary metals.

Employment surges

Employment jumped 2.8% in the first quarter. The economy added a further 67,000 new jobs in April and May, bringing the number created so far this year to 237,000. The majority of these new jobs have been full-time and in the private sector.

The strong labour market induced 202,000 people to enter the labour force over the same period. As a result, the unemployment rate was 7.7% in May, compared to 8.0% in December (Chart 4).

Bank of Canada moves to reduce stimulus

With the strengthening Canadian economy, the Bank of Canada reduced the substantial amount of monetary stimulus in the economy. It boosted its key policy rate by 25 basis points on April 16 and again on June 4. It had reduced it 10 times during 2001 and early 2002 by a total of 375 basis points. Canadian short-term market interest rates and the key policy rate moved together during this entire period.

Canadian and U.S. long rates have been steady during the year and are presently near their levels at the end of 2000.

The value of the Canadian dollar fell to an all-time closing low of 62.02 cents against the American dollar on January 18. It has since recovered to close at 65.21 cents U.S. on June 6.

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 Mostafa Askari at (613) 992-3055.
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