THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 2002

OVERVIEW

- In the second quarter of 2002 real gross domestic product (GDP) increased 4.3%, following a 6.2% gain in the first quarter.
- The increase in demand was widespread across the economy. Final domestic demand rose 3.7%, driven by a 20.6% advance in business investment in machinery and equipment. Consumer spending continued to rise at a healthy pace.
- A $7.5-billion inventory buildup, following a $7.2-billion rundown in the first quarter, contributed to growth.
- A 16.8% surge in real imports satisfied part of the increase in final domestic demand and in inventory investment.
- Higher foreign demand boosted real exports by 1.8%, the second consecutive gain after four successive quarterly declines. However, with the stronger growth in imports, the current account surplus narrowed by $1.5 billion to a still impressive $19.6 billion.
- The Canadian economy created 386,000 net new jobs in the first eight months of the year. This is the largest employment gain over any eight-month period on record back to 1976. In August the unemployment rate was 7.5%, compared to its recent peak of 8.0% in December 2001.

Solid real GDP growth

Helped by strong growth in domestic demand, real GDP increased 4.3% in the second quarter of 2002, following a 6.2% gain in the first quarter (Chart 1).

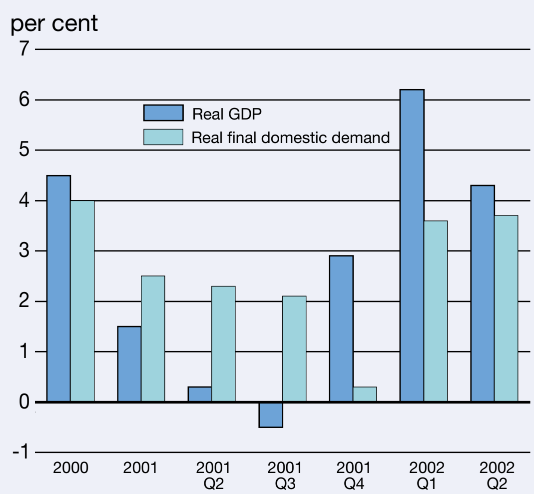
Consumers spend more

Real consumer expenditure grew 3.0% in the second quarter. The largest increase was a 5.0% jump in spending on services, with a sharp gain in outlays on recreation.

Higher incomes, aided by increases in employment, supported this growth in consumer expenditure.

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, September 6, 2002.

Chart 1
Growth in real GDP and real final domestic demand



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

	2000	2001	2001:Q4	2002:Q1	2002:Q2	Most recent	
Real gross domestic product	4.5	1.5	2.9	6.2	4.3		–
Final domestic demand	4.0	2.5	0.3	3.6	3.7		–
Government expenditure							–
Goods and services	2.3	3.3	0.9	1.2	1.2		–
Gross fixed capital	3.0	11.5	18.5	4.9	13.4		–
Consumer expenditure	3.7	2.6	4.1	2.8	3.0		–
Residential investment	3.5	4.7	23.9	35.7	-2.1		–
Business fixed investment	8.2	-1.1	-25.3	-1.3	12.5		–
Non-residential construction	6.4	0.8	-7.5	-6.3	0.4		–
Machinery and equipment	9.3	-2.2	-34.5	1.9	20.6		–
Business inventory investment ($ billion)	9.9	-3.5	-12.7	-7.2	7.5		–
Exports	8.0	-3.8	-0.6	5.4	1.8		–
Imports	8.2	-5.8	-16.9	4.3	16.8		–
Current account balance							
(nominal $ billion)	27.8	30.0	17.7	21.2	19.6		–
(percentage of GDP)	2.6	2.8	1.6	1.9	1.7		–
Nominal personal income	7.1	4.0	3.2	5.7	3.5		–
Nominal personal disposable income	6.9	4.4	5.2	7.0	6.0		–
Real personal disposable income	4.7	2.5	6.4	4.2	2.5		–
Profits before taxes	19.4	-8.9	-31.9	55.8	45.4		–
Costs and prices (%, y/y)							
GDP price deflator	3.9	1.1	-1.2	-1.6	0.2		–
Consumer price index	2.7	2.6	1.1	1.5	1.3	2.1	Jul-2002
CPI excluding eight most volatile items	1.3	2.0	1.8	2.1	2.2	2.1	Jul-2002
Unit labour costs	3.7	2.8	2.2	0.9	0.8		
Wage settlements (total)	2.5	3.1	3.0	2.9	2.7	3.8	Jun-2002
Labour market							
Unemployment rate (%)	6.8	7.2	7.7	7.8	7.6	7.5	Aug-2002
Employment growth	2.6	1.1	0.5	2.8	3.7	4.7	Aug-2002
Financial markets (average)							
Exchange rate (cents U.S.)	67.34	64.58	63.28	62.72	64.35	63.62	5-Sep-02
Prime interest rate (%)	7.3	5.8	4.2	3.8	4.1	4.50	5-Sep-02

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

Growing employment income and increased tax refunds helped boost personal disposable income 6.0%. Real personal disposable income per capita advanced to a level nearly 14% above its most recent low in 1996. The personal savings rate, at 5.3% in the second quarter, remained unchanged from its first-quarter level and above the low of 3.7% in mid-2001.

Residential investment remains high

Residential investment declined a modest 2.1% in the second quarter after a 35.7% gain in the first that had been driven by reductions in interest rates throughout 2001 and early 2002, rising incomes and milder-than-usual weather conditions. This had boosted housing starts and home resales to high levels.

With modest interest rate increases since the spring, resales of existing homes dropped in the second quarter. Further, growth in new construction activity and spending on renovations slowed, as starts dipped.

Business fixed investment surges

Business spending on plant and equipment jumped 12.5% in the second quarter, following declines in the previous two quarters. Investment in import-intensive machinery and equipment soared 20.6%, with particularly robust gains in other transportation equipment (aircraft and locomotives) and computers and other office equipment.

Non-residential construction increased slightly following three consecutive declines. This reflected greater spending on engineering projects as building construction declined.

Businesses accumulate inventories

Businesses boosted inventories by $7.5 billion in the quarter compared to a decumulation of $7.2 billion in the first. Despite this nearly $15-billion swing in inventory investment, the largest on record, solid sales growth left the inventory-to-sales ratio at a low level by historical standards. The inventory accumulation was concentrated in the retail motor vehicle sector, mirroring the strong increase in imports of these products. Robust car sales in recent quarters had sharply reduced inventories on car dealers' lots.

Imports rise more than exports

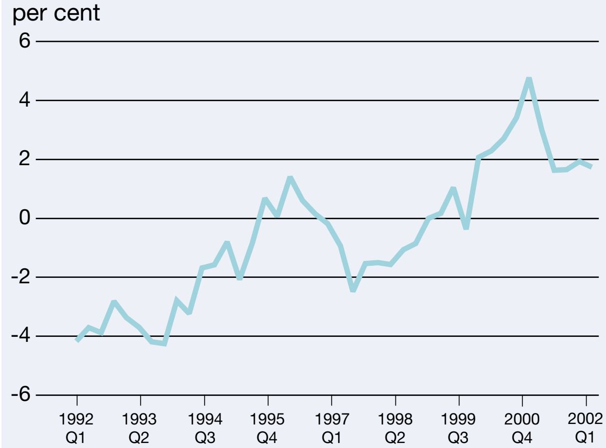
Real exports rose a modest 1.8% in the second quarter. Automotive and industrial products registered notable increases in sales while exports of machinery and equipment continued to slump in the face of weak investment growth in the United States.

Real imports surged 16.8%, with particular strength in machinery and equipment, cars and automotive parts. Increased imports of parts were required to boost Canadian production to meet increased foreign demand for motor vehicles.

Current account surplus stays high

The current account surplus narrowed by $1.5 billion but remained at a high level of $19.6 billion, or 1.7% of GDP (Chart 2). Stronger growth in real imports was partly offset by higher prices for energy exports, lower import prices for machinery and equipment and an improvement in the investment income balance. This was the 10th consecutive quarter that the surplus exceeded $17 billion, a level never reached before 2000.

Chart 2
Current account as a percentage of nominal GDP



Inflation remains moderate

Underlying price and cost pressures remained subdued in the second quarter. Consumer price inflation stood at 2.1% in July. Core CPI inflation, which excludes the eight most volatile items, registered the same rate of increase in that month.

Rising world commodity prices helped to boost export prices and thus the GDP deflator in the first two quarters of 2002. This comprehensive measure of inflation rose 7.0% in the second quarter, but stood only marginally above its level of a year earlier.

Total economy labour productivity rose modestly in the second quarter: output per employed person advanced 0.6% while output per hour worked rose 0.1%. Labour costs per unit of output were 0.8% higher than a year earlier, compared to 0.9% in the first quarter.

Corporate profits jump

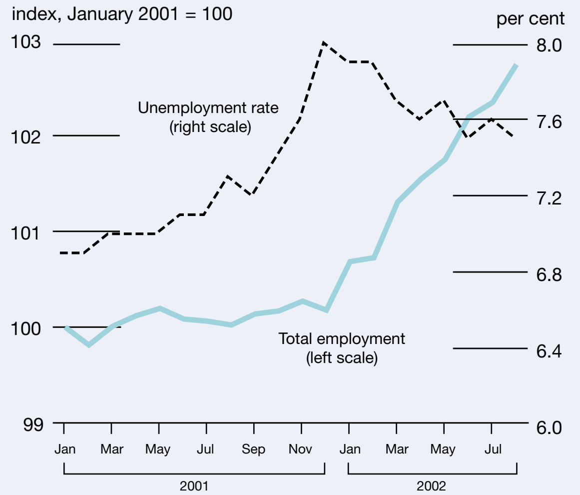
Corporate profits soared 45.4% in the second quarter, the second successive jump after three consecutive drops. Reflecting the strength of the recovery, gains were widespread, with notable advances in the oil and gas, manufacturing, retailing and wholesaling industries.

Employment surges

Employment jumped 3.7% in the second quarter. The economy added a further 82,000 new jobs in July and August, bringing the number of jobs created so far this year to 386,000. The majority of these new jobs were full-time.

The strong labour market induced 329,000 people to enter the labour force during the first eight months of the year, bringing the participation rate to its highest level since late 1990. As a result, the unemployment rate was 7.5% in August, compared to 8.0% in December (Chart 3).

Chart 3
Employment and the unemployment rate



Bank of Canada reduces stimulus

In the first half of the year the Bank of Canada reduced the substantial amount of monetary stimulus in the economy, boosting its key policy rate by 25 basis points on three occasions, most recently on July 16. It left its target rate unchanged in its September 4 announcement, citing weaker near-term prospects in the United States and major overseas economies.

Canadian and U.S. long rates have fallen since the spring. In the U.S. they have dropped to the low levels seen in the period after the terrorist attacks of September 2001.

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.
Also available on the Internet at www.fin.gc.ca
Ce document est également offert en français.