THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 1998

KEY MESSAGES

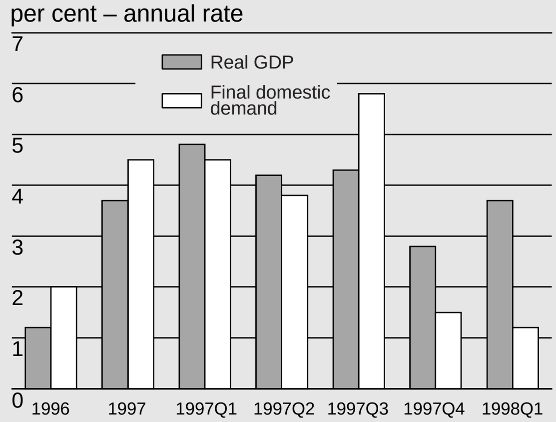
- In the first quarter of 1998, real GDP grew at an annual rate of 3.7%, up from 2.8% in the fourth quarter, despite the disruption caused by the ice storm in central and eastern Canada in January. This was the seventh consecutive quarter of solid growth, averaging 3.8%.
- Real personal disposable income surged 7.2%, its sharpest rate of growth since 1992.
- Growth in real exports remained strong and so continued to raise domestic production, but not as robustly as in the fourth quarter.
- A shift in domestic demand toward goods and services produced in Canada and away from import-intensive products boosted the growth rate of domestic production. In particular, business investment in buildings and engineering projects (such as roads, pipelines, transmission lines and oil and gas well drilling) jumped as did consumer spending on services. Meanwhile, demand fell for import-intensive products like consumer durables and machinery and equipment. This reduced imports and held growth in final domestic demand to 1.2%.
- With real exports rising and real imports falling, the real trade balance improved $5 billion. But a terms-of-trade deterioration moderated the gain in the nominal trade balance. Nonetheless, trade contributed to an improvement of over $3 billion in the current account deficit (to 1.8% of GDP).
- Strong growth has boosted the number of people with jobs by 164,100 during 1998, despite modest losses in May. The unemployment rate in May was 8.4%, the same as in April and the lowest level since 1990.

SUMMARY[1]

While growth in final domestic demand (that is, spending by households, businesses and government) slowed in the first quarter, a shift in spending toward Canadian-made products and away from foreign products boosted output growth (Chart 1). A drop in imports, when combined with continuing strong exports, raised the trade balance.

Domestic cost and inflation pressures remained very subdued according to all national accounts measures.

Chart 1
Growth in real GDP and real final domestic demand*



* Final domestic demand is the sum of consumer spending, business fixed investment and government spending.

1 Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, June 5, 1998.

Consumers switch to Canadian products and save more of their rising incomes

Real consumer expenditure growth slowed slightly to 2.6% in the first quarter. Demand shifted toward domestic-made products. Spending increased in all major categories except durables, with the growth rate of spending on services rising to 4.9% from 1.7% in the fourth quarter. Spending on durable goods, which are generally more import intensive, fell 9.3% after having risen 21.5% in the previous quarter when dealer incentives sharply boosted spending on motor vehicles (Chart 2).

Personal disposable income rose 7.2%, its sharpest pace since 1992. Labour income bounced up 6.0%, its best pace since 1994.

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

	1996	1997	1997Q3	1997Q4	1998Q1	Most Recent	
Real gross domestic product	1.2	3.7	4.3	2.8	3.7	–	
GDP excluding inventories	2.1	2.9	3.4	1.4	4.4	–	
Final domestic demand	2.0	4.5	5.8	1.5	1.2	–	
Government expenditure	-1.5	-0.7	1.7	-1.4	-0.4	–	
Consumer expenditure	2.4	4.1	5.0	2.7	2.6	–	
Residential investment	10.9	13.1	-1.3	8.7	-0.9	–	
Business fixed investment	4.2	14.5	23.0	-2.0	-1.5	–	
Non-residential construction	4.3	9.1	10.7	-3.1	19.5	–	
Machinery and equipment	4.2	18.7	32.3	-1.3	-14.1	–	
Business inventory change[1]	-0.9	0.8	0.9	1.5	-0.6	–	
Exports	5.7	8.0	13.6	7.3	5.9	–	
Imports	5.2	13.3	23.6	9.2	-0.8	–	
Current account balance							
(BOP basis, nominal $ billion)	4.5	-12.8	-21.7	-18.7	-15.4	–	
(percentage of GDP)	0.6	-1.5	-2.5	-2.2	-1.8	–	
Real personal disposable income	-0.1	-0.7	-2.2	0.0	7.2	–	
Profits before taxes	-3.4	16.2	31.4	14.8	-23.8	–	
Costs and prices (%, y/y)							
GDP price deflator	1.4	0.5	0.4	-0.3	-0.2	–	
Consumer Price Index	1.6	1.6	1.7	1.0	1.0	0.8	Apr-98
CPI – excluding food and energy	1.4	1.6	1.5	1.1	1.4	1.2	Apr-98
Unit labour costs	1.3	0.1	0.3	-0.7	0.1		
Wage settlements (total)	0.9	1.6	1.4	1.7	1.8	1.7	Mar-98
Labour market							
Unemployment rate (%)	9.7	9.2	9.0	8.9	8.6	8.4	May-98
Employment growth	1.3	1.9	3.3	1.8	3.0	-0.6	May-98
Financial markets (average)							
Exchange rates (cents U.S.)	73.34	72.24	72.21	70.99	69.92	68.76	June 4-98
Prime interest rates (%)	6.06	4.96	4.75	5.58	6.33	6.50	June 4-98

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

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

Chart 2
Growth in real consumer spending by category

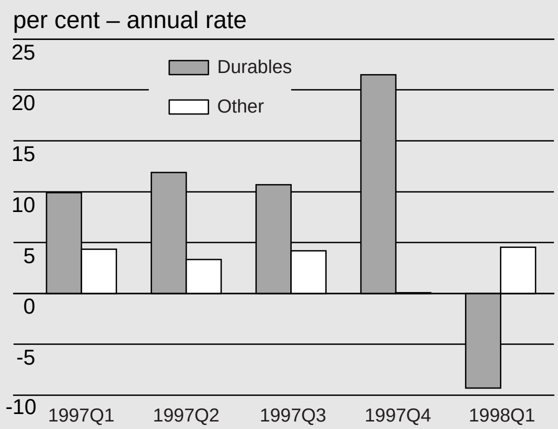
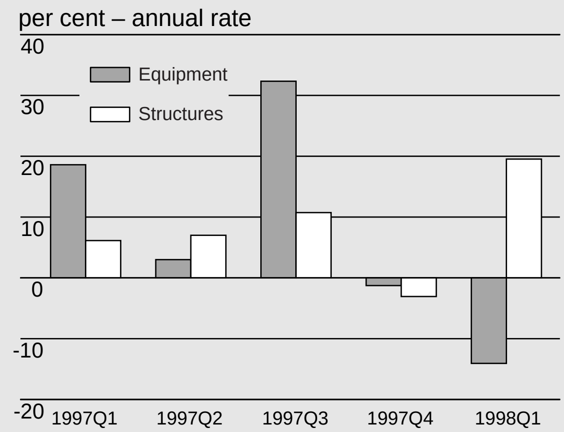


Chart 3
Growth in real business non-residential investment by category



This contrasted favourably with 1.8% growth in the fourth quarter when slower employment growth and work stoppages by Canadian postal workers and educators in Ontario slowed growth. Unincorporated business income continued to grow strongly. And investment income jumped for a second time after six consecutive declines. Personal transfers to government grew 4.0%, their slowest pace since the end of 1996, with personal income taxes rising only 1.2%.

With nominal disposable income growth exceeding that of nominal personal spending, the personal savings rate rose to 1.2% from a downwardly revised 0.1% in the previous quarter, its lowest recorded level.

Business investment growth remains stalled but moves closer to home

Business investment in plant and equipment fell 1.5% in the first quarter, a second consecutive decline. Machinery and equipment investment plunged 14.1% following a modest drop in the fourth quarter (Chart 3).

But investment in non-residential buildings and engineering projects, which is satisfied less by imports and so provides a stronger impetus to domestic production, rebounded sharply. After a modest loss in the fourth quarter, such investment resumed its strong growth of the previous two years and soared 19.5%. Investment in buildings registered a third consecutive sharp increase while that in engineering works rebounded from a fourth quarter decline.

Residential investment fell 0.9%, as lower resale activity sharply reduced transfer costs (primarily real estate commissions) by nearly 30%. But this was largely offset by other components of residential investment. New house construction rose 3.2%, in line with higher housing starts in the quarter, while alterations and improvements grew strongly.

Inventories slow

Total business inventory accumulation eased from $11.5 billion in the fourth quarter to a still strong $10.4 billion in the first quarter. Since this coincided with rising sales, the economy-wide inventory-to-sales ratio remained near its all-time low and well below levels in the early 1990s. With Statistics Canada’s April Quarterly Survey of Business Conditions showing that most manufacturers judge inventory levels to be acceptable, this suggests that further demand increases in the near term are likely to translate directly into production gains.

Exports stay strong while imports fall

Strong foreign demand for Canadian products boosted real exports 5.9% in the first quarter, only modestly off the pace in the previous quarter despite problems in Asia. Slower domestic demand growth, and a shift in that demand, produced declines in spending on import-intensive consumer durables and business machinery and equipment. As a result, real imports dropped 0.8% and the real trade balance rose $5.0 billion (1992 dollars).

Current account posts smaller deficit

The current account deficit narrowed $3.2 billion to $15.4 billion, or 1.8% of nominal GDP. This reflected an improvement in the nominal balance on goods and services of over $4 billion that accompanied the gain in the real trade balance.

Inflation subdued while profits dive

With the economy still operating below potential, underlying price and cost pressures remained subdued in the first quarter.

The implicit price index for GDP was 0.2% below its level of a year earlier. This decline was largely due to weakening export prices, a reflection of softening commodity prices.

While unit labour costs rose 2.1% relative to their fourth quarter level, they were up only 0.1% from their level of a year earlier because of previous declines.

Pre-tax corporate profits slumped 23.8% in the first quarter to an 8.9% share of nominal GDP. This reflected the impact on profits of falling commodity prices and the insurance pay-outs associated with the ice storm. The drop in profits followed strong gains in five of the previous six quarters.

Employment situation is positive

The strong growth in the Canadian economy is also reflected in the labour market. Despite a modest loss in May, employment has risen by 164,000 jobs so far in 1998, boosting the number of net new jobs created since the end of 1996 to 536,000. Net job creation during those 17 months has been entirely in the private sector, with full-time jobs making up almost all of the gain. The unemployment rate was 8.4% in May, the same as in April and the lowest level since 1990.

Interest rates steady

Short-term interest rates are modestly above their level in early March, while long-term interest rates are modestly below. Rates remain low by historical standards, reflecting fiscal restraint by federal and provincial governments, low inflation and continuing slack in the economy. Short-term rates are about 3½ percentage points lower than their peak in early 1995 while long rates remain more than 4 percentage points lower.

On 3-month Treasury bills, the negative spread between Canadian and U.S. rates has narrowed but remains above ¼ percentage point. And interest rate spreads with U.S. rates remain negative across the entire maturity spectrum.

Recently, the dollar has been trading between 68 and 69 cents U.S.

Second quarter indicators show strength

The few indicators available to date suggest that the substantial momentum in the economy should yield further strong growth in the second quarter.

Average employment in April and May exceeded that in the first quarter by 0.8% (quarterly rate). Further, preliminary estimates show April’s new motor vehicle sales, department store sales and house resales to be well ahead of their first quarter pace. Residential construction, however, seems to have weakened, as housing starts appear likely to decline in the second quarter.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Distribution Centre (613) 995-2855. For other inquiries about this publication, contact Jeremy Rudin (613) 992-2370.
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