THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE — MARCH 1999

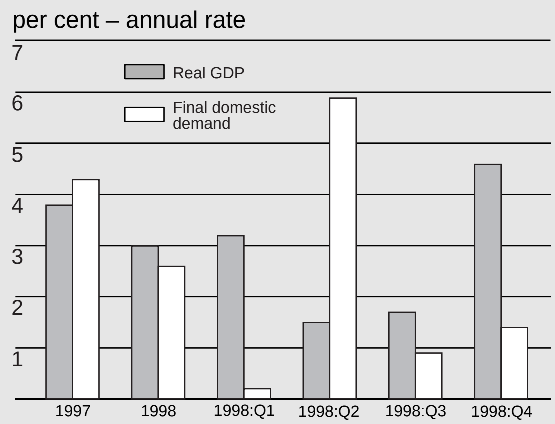
KEY MESSAGES

- In the fourth quarter of 1998, real GDP growth increased sharply to 4.6% from its more moderate average pace of 1.6% in the previous two quarters. The growth rate for all of 1998 was 3.0%.
- Stronger foreign demand, especially for automotive products in the United States, contributed to a 16.2% increase in real exports in the fourth quarter, boosting Canadian production.
- A large positive swing in business inventory investment from the third to the fourth quarter also contributed to the increase in growth. The inventory accumulation was largely in motor vehicles and was accomplished through both domestic production and increased imports. Excluding inventories, real GDP rose 1.3% in the fourth quarter.
- Growth in demand by Canadians for consumer goods and services, housing and non-residential construction remained modest while investment in machinery and equipment continued to grow strongly.
- Part of the increase in total demand was met through sharply higher imports, especially of automotive products, computers and other office equipment.
- Real personal disposable income jumped 2.4% in the fourth quarter, bringing its increase for 1998 as a whole to 1.9%, its first significant annual increase since 1995.
- The robust employment growth seen since June of last year continued into 1999. With a total gain of 100,000 in January and February, cumulative job creation climbed to over 550,000 since the end of 1997. The unemployment rate in February was 7.8%, its lowest level in over eight years.

SUMMARY[1]

In the fourth quarter of 1998, Canadian exports continued to be a major force behind growth in real GDP. A large swing in inventory investment also boosted Canadian production. But final domestic demand gains remained modest, with import growth accounting for an increased share of total demand (Chart 1). 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, March 12, 1999.

Strong export growth boosts production

Strong foreign demand for Canadian products boosted real exports 16.2% in the fourth quarter, double the pace of the previous quarter. The increase in exports was concentrated in automotive products to the United States. Strong economic growth in that country, increased Canadian competitiveness and a rebound from the effects on Canadian production of a strike at General Motors in the United States in the summer of 1998 were the major factors behind this strengthening of Canadian exports.

Consumers limit spending gains

Real consumer expenditure growth eased further to 0.8% in the fourth quarter from 1.5% in the third and 6.0% in the second. Spending on goods, particularly on motor vehicles, fell while spending on services rose moderately.

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

	1997	1998	1998:Q2	1998:Q3	1998:Q4	Most recent	
Real gross domestic product	3.8	3.0	1.5	1.7	4.6	–	
GDP excluding inventories	3.0	3.4	3.0	7.0	1.3	–	
Final domestic demand	4.3	2.6	5.9	0.9	1.4	–	
Government expenditure	-1.5	1.0	2.8	1.3	1.1	–	
Consumer expenditure	4.1	2.7	6.0	1.5	0.8	–	
Residential investment	12.4	-1.6	-3.7	-9.8	2.4	–	
Business fixed investment	15.0	6.7	15.7	1.8	4.6	–	
Non-residential construction	8.4	1.9	2.7	-0.9	-1.0	–	
Machinery and equipment	19.6	9.8	24.4	3.4	8.0	–	
Business inventory change[1]	0.8	-0.4	-1.4	-4.9	3.3	–	
Trade balance[1]	-1.5	0.7	-2.6	5.6	0.6	–	
Exports	8.0	8.1	2.2	7.7	16.2	–	
Imports	13.3	6.4	9.8	-7.0	15.5	–	
Current account balance							
(nominal $ billion)	-12.8	-18.4	-20.2	-18.3	-20.9	–	
(percentage of GDP)	-1.5	-2.1	-2.3	-2.1	-2.3	–	
Real personal disposable income	0.2	1.9	0.0	-0.7	2.4	–	
Profits before taxes	13.3	-5.3	-4.3	-4.1	11.9	–	
Costs and prices (%, y/y)							
GDP price deflator	0.7	-0.5	0.0	-0.7	-0.6	–	
Consumer Price Index	1.6	0.9	1.0	0.9	1.1	0.6	Jan-99
CPI – excluding food and energy	1.6	1.3	1.2	1.4	1.5	1.0	Jan-99
Unit labour costs	0.9	0.8	1.0	0.9	0.8	1.3	Dec-98
Wage settlements (total)	1.6	1.7	1.7	1.4	1.7	2.2	Dec-98
Labour market							
Unemployment rate (%)	9.2	8.3	8.4	8.3	8.0	7.8	Feb-99
Employment growth	1.9	2.8	2.6	1.9	5.1	1.1	Feb-99
Financial markets (average)							
Exchange rates (¢ U.S.)	72.24	67.48	69.13	66.03	64.84	65.55	Mar-11-99
Prime interest rates (%)	4.96	6.60	6.50	6.75	6.83	6.75	Mar-11-99

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

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

Personal income grew 3.8% in the fourth quarter, nearly double its pace of the previous quarter, with labour income rising much more sharply than in the third quarter. More jobs were created in the fourth quarter than in any quarter on record (dating back to 1976), and full-time jobs rose sharply. Also, part of the income acceleration reflected the end of labour disputes in Canada and the United States, which had depressed earnings in the middle of 1998.

With personal taxes rising at about the same pace as in the previous quarter, real personal disposable income increased 2.4% following a drop in the third quarter. For 1998 as a whole, real personal disposable income increased 1.9%, the first significant annual gain since 1995.

As growth in nominal disposable income exceeded growth in nominal personal spending, the personal savings rate rose to 0.8% from 0.4% in the third quarter.

Stronger growth in business investment

Business investment in plant and equipment rose 4.6% in the fourth quarter, a stronger pace than in the previous quarter. The acceleration came in import-intensive machinery and equipment investment, with growth in that category rising to 8.0% from 3.4% in the third quarter. Investment in non-residential construction fell 1.0%, a second consecutive decline. The slowdown resulted from another drop in engineering projects, notably in the oil and gas industry, while building construction continued to rise.

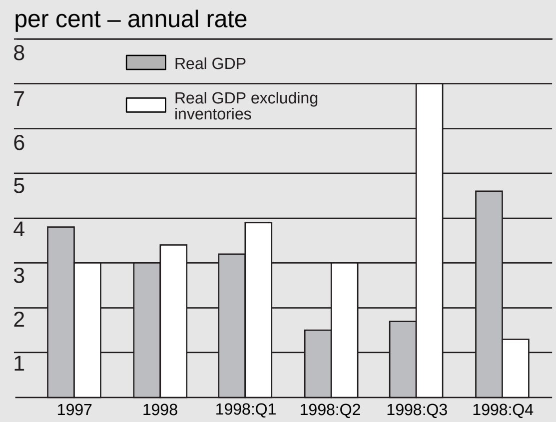
Residential investment rose 2.4% following a drop in the third quarter. Increased housing starts boosted new house construction activity, and spending on alterations and improvements also rose. This was partly offset by sharply lower real estate commissions, the result of fewer house resales in the quarter.

Inventories add to production

Businesses increased their non-farm inventories by $3.6 billion in the fourth quarter following a decumulation of $2.6 billion in the third quarter. Even with the relatively high import content of inventory investment, this accumulation had a significant positive impact on production (Chart 2). Most of the inventory build-up came in motor vehicles and in the retail and wholesale sectors. The summer strike at General Motors in the United States had previously pared stocks.

With strong exports boosting sales, the economy-wide inventory-to-sales ratio declined, remaining well below the levels of the early 1990s.

Chart 2
Real GDP growth with and without inventories



Imports rebound strongly

Real imports rose sharply in the fourth quarter owing to the stronger Canadian demand for import-intensive machinery and equipment and automotive products.

Current account deficit increases

The import rebound was more than offset by stronger real export growth, so the real trade surplus rose modestly in the fourth quarter. However, the nominal trade surplus fell slightly as import prices rose more than export prices in the quarter. That development, plus a widening of the investment income deficit, caused the fourth-quarter current account deficit to increase by $2.6 billion from the third quarter; in the fourth quarter the current account deficit reached $20.9 billion, or 2.3% of nominal GDP. The deterioration in the investment income account resulted from increased retained earnings assigned to non-residents from profits earned in Canada.

For 1998 as a whole, the current account deficit worsened by $5.6 billion from 1997, increasing to $18.4 billion, or 2.1% of nominal GDP.

Inflation subdued while profits climb

With the economy operating at a level of production below potential, underlying price and cost pressures remained subdued in the fourth quarter. Both the implicit price index and the chain price index were below their levels of a year earlier, owing in part to lower export prices than at the end of 1997. Weak commodity prices help to explain this development.

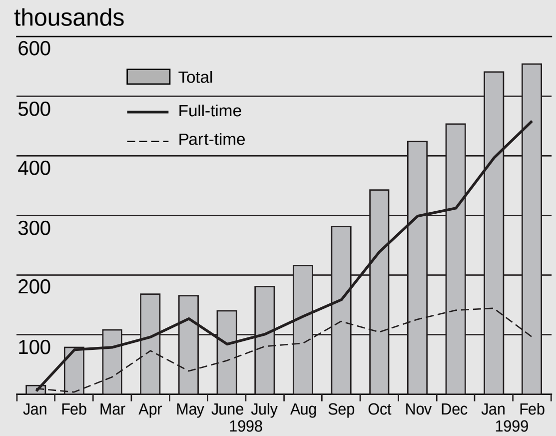
Labour costs per unit of output fell marginally from their third-quarter level and were up only 0.8% from their level of a year earlier. Both the average wage and labour productivity fell slightly in the fourth quarter.

Pre-tax corporate profits climbed 11.9% after having fallen 4.1% in the third quarter. Gains in the quarter were most notable in the motor vehicle industry, as the General Motors strike in the United States in the summer had negatively impacted profits in Canada in the third quarter. This overall rise in profits followed contractions in the first three quarters of the year, and their level in the fourth quarter remained 8.4% below that of a year-earlier.

Robust job creation continues

Fourth-quarter employment growth was 5.1%, its strongest rate of growth since the last quarter of 1987. The growth rate of 2.8% in 1998 as a whole reflected the over 450,000 net new jobs added during the year. Robust job creation continued into 1999, with another 100,000 net new positions created in January and February together (Chart 3). The unemployment rate declined from 8.1% in September to 7.8% in January and February, its lowest level in over eight years. Further, the job gains since September were largely in full-time employment.

Chart 3
Cumulative employment growth since December 1997



The Canadian dollar strengthens

After having traded around 65 cents U.S. for most of the last four months of 1998, the Canadian dollar strengthened somewhat in January and February, peaking at over 67 cents U.S. in mid-February. However, more recently, the dollar has weakened in response to renewed concerns about the global commodity price outlook and the continued strength of the U.S. economy. On March 11, the dollar closed at 65.55 cents U.S.

The Canadian dollar has strengthened somewhat against the Euro, the new common currency of the European Monetary Union, since it was launched at the start of 1999.

Although relatively stable during December and January, short- and long-term interest rates have risen since mid-February. This reflects some spillover into Canada of upward pressure on market interest rates in the United States coming from the continuing strong performance of that economy. This pressure, however, eased after the United States released favourable wage growth and productivity reports in early March.

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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