THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 1999

KEY MESSAGES

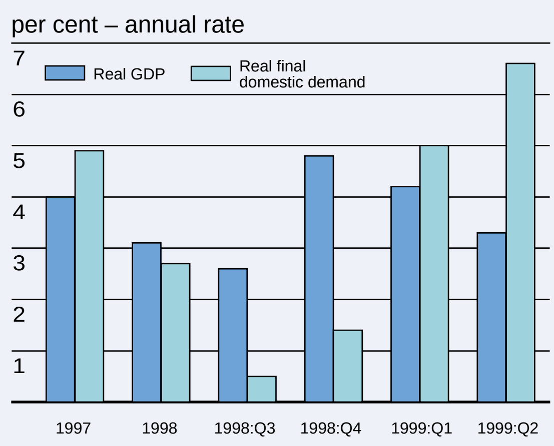
- In the second quarter of 1999, real gross domestic product (GDP) grew a solid 3.3% following gains of over 4% in the previous two quarters.
- Demand growth in the quarter was relatively widespread. Private and public demand for goods and services, housing and investment rose 6.6% in the quarter, stronger than the 5.0% pace recorded in the first quarter. Inventory accumulation also boosted output in the second quarter.
- Stronger foreign demand contributed to increased Canadian production through a 1.5% increase in real exports, although this was a much smaller gain than in recent quarters. But rising imports satisfied much of the increased domestic demand, moderating the gain in real GDP. As a result of these movements, real economic growth slowed moderately and the real trade balance worsened.
- The decrease in the nominal trade surplus, however, was modest as the decline in the real trade balance was largely offset by a gain in the terms of trade (export prices rose while import prices fell). The current account deficit worsened slightly from $4.0 billion to about $5.3 billion but was still much better than the levels observed throughout 1998.
- July employment stood nearly 116,000 above the level at the end of 1998, with full-time jobs accounting for more than the total net gain. Nearly 400,000 net new jobs were created between July 1998 and July 1999. The unemployment rate in July was 7.7%, down from 8.3% in April, but slightly above the 7.6% seen in June.

SUMMARY[1]

In the second quarter of 1999, the impetus to growth came largely from increased domestic demand. Final domestic demand (spending by consumers, business and government on goods, services, housing and plant and equipment) rose at its fastest rate in nearly three years (Chart 1) and, along with a large positive swing in inventory investment, boosted production. But weaker export growth than in the first quarter and rising imports to meet the increased domestic demand slowed the pace of growth slightly relative to that in the first quarter. Cost and inflation pressures remained relatively subdued.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is August 31, 1999.

Chart 1
Growth in real GDP and real final domestic demand



Consumers still spending

Real consumer expenditure increased 3.0% in the second quarter following a 4.2% gain in the first quarter of 1999. Growth in spending on services was nearly double its pace in the first quarter while that on goods was noticeably slower, with an outright decline in spending on automotive products.

Personal income grew 3.4% in the second quarter, about the same pace as in the first quarter. Labour income growth was sustained by a pickup in the average wage per employed person.

With personal taxes rising faster than in the previous quarter, and faster than personal income, real personal disposable income growth moderated to 0.8%.

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

	1997	1998	1998:Q4	1999:Q1	1999:Q2	Most recent	
Real gross domestic product	4.0	3.1	4.8	4.2	3.3	-	
GDP excluding inventories	3.2	3.6	1.3	6.0	0.2	-	
Final domestic demand	4.9	2.7	1.4	5.0	6.6	-	
Government expenditure	-1.0	2.0	2.2	1.4	4.2	-	
Consumer expenditure	4.2	2.8	0.0	4.2	3.0	-	
Residential investment	12.6	-1.9	0.3	18.6	15.4	-	
Business fixed investment	18.8	5.7	6.8	9.6	25.3	-	
Non-residential construction	14.0	0.1	-2.4	4.5	1.5	-	
Machinery and equipment	22.2	9.5	12.7	12.7	40.5	-	
Business inventory change[1]	0.7	-0.4	3.4	-1.7	3.1	-	
Trade balance[1]	-1.7	1.0	-0.2	2.0	-5.5	-	
Exports	8.5	8.2	14.2	9.5	1.5	-	
Imports	14.6	5.8	15.9	4.5	18.2	-	
Current account balance							
(nominal $ billion)	-14.3	-16.4	-16.5	-4.0	-5.3	-	
(percentage of GDP)	-1.6	-1.8	-1.8	-0.4	-0.6	-	
Real personal disposable income	1.3	2.4	2.7	3.1	0.8	-	
Profits before taxes	8.5	-6.0	13.0	29.5	16.5	-	
Costs and prices (%, y/y)							
GDP price deflator	0.8	-0.6	-0.7	0.4	1.0	-	
Consumer price index	1.6	0.9	1.1	0.8	1.6	1.8	99-Jul
CPI – excluding food and energy	1.6	1.3	1.5	1.0	1.5	1.7	99-Jul
Unit labour costs	1.8	0.9	0.7	-0.3	-0.6		
Wage settlements (total)	1.4	1.7	1.7	1.5	2.4	2.5	99-Jun
Labour market							
Unemployment rate (%)	9.2	8.3	8.0	7.8	8.0	7.7	99-Jul
Employment growth	1.9	2.8	5.1	3.7	-0.2	3.3	99-Jul
Financial markets (average)							
Exchange rates (cents U.S.)	72.24	67.48	64.84	66.17	67.90	67.00	31-Aug-99
Prime interest rate (%)	4.96	6.60	6.83	6.75	6.33	6.25	31-Aug-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.

As growth in nominal disposable income fell short of that in nominal personal spending, the personal savings rate fell to 1.4% from 1.9% in the first quarter.

Investment activity soars

Business investment in plant and equipment soared 25.3% in the second quarter, more than double the pace in the first quarter. Growth in machinery and equipment investment exceeded 40%. Computer purchases contributed significantly to the gain, at least partly due to continued efforts to improve Y2K readiness. Investment in non-residential construction recorded a smaller gain than in the first quarter, as building construction rose while engineering construction fell, largely due to reduced oil and gas drilling activity.

Residential investment jumped 15.4%, only somewhat off the 18.6% pace of the first quarter. Much higher house resales sharply boosted real estate commissions. An increase in housing starts raised new house construction activity while renovations also registered a healthy increase.

Exports rise but imports surge

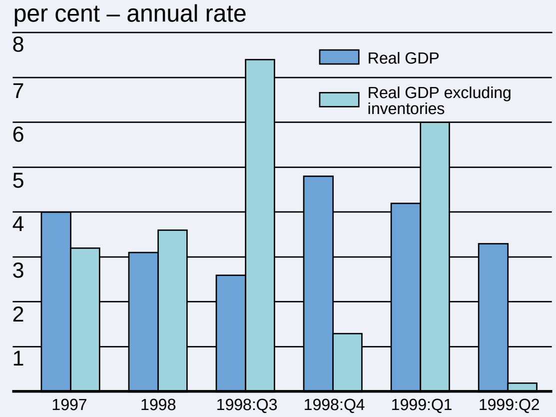
Foreign demand for Canadian products contributed to higher real exports in the second quarter, which, however, rose at a much slower pace than in recent quarters. Slower growth in final domestic demand and lower inventory accumulation in the United States reduced the pace of import growth from Canada. In contrast, total real imports by Canadians rose a strong 18.2% in the second quarter, driven by business investment as large gains in imports of machinery and equipment were recorded.

Inventory accumulation climbs

Businesses increased their inventories by $6.8 billion in the second quarter following a much smaller accumulation of $0.2 billion in the first quarter. This buildup, combined with strong final domestic demand, was a factor behind the growth in production (Chart 2).

With strong domestic demand boosting sales and the sharp accumulation in inventories, the economy-wide inventory-to-sales ratio fell slightly, remaining near its lowest recorded level.

Chart 2
Real GDP growth with and without inventories



Current account deficit roughly stable

The decline in the trade surplus relative to the first quarter, due to stronger real import than export growth, was largely moderated by a gain in the terms of trade. There were noticeable increases in commodity prices, which supported higher export prices. Energy prices rose significantly, for example, as OPEC restricted its supply of crude petroleum.

The modest reduction in the nominal trade surplus, combined with a deterioration in net transfers and a slight improvement in the investment income deficit, produced a slight worsening of the current account deficit from $4.0 billion to about $5.3 billion, or 0.6% of nominal GDP. But this was still much better than the levels observed throughout 1998.

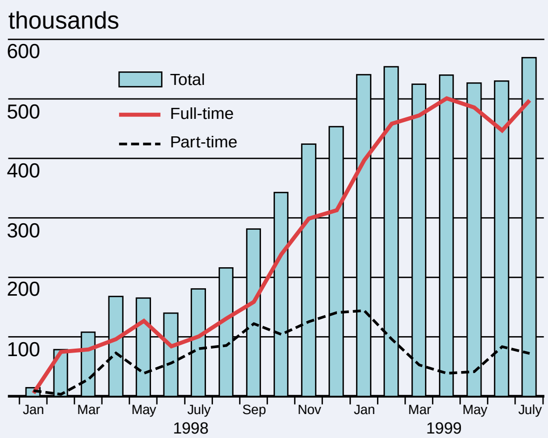
Inflation subdued while profits jump

With the economy still operating below potential, underlying price and cost pressures remained subdued in the second quarter. The implicit and chain price indices for GDP were both only 1.0% above their year-earlier levels despite noticeable jumps in the second quarter. Consumer prices accelerated to 1.8% in July on a year-over-year basis, owing in part to the temporary impact of higher energy prices.

Labour productivity, when measured as output per employed person, rose noticeably in the second quarter. And labour costs per unit of output rose modestly from their first quarter level but remained 0.6% below that of a year earlier.

Pre-tax corporate profits surged another 16.5% after having risen 13.0% and 29.5% in the fourth quarter of 1998 and the first quarter of 1999 respectively. These gains raised profits to 9.8% of nominal GDP and to a level 15.3% above that of a year earlier.

Chart 3
Cumulative employment growth since December 1997



Job creation resumes

Second quarter employment fell slightly after increasing 5.1% in the fourth quarter of 1998 and 3.7% in the first quarter of 1999. But employment growth has resumed, with the addition of 40,000 net new jobs in July (Chart 3). The unemployment rate was 7.7% in July, up from 7.6% in June but down from 8.3% in April. These are the lowest rates of unemployment in Canada in the last nine years.

The Canadian dollar gives back some gains

After having traded around 65 cents U.S. in the last quarter of 1998, the Canadian dollar strengthened along with world commodity prices, peaking near 69 cents U.S. in early May 1999. It has since lost some ground, trading near 67 cents U.S. On August 31, the dollar closed at 67 cents U.S.

After easing back from March until early May, Canadian market interest rates rose along with those in the United States.

The U.S. Federal Reserve raised the target for the Federal Funds Rate from 5% to 5.25% on August 24, its second round of monetary tightening in 1999. These moves were aimed at staving off inflationary pressures given a tight U.S. labour market, continued strong U.S. domestic demand and firming foreign economies.

The Bank of Canada did not match the August increase by the Federal Reserve and as a result interest rates in Canada generally remained below those in the United States.

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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