THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE SEPTEMBER 2001

OVERVIEW

- In the second quarter of 2001 real gross domestic product (GDP) grew 0.4%, following a 2.0% gain in the first quarter.
- Declining foreign demand, notably from the United States, slowed the pace of growth, as real exports dropped 3.1%.
- A slowing pace of real final domestic demand also contributed to the moderating pace of growth while an inventory accumulation helped to limit the slowdown. Imports satisfied part of the higher domestic demand, further restraining Canadian output growth.
- Falling world energy prices dragged down export prices and reinforced the negative impact of real trade movements on the nominal trade balance. This contributed to the $14.5-billion drop in the current account surplus to $39.5 billion, or 3.6% of nominal GDP.
- Employment grew 1.1% in the second quarter overall but registered slight losses in June, July and August. Nonetheless, over 330,000 net new jobs have been created since the end of 1999. The unemployment rate was 7.2% in August 2001, up from 7.0% in July.

Real GDP growth slows

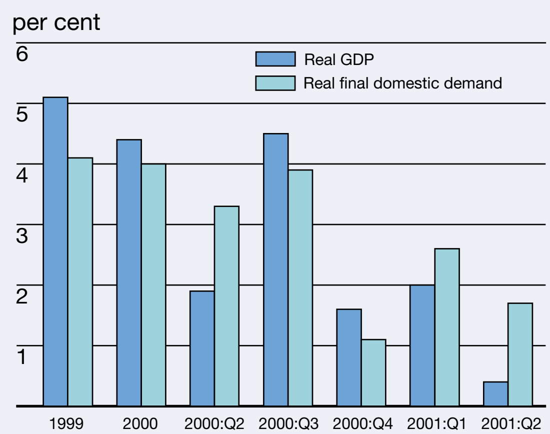
The modest gain in the second quarter represented the 37th consecutive quarter of output growth. Real final domestic demand growth slowed to 1.7% from 2.6% in the first quarter. This, combined with higher imports, moderated the need to boost Canadian production (Chart 1).

Consumer spending growth moderates

Real consumer expenditure advanced 1.1%, a slower pace than in the previous quarter. Spending growth on durables slowed dramatically to 2.1%, with all major categories contributing, while that on

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, September 7, 2001.

Chart 1
Growth in real GDP and real final domestic demand



Note: Final domestic demand is spending by Canadians on goods, services, housing, plant and equipment.

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

	1999	2000	2000:Q4	2001:Q1	2001:Q2	Most recent	
Real gross domestic product	5.1	4.4	1.6	2.0	0.4		–
Final domestic demand	4.1	4.0	1.1	2.6	1.7		–
Government expenditure							
Goods and services	2.6	2.2	3.5	3.0	3.2		–
Gross fixed capital	12.3	7.6	2.2	1.5	-4.5		–
Consumer expenditure	3.4	3.6	1.2	3.4	1.1		–
Residential investment	5.3	2.7	3.9	6.5	0.4		–
Business fixed investment	7.2	8.1	-3.5	-2.6	3.8		–
Non-residential construction	1.8	5.3	2.7	2.5	2.1		–
Machinery and equipment	10.5	9.7	-7.0	-5.6	4.8		–
Business inventory investment ($ billion)	4.6	9.2	4.5	-0.1	1.6		–
Exports	9.9	7.6	-0.1	-4.7	-3.1		–
Imports	7.3	8.1	-9.1	-9.6	2.1		–
Current account balance							
(nominal $ billion)	1.7	26.9	34.2	54.0	39.5		–
(percentage of GDP)	0.2	2.5	3.2	4.9	3.6		–
Nominal personal income	4.8	6.1	6.0	7.4	-0.2		–
Nominal personal disposable income	5.0	5.6	9.3	6.5	-1.3		–
Real personal disposable income	3.3	3.5	6.8	5.7	-5.6		–
Profits before taxes	21.9	21.8	7.5	13.1	-6.4		–
Costs and prices (%, y/y)							
GDP price deflator	z	3.7	3.4	3.7	2.5		–
Consumer price index	1.7	2.7	3.1	2.8	3.6	2.6	Jul-2001
CPI – excluding eight most volatile items	1.3	1.3	1.5	1.8	2.3	2.4	Jul-2001
Unit labour costs	0.8	2.3	2.7	3.2	1.7		
Wage settlements (total)	2.2	2.5	2.9	3.5	2.9	3.2	Jun-2001
Labour market							
Unemployment rate (%)	7.6	6.8	6.9	7.0	7.0	7.2	Aug-2001
Employment growth	2.8	2.6	3.0	0.9	1.1	-0.6	Aug-2001
Financial markets (average)							
Exchange rate (cents U.S.)	67.32	67.34	65.55	65.47	64.89	64.22	6-Sep-2001
Prime interest rate (%)	6.4	7.3	7.5	7.1	6.3	5.75	6-Sep-2001

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

services also eased. As well, consumers spent less on non-durables than they did in the first quarter.

Personal income was roughly unchanged from its first-quarter level. Transfers from government dropped sharply after being temporarily inflated in the first quarter by federal energy relief payments. In addition, labour income rose less robustly than in the previous quarter as employees worked, on average, fewer hours per week than in the first quarter. As a result, personal disposable income declined even though there was only a modest advance in income taxes paid to government. This, together with rising spending by households on goods and services, caused the personal savings rate to fall to 2.8% from 4.6%, matching the record low in the third quarter of 2000 (Chart 2).

Residential investment growth flattens

Residential investment, which is largely satisfied through domestic production, increased a very modest 0.4% in the second quarter following a gain of 6.5% in the first. A noticeably stronger house resale market offset declines in construction activity associated with housing starts and renovations.

Business fixed investment grows

Following three consecutive declines, business spending on plant and equipment rose 3.8% in the second quarter. Investment in import-intensive machinery and equipment rose 4.8% after falling 5.6% in the previous quarter. The gains were especially evident in transportation equipment and software purchases. Non-residential construction, which is largely satisfied by domestic production, increased a more modest 2.1%, with increased spending on both building and engineering projects, notably by the oil and gas industry.

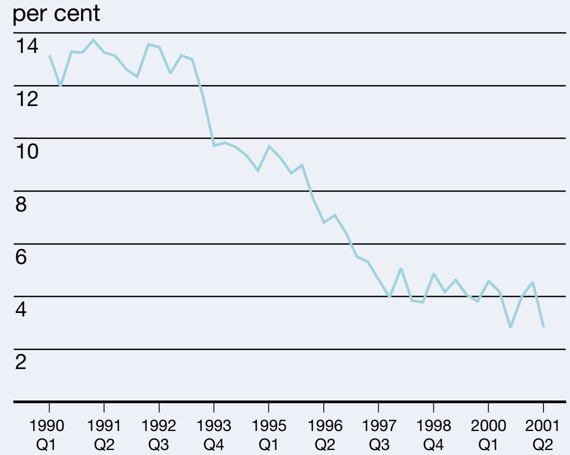
Businesses accumulate inventories

A business inventory accumulation of \$1.6 billion in the second quarter followed a slight rundown in the first quarter, adding to real GDP growth. The increase in the second quarter was partly due to a rise in energy inventories while the slight drop in the first quarter was a response to a need to reduce stocks of automotive and high-technology products.

Exports fall while imports rise

Foreign demand for Canadian goods and services weakened in the second quarter, with real exports declining 3.1%. Exports of energy products and machinery and equipment, especially high-technology products, took the brunt of the fall. This is consistent with slowing U.S. growth and the inventory rundown in that country in the first half of the year.

Chart 2
Personal savings rate



Real imports rose 2.1% in the quarter, with particular strength in energy and automotive products. However, a decline in non-automotive machinery and equipment imports restrained import growth.

Current account surplus falls

With real exports falling, real imports rising and the terms of trade worsening (export prices fell while import prices rose), the nominal trade surplus dropped \$10.9 billion from the first-quarter level. Along with deteriorations in net investment income and net transfers between Canadians and non-residents, this lowered the current account surplus by \$14.5 billion from its record level in the first quarter to \$39.5 billion, or 3.6% of GDP. However, this remains a sharp improvement from the deficits registered throughout most of the 1990s.

Inflation remains subdued

Underlying price and cost pressures remained subdued in the second quarter. Falling world energy prices moderated the growth of the GDP deflator. This most comprehensive measure of inflation dropped to a year-over-year increase of 2.5% from 3.7% in the first quarter. Domestic inflation also remained subdued, with consumer price inflation moderating to 2.6% in July on a year-over-year basis from 3.3% in June. Core CPI inflation, which excludes the eight most volatile items, was 2.4% in July on a year-over-year basis.

Labour productivity registered a mixed result in the second quarter: output per employed person fell a modest 0.6% while output per hour worked jumped 7.5%. With that, labour income growth exceeded output growth, modestly boosting labour costs per unit of output to a level 1.7% higher than a year earlier, down from a year-over-year increase of 3.2% in the first quarter.

Corporate profits decline

Corporate profits decreased 6.4% following 11 consecutive quarterly gains. The decrease brought profits to 6.5% above the level of a year earlier. Declining profits were especially notable in the energy sector, reflecting falling prices. As well, manufacturers' profits slid as demand softened, especially for electronic and computer products.

Unemployment rate rises slightly

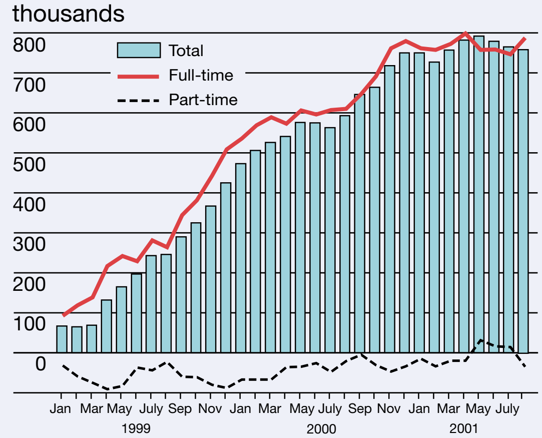
In the second quarter, employment growth remained moderate, rising 1.1% after a gain of 0.9% in the first quarter. Weak economic growth resulted in moderate job losses in June, July and August, with the unemployment rate in August standing at 7.2%, up from 7.0% in July. The modest employment gains to date in 2001 have been in full-time jobs.

Taking a longer view, this sluggishness follows a period of strong employment growth, with 750,000 net new jobs created during 1999 and 2000 (Chart 3), with gains in those years entirely in full-time jobs.

Interest rates fall

In response to weakening economic growth, the U.S. Federal Reserve has lowered its target for the Federal Funds rate seven times during 2001 for a total decline of 3 percentage points. The most recent change was a 25-basis-point decline on August 21. The Bank of Canada lowered its Bank Rate six times over the same period by a total of 175 basis points, with the most recent change a 25-basis-point drop on August 28.

Chart 3
Cumulative employment growth since December 1998



Market interest rates in the United States have also fallen over the last three months. The drop in long-term rates has reduced them to near levels at the beginning of 2001 while that in short rates has been more or less in line with the reductions in the Federal Funds target rate. Canadian interest rates generally moved with those in the United States in recent months and so remain above them, with the spread on short rates falling slightly and that on long rates rising modestly.

With both the Canadian and U.S. economies registering subdued growth and with spreads in interest rates in the two countries changing little in recent months, the Canadian dollar has been trading between 64 cents U.S. and 66 cents U.S., closing at 64.22 cents U.S. on September 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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