THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE DECEMBER 2001

OVERVIEW

- In the third quarter of 2001 real gross domestic product (GDP) shrank 0.8%, following a 0.6% gain in the second quarter. This first quarterly decline since early 1992 was partly the result of the September 11 terrorist attacks on the United States.
- Declining foreign demand from both the United States and overseas resulted in a drop of 7.7% in real exports.
- Consumer expenditure dipped 0.3% in the third quarter.
- Businesses reduced inventories by $4.9 billion, subtracting over 2 percentage points from real GDP growth.
- Falling world energy prices lowered export prices, contributing to the $13.9-billion drop in the current account surplus to $22.1 billion.
- Employment fell 0.5% in the third quarter despite a small gain in September. Labour market signals were mixed in October and November. In November there was a modest gain in employment, but the unemployment rate rose to 7.5% from 7.3% in October.

Real GDP falls

Real GDP declined in the third quarter after 37 consecutive gains (Chart 1). Falling foreign demand and a decrease in business inventories were the major contributors to this.

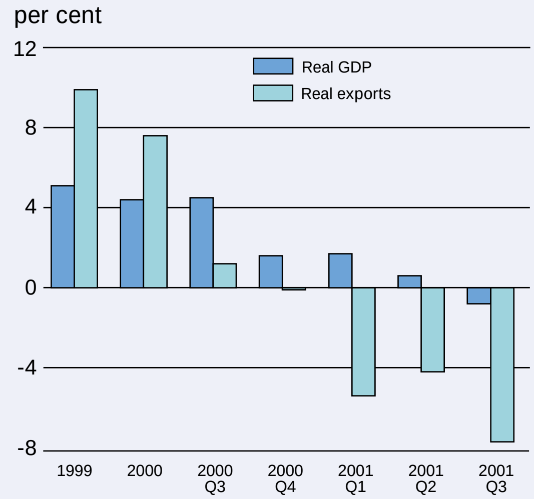
Exports and imports both drop

The world economic slowdown reduced trade flows in the third quarter. As well, trade was disrupted in the weeks immediately after the September 11 terrorist attacks on the United States.

Consistent with slowing world growth, foreign demand for Canadian goods and services continued to decline in the third

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

Chart 1
Growth in real GDP and real exports



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

	1999	2000	2001:Q1	2001:Q2	2001:Q3	Most recent	
Real gross domestic product	5.1	4.4	1.7	0.6	-0.8		–
Final domestic demand	4.1	4.0	2.7	1.7	1.1		–
Government expenditure							–
Goods and services	2.6	2.2	2.8	4.7	1.6		–
Gross fixed capital	12.3	7.6	1.7	-5.0	1.6		–
Consumer expenditure	3.4	3.6	3.6	0.6	-0.3		–
Residential investment	5.3	2.7	5.9	1.1	4.2		–
Business fixed investment	7.2	8.1	-2.6	3.8	5.8		–
Non-residential construction	1.8	5.3	1.2	1.3	-5.1		–
Machinery and equipment	10.5	9.7	-4.8	5.4	12.8		–
Business inventory investment ($ billion)	4.6	9.2	-0.2	0.5	-4.9		–
Exports	9.9	7.6	-5.4	-4.2	-7.7		–
Imports	7.3	8.1	-9.3	-1.3	-7.8		–
Current account balance							
(nominal $ billion)	1.7	26.9	54.4	36.0	22.1		–
(percentage of GDP)	0.2	2.5	5.0	3.3	2.1		–
Nominal personal income	4.8	6.1	6.5	-0.4	1.9		–
Nominal personal disposable income	5.0	5.6	5.2	-1.0	3.5		–
Real personal disposable income	3.3	3.5	4.8	-5.8	2.3		–
Profits before taxes	21.9	21.8	7.1	-14.7	-45.0		–
Costs and prices (%, y/y)							
GDP price deflator	1.4	3.7	3.7	1.9	0.2		–
Consumer price index	1.7	2.7	2.8	3.6	2.7	1.9	Oct-2001
CPI – excluding eight most volatile items	1.3	1.3	1.8	2.3	2.4	2.2	Oct-2001
Unit labour costs	0.8	2.3	3.2	1.5	2.5		
Wage settlements (total)	2.2	2.5	3.5	2.9	3.4	3.5	Sep-2001
Labour market							
Unemployment rate (%)	7.6	6.8	7.0	7.0	7.1	7.5	Nov-2001
Employment growth	2.8	2.6	0.9	1.1	-0.5	1.1	Nov-2001
Financial markets (average)							
Exchange rates (cents U.S.)	67.3	67.3	65.5	64.9	64.7	63.59	6-Dec-2001
Prime interest rate (%)	6.4	7.3	7.1	6.3	5.7	4.0	6-Dec-2001

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

quarter. Real exports declined 7.7%, led by reductions in energy products, automotive products and machinery and equipment, especially high-technology products. Exports of services dropped by 16.7%, in part due to a sharp 26.4% reduction in real spending by non-residents on travel in Canada.

Meanwhile, real imports fell 7.8%, with widespread declines as Canadian domestic demand growth slowed.

Consumer spending dips

Real consumer expenditure fell 0.3% in the third quarter. Spending on all major categories of goods fell, with pronounced declines for durables, especially automotive products. Outlays for services rose 1.9%.

Personal income increased 1.9%, boosted by an increase in transfers from government. Wages and salaries rose, as a modest increase in hours worked per week offset losses in employment. Meanwhile, income taxes fell, leading to a 3.5% increase in nominal personal disposable income. The personal savings rate increased to 3.3% from the record low 2.6% of the previous quarter.

Businesses cut inventories

Businesses lowered their inventories by $4.9 billion in the third quarter following a modest accumulation in the second. This subtracted over 2 percentage points from real GDP growth. The September 11 attacks in the United States may have influenced the level of inventories held in the third quarter.

Residential investment rises

Residential investment, which is largely satisfied through domestic production, rose 4.2% in the third quarter, the fifth consecutive increase, with gains coming from the house resale market, renovations and new construction despite a drop in housing starts during the quarter.

Business fixed investment increases

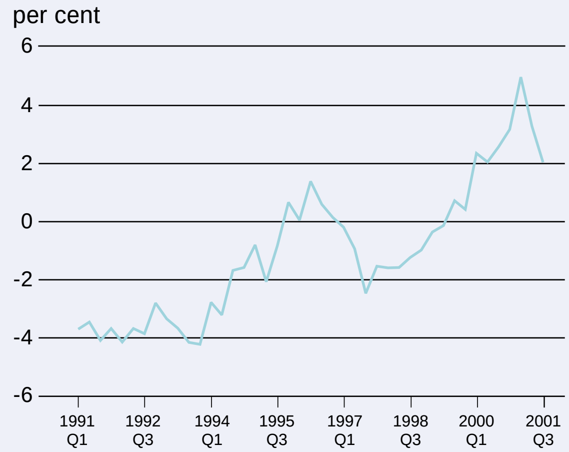
Business spending on plant and equipment rose 5.8% in the third quarter, following a gain of 3.8% in the second. Investment in import-intensive machinery and equipment increased 12.8% after rising 5.4% in the previous quarter. The gain was boosted by an increase in transportation equipment, including a floating drilling rig for the Nova Scotia energy sector. Excluding non-motor vehicle transportation equipment, investment in machinery and equipment declined in the third quarter.

Non-residential construction, which is largely satisfied by domestic production, decreased 5.1% following three consecutive gains. This reflected decreased spending on both building and engineering projects.

Current account remains in surplus

A sharp drop in the price of exported energy products contributed to a $17.1-billion reduction in the nominal trade surplus from the second-quarter level. As this deterioration in the trade surplus was partly offset by a $3.5-billion improvement in the investment income deficit, the current account surplus fell by $13.9 billion from its second-quarter level to $22.1 billion, or 2.1% of GDP (Chart 2). However, this remains a sharp improvement from the deficits registered throughout most of the 1990s.

Chart 2
Current account as a percentage of nominal GDP



Inflation remains subdued

Underlying price and cost pressures remained subdued in the third quarter. Falling world energy prices led to a substantial decline in the GDP deflator. This comprehensive measure of inflation dropped 4.8% in the third quarter, bringing the year-over-year increase to 0.2% from 1.9% in the second quarter. Consumer price inflation also remained subdued at 1.9% in October. Core CPI inflation, which excludes the eight most volatile items, was 2.2% in that month.

Labour productivity declined in the third quarter: output per employed person fell a modest 0.3% while output per hour worked dropped 1.1%. And labour costs per unit of output were 2.5% higher than a year earlier, compared to 1.5% in the second quarter.

Corporate profits fall

Corporate profits decreased 45%, the second consecutive drop following 11 consecutive quarterly gains. This brought profits to 14.3% below the level of a year earlier. Declining profits were particularly notable in the energy sector, reflecting falling prices, and manufacturing, as demand softened, especially for automotive and electronic and computer products.

Unemployment rate edges up

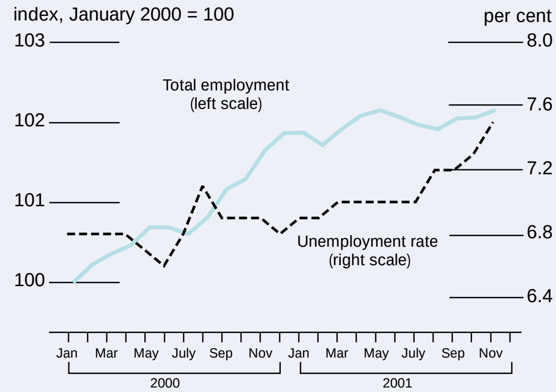
In tandem with falling foreign demand, signs of weakness appeared in the Canadian labour market early in 2001. This was particularly evident in export-oriented manufacturing industries. Total employment has remained virtually unchanged so far during 2001 (Chart 3). It declined 0.5% in the third quarter, after rising 1.1% in the second. Employment increased modestly in October and November, with a gain in part-time jobs offsetting loses in full-time employment.

The unemployment rate has risen modestly during the year. It increased to 7.5% in November from 7.3% in October and a recent low of 6.6% in June 2000.

Interest rates fall further

In response to economic weakness, the U.S. Federal Reserve has lowered its target for the Federal Funds rate 10 times during 2001 for a total decline of 450 basis points. The most recent change was a 50-basis-point decline on November 6. The Bank of Canada has lowered its Bank Rate nine times over the same period by a total of 350 basis points, including a 50-basis-point drop on November 27.

Chart 3
Employment and the unemployment rate



Short-term market interest rates in the United States have fallen roughly in line with the reductions in the Federal Funds target rate over the last three months. However, after initially dipping, long-term rates have risen somewhat, although not back to the levels of late August. Canadian interest rates have generally moved with those in the United States in recent months.

The value of the Canadian dollar fell to an all-time low close of 62.37 cents against the American dollar on November 9. It has since rebounded to close at 63.59 cents U.S. on December 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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