THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE MARCH 2002

OVERVIEW

- In the fourth quarter of 2001 real gross domestic product (GDP) increased 2.0%, following a 0.6% decline in the third quarter. Growth for 2001 as a whole was 1.5%.
- Consumer expenditure rose 4.2% in the fourth quarter. This and a large gain in residential investment led to a 0.8% increase in final domestic demand despite a drop of 31.3% in investment in machinery and equipment.
- Foreign demand decreased, with real exports falling 3.2%. Real imports, however, plunged 15.6%, implying that the increase in domestic demand was satisfied by current Canadian production and previously acquired inventories, rather than through foreign-produced goods and services.
- Business inventories dropped by $12.4 billion, subtracting about 4 percentage points from growth.
- Falling world energy prices again reduced export prices, offsetting the boost to the trade balance from lower real imports. The current account surplus dropped $2.8 billion to $13 billion.
- Employment rose modestly in the fourth quarter but jumped by nearly 76,000 in January. The unemployment rate, which had risen to 8.0% in December, dipped to 7.9% in January.

Real GDP rebounds

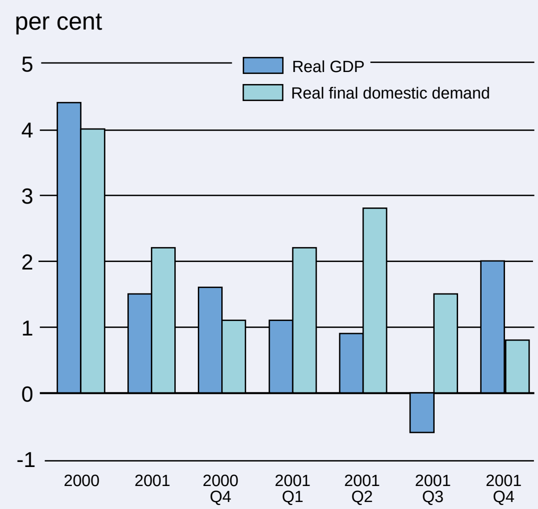
Real GDP rose in the fourth quarter after a modest decline in the third (Chart 1). Demand growth for domestic goods and services was satisfied by increased Canadian production and a rundown in inventories.

Consumers spend more

Real consumer expenditure jumped 4.2% in the fourth quarter. Spending on all major categories of goods rose, especially automotive products, partly as a result of

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, February 28, 2002.

Chart 1
Growth in real GDP
and real final domestic demand



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

	2000	2001	2001:Q2	2001:Q3	2001:Q4	Most recent	
Real gross domestic product	4.4	1.5	0.9	-0.6	2.0		–
Final domestic demand	4.0	2.2	2.8	1.5	0.8		–
Government expenditure							–
Goods and services	2.2	2.2	5.5	1.5	1.6		–
Gross fixed capital	7.6	6.8	2.6	9.4	19.1		–
Consumer expenditure	3.6	2.5	1.7	-0.7	4.2		–
Residential investment	2.7	4.4	2.3	4.0	20.7		–
Business fixed investment	8.1	-0.7	4.4	9.5	-23.1		–
Non-residential construction	5.3	0.9	1.1	-2.8	-7.5		–
Machinery and equipment	9.7	-1.6	6.4	17.7	-31.3		–
Business inventory investment ($ billion)	9.2	-3.3	1.5	-2.5	-12.4		–
Exports	7.6	-3.7	-5.4	-9.2	-3.2		–
Imports	8.1	-5.7	-0.8	-7.4	-15.6		–
Current account balance							
(nominal $ billion)	26.9	29.1	34.3	15.7	13.0		–
(percentage of GDP)	2.5	2.7	3.1	1.5	1.2		–
Nominal personal income	6.1	3.8	-0.1	1.4	2.9		–
Nominal personal disposable income	5.6	4.3	-0.4	2.7	5.3		–
Real personal disposable income	3.5	2.3	-4.8	2.0	5.7		–
Profits before taxes	21.8	-6.0	-14.8	-42.4	-20.5		–
Costs and prices (%, y/y)							
GDP price deflator	3.7	1.2	2.0	0.0	-0.9		–
Consumer price index	2.7	2.6	3.6	2.7	1.1	1.3	Jan-2002
CPI excluding eight most volatile items	1.3	2.0	2.3	2.4	1.8	1.8	Jan-2002
Unit labour costs	2.3	2.7	2.0	2.8	2.3		
Wage settlements (total)	2.5	3.2	2.9	3.4	3.0	2.6	Dec-2001
Labour market							
Unemployment rate (%)	6.8	7.2	7.0	7.2	7.7	7.9	Jan-2002
Employment growth	2.6	1.1	0.8	-0.2	0.5	6.2	Jan-2002
Financial markets (average)							
Exchange rate (cents US)	67.3	64.6	64.9	64.7	63.3	62.13	27-Feb-2002
Prime interest rate (%)	7.3	5.8	6.3	5.7	4.2	3.75	27-Feb-2002

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

incentives provided by manufacturers. Outlays for services were largely unchanged from their level in the previous quarter.

Spending was also supported by higher incomes. Personal income increased 2.9% and income taxes fell sharply, leading to a 5.3% increase in nominal personal disposable income. The personal savings rate rose to 3.7% from 3.4% in the previous quarter.

Residential investment strengthens

Residential investment, which is largely satisfied through domestic production, surged 20.7% in the fourth quarter, fuelled by reductions in interest rates throughout 2001. This sixth consecutive increase saw gains in new construction, the house resale market and renovations, as housing starts jumped at an annual rate of 45% and sales of existing homes increased even more dramatically.

Business fixed investment decreases

Business spending on plant and equipment plunged 23.1% in the fourth quarter, following a gain of 9.5% in the third. Investment in import-intensive machinery and equipment fell 31.3% after rising 17.7% in the previous quarter. However, this decrease partly reflected a return to a more normal level following the purchase of a floating drilling rig in the previous quarter. Computer investment rose 5.5%, following four consecutive quarters of decline. The sharp decline in telecommunications equipment investment continued, with a loss of 43.8% in the quarter.

Non-residential construction, which is largely satisfied by domestic production, decreased a more modest 7.5%, the second consecutive loss. This reflected decreased spending on both building and engineering projects.

Businesses accelerate inventory reduction

Businesses lowered their inventories by $12.4 billion in the fourth quarter compared with $2.5 billion in the third quarter. The faster pace of inventory reduction subtracted about 4 percentage points from growth.

Exports decline while imports plunge

As a result of slow world economic growth, foreign demand for Canadian goods and services decreased in the fourth quarter. Real exports fell 3.2%, with notable drops in services related to travel and transportation.

Real imports fell 15.6%, with the largest decline in machinery and equipment. Imports of automotive and energy products, as well as spending on travel and transportation, also fell. With the decline in imports, increased domestic demand was satisfied through increased Canadian production and a rundown of previously accumulated inventories.

Current account remains in surplus

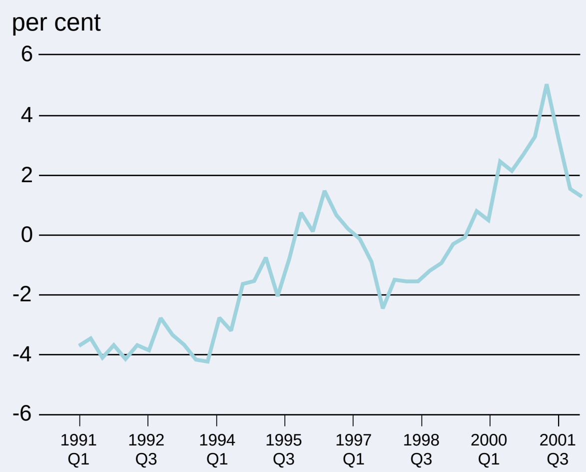
Although real imports declined more than real exports, a significant drop in export prices (particularly for energy products) lowered the nominal trade balance from its third-quarter level. This, combined with a $1.5-billion worsening in the investment income deficit, lowered the current account surplus by $2.8 billion to $13 billion, or 1.2% of GDP (Chart 2).

For 2001 as a whole the current account surplus, at $29.1 billion or 2.7% of GDP, reached a record level. This was $2.2 billion greater than in 2000 and a significant improvement from the deficits registered throughout most of the 1990s.

Inflation remains subdued

Underlying price and cost pressures remained subdued in the fourth quarter. Falling world energy prices led to a third consecutive decline in the GDP deflator. This comprehensive measure of inflation dropped 2.6% in the fourth quarter, leaving it 0.9% below its level of a year earlier. Consumer price inflation also remained subdued at 1.3% in January. Core CPI inflation, which excludes the eight most volatile items, was 1.8% in that month.

Chart 2
Current account as a percentage of nominal GDP



Labour productivity measured as output per employed person rose 1.4% while output per hour worked jumped 5.4%. Labour costs per unit of output were 2.3% higher than a year earlier, compared to 2.8% in the third quarter.

Corporate profits fall

Corporate profits decreased 20.5%, the third consecutive drop following 11 consecutive quarterly gains. This brought profits to 19.9% below the level of a year earlier. Declining profits were particularly notable among financial industries and in the energy sector, the latter reflecting falling world commodity prices.

Employment grows

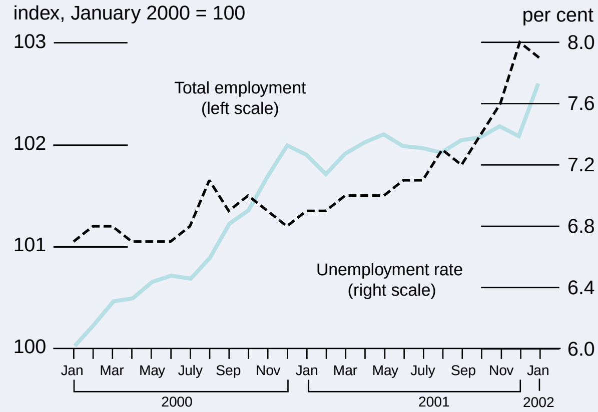
After falling 0.2% in the third quarter, employment rose 0.5% in the fourth with the gain entirely in part-time jobs, as full-time employment fell (Chart 3). A further 76,000 jobs were added in January, with strong gains in both full- and part-time employment.

The unemployment rate trended modestly upward from a recent low of 6.7% in June 2000 to 7.2% in September 2001. It rose further to 8.0% in December 2001 before dipping to 7.9% in January. Slower employment growth during 2001 and rising labour force participation after September accounted for the overall upward trend.

Short-term market interest rates decline

In response to economic weakness, the US Federal Reserve lowered its target for the Federal Funds rate 11 times during 2001 and early 2002 for a total decline of 475 basis points. The most recent change was a 25-basis-point decrease on December 10, with the rate held steady in January.

Chart 3
Employment and the unemployment rate



The Bank of Canada reduced its key policy rate 10 times over the same period by a total of 375 basis points, including a 25-basis-point drop on January 15.

Short-term market interest rates in the United States have fallen roughly in line with the reductions in the Federal Funds target rate since the beginning of 2001. Long-term rates only began to decline in the late summer of 2001, but they have since risen back to levels near those at the end of 2000. Canadian short-term interest rates have also moved with the key policy rate. Canadian long rates are presently near their levels at the end of 2000.

The value of the Canadian dollar fell to an all-time closing low of 62.02 cents against the American dollar on January 18. However, in recent years the Canadian dollar has outperformed most other major currencies. It closed at 62.13 cents US on February 27.

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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