



Industry  
Canada

Industrie  
Canada

# ***M***icro-Economic *Monitor*

---

**Second Quarter 2003**

Micro-Economic Analysis Directorate, Policy Sector, Industry Canada  
This document is based on data up to September 12 and is also available on the Internet at  
[http://strategis.ic.gc.ca/sc\\_ecnmy/mera/engdoc/04.html](http://strategis.ic.gc.ca/sc_ecnmy/mera/engdoc/04.html)

Canada

## Table of Contents

***Overview***

**A**

***Domestic Scene***

**Real Economic Activity**

**B**

**Income Side**

**C**

**Labour Situation**

**D**

**Sectoral Overview**

**E**

**Productivity and Competitiveness**

**F**

**International Accounts**

**G**

**Price Movements**

**H**

**Financial Variables**

**I**

**Fiscal Track**

**J**

***U.S. Developments***

**K**

***Annex: Unforeseen shocks have impacted the Canadian economy***

# Overview

## Real GDP growth stalled in the second quarter...

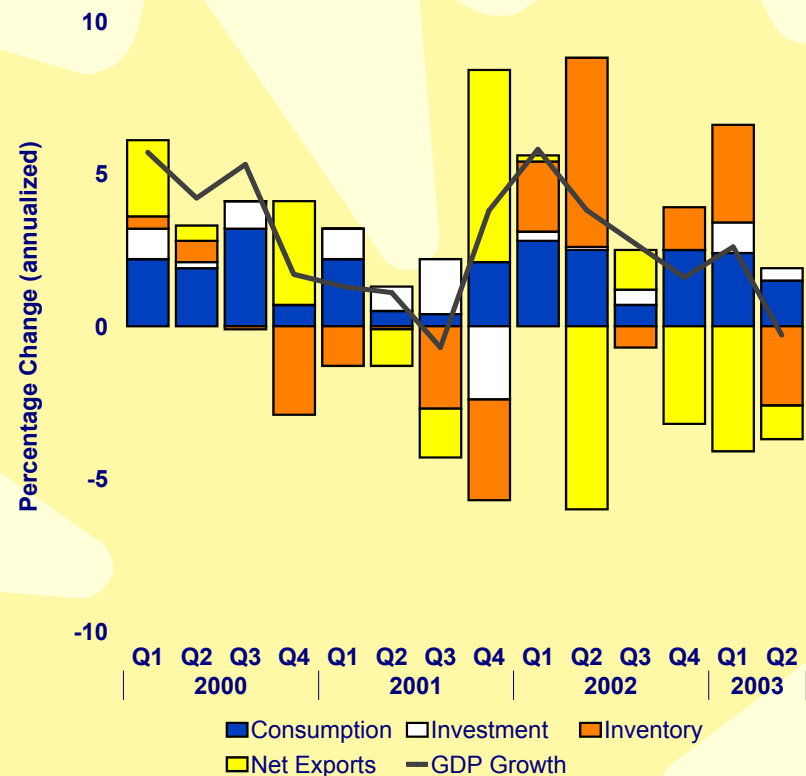
Real Gross Domestic Product (GDP) retreated 0.3% (annualized) in the second quarter, following an increase of 2.6% in the first quarter. This reflected the economic impact of the Severe Acute Respiratory Syndrome (SARS) outbreak and an isolated case of mad cow disease. The appreciation of the Canadian dollar and global economic weakness also contributed to the slowdown.

A reduction in business investment in inventories, combined with lower exports of services and higher imports, led to the contraction of GDP in the second quarter. Meanwhile, domestic demand remained strong, advancing 2.9%.

After five consecutive quarterly increases, corporate profits fell 28.9% in the second quarter, mostly due to lower profits in the energy sector. Despite slower employment growth, real disposable income grew 3.4% compared to 0.4% in the first quarter.

In the United States (U.S.), real GDP rose 3.1%, after increasing 1.4% in the first quarter. This combined with job losses led to a sharp increase (7.2%) in the labour productivity in the business sector. Canada's labour productivity rose 0.4% in the second quarter.

### Contributions to Quarterly Real GDP Growth\* (Annualized)



\* For the purpose of simplification and given their relative stability over time, contributions from government expenditures are not shown.

Source: Statistics Canada

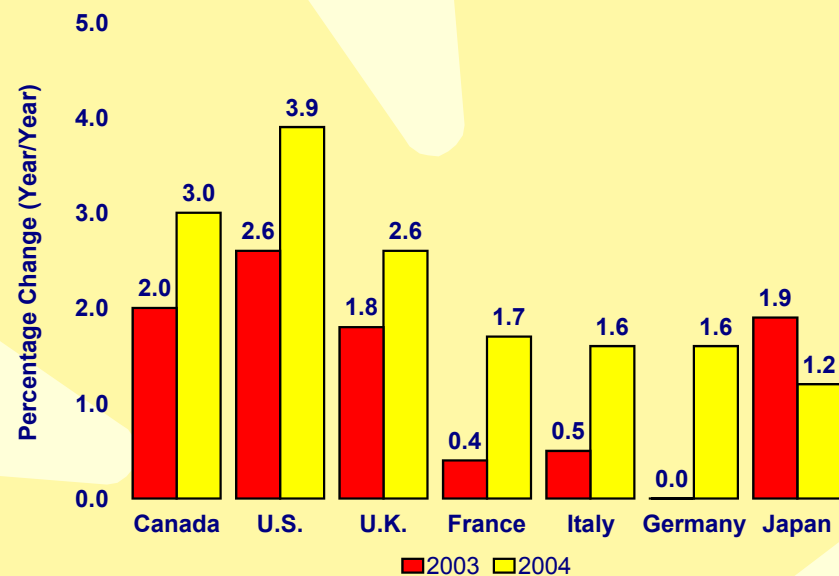
## ***...but the economic situation is expected to improve***

In light of economic slowdown and falling inflation, the Bank of Canada lowered its policy rate by 25 basis points in June and again in September to 2.75%. The U.S. Federal Reserve kept its funds rate at 1% on September 16.

Low interest rates continue to underpin housing markets in both countries. Moreover, a slew of other economic indicators point to improving economic conditions, particularly in the U.S. However, events such as the blackout in Ontario, forest fires in Western Canada are dampening growth prospects in the third quarter.

In line with these developments, analysts have scaled down their growth forecast for Canada in 2003 to 2.0%, from 2.3% in July and 3.2% in January, with a pick up expected in the fourth quarter as the lingering effects of temporary shocks will likely recede. On the other hand, U.S. growth for 2003 has been revised upward to 2.6% from 2.3% in July.

### **Real GDP Growth Outlook**



Source: Consensus Forecasts (U.K.), September 2003  
Consensus Economics Inc.



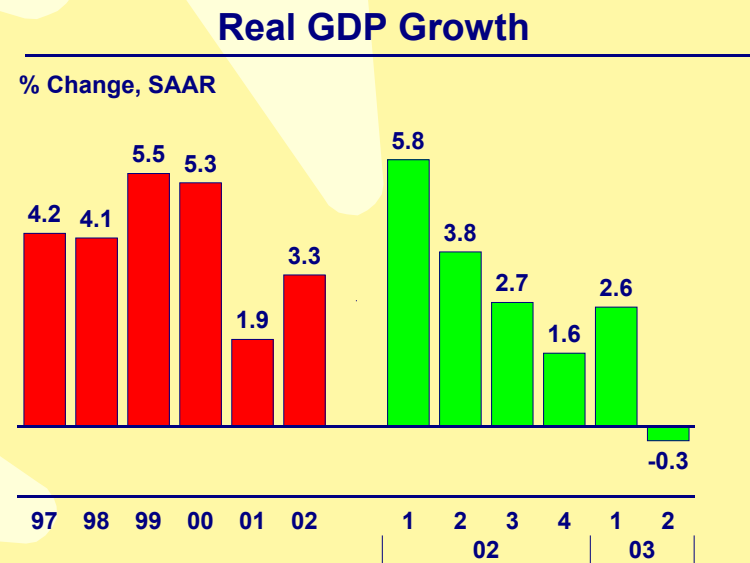
**Domestic Scene**

*Real Economic Activity*

## ***The economy contracted in the second quarter...***

**Real GDP decreased at an annualized rate of 0.3% in the second quarter, after rising 2.6% in the first quarter.**

**- A reduction in inventory investment, lower exports of services, and higher imports led to the contraction of GDP.**



**U.S. real GDP grew 3.1% in the second quarter, up from 1.4% growth in the first quarter, supported by defense and consumer spending as well as a small rebound in business investment.**

**...dragged down by a decline in inventory investment...**

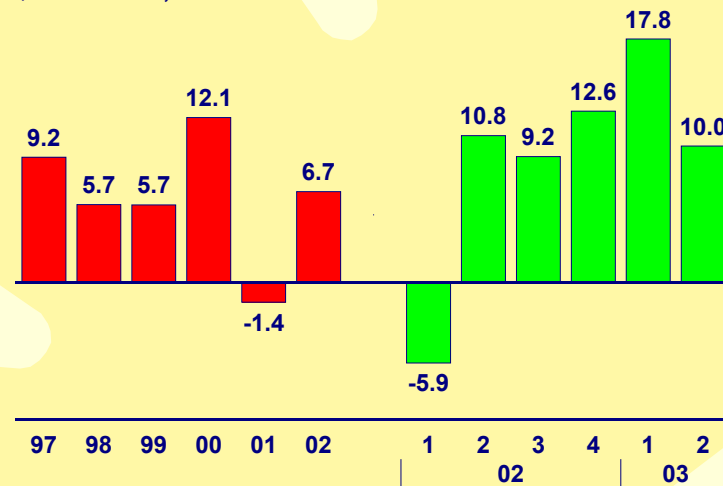
**Non-farm inventory investment fell from \$17.8 billion in the first quarter to \$10.0 billion in the second quarter.**

- Lower motor vehicle inventories contributed most to the slowdown.

Despite this decline, the inventory-to-sale ratio remained stable. According to the business conditions survey in July, a rising number of manufacturers felt their inventory levels may be too high in the coming months.

### Non-farm Business Inventory Investment

\$1997 Billion, SAAR



Source: Statistics Canada



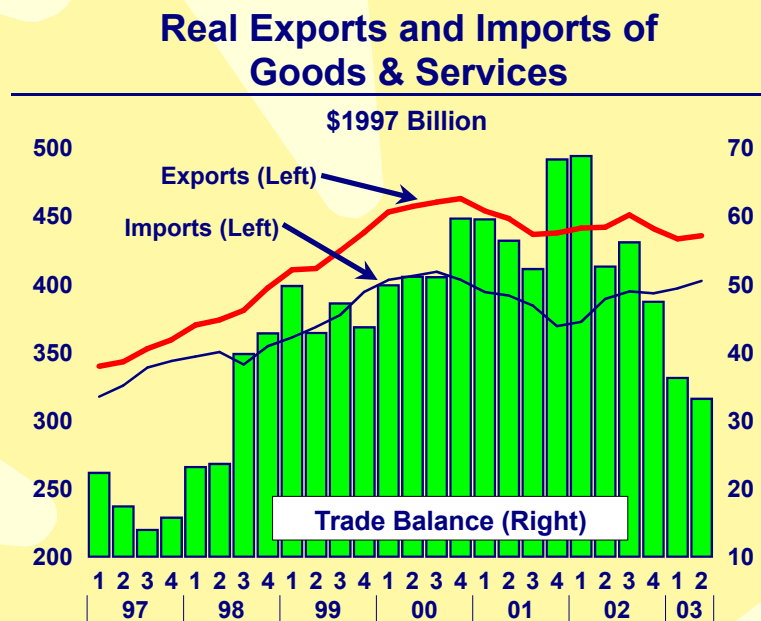
**...and higher imports, which led to a lower trade surplus**

Real exports rose 2.2% in the second quarter, following a 6.7% drop in the first quarter.

- Exports of goods advanced, but exports of services, particularly travel-related, declined.

Imports rose 5.6%, following 3.8% growth in the previous quarter, leading to a lower trade surplus.

- Imports of machinery and equipment, automotive products, and consumer goods increased.



Source: Statistics Canada

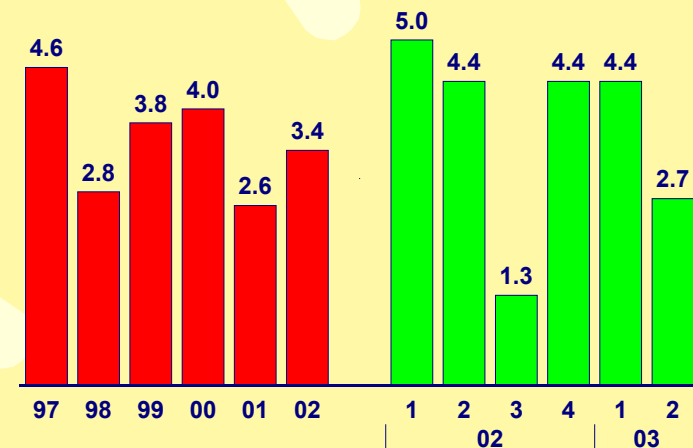
## Consumer spending slowed...

After a 4.4% increase in the first quarter, consumer spending growth moderated to 2.7% in the second.

- The slowdown was concentrated in spending on non-durables and semi-durables. Spending on durables, such as furniture and household appliances, advanced 3.9% after declining 0.1% in the first quarter.
- Spending on services, which grew 3.6% in the second quarter compared to 5.3% in the first, contributed most to overall growth.

### Real Consumer Expenditure Growth

% Change, SAAR



Source: Statistics Canada

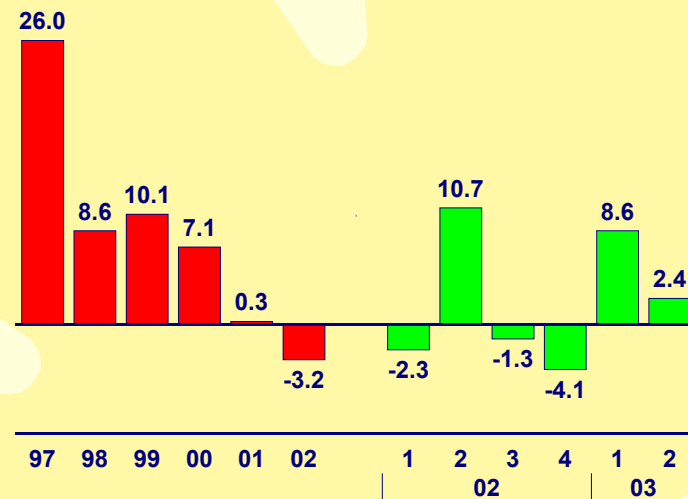
## *...as did investment in Machinery and Equipment*

Business investment in Machinery and Equipment (M&E) rose 2.4% in the second quarter, following 8.6% growth in the first quarter.

- Industrial machinery and office equipment accounted for most of the increase.

### Real Machinery & Equipment Investment

% Change, SAAR



Source: Statistics Canada

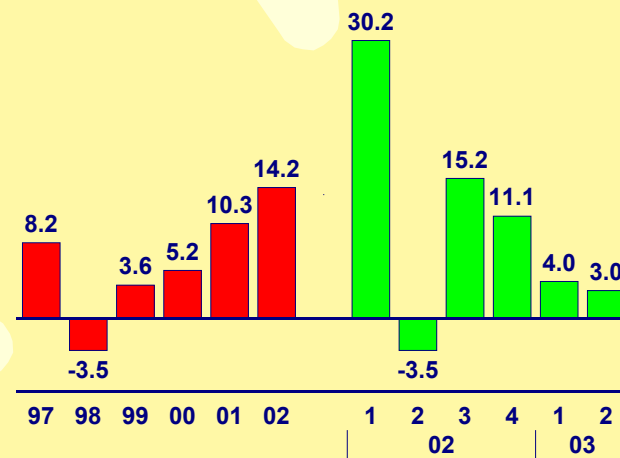
## ***Housing activity helped support the economy...***

Residential investment rose by 3.0% in the second quarter after rising 4.0% in the first quarter.

- After a strong first quarter, average housing starts declined in the second quarter to 201,600 units. The housing market held its momentum into the third quarter with housing starts reaching 233,900 in August.

### **Real Residential Construction Growth**

% Change, SAAR

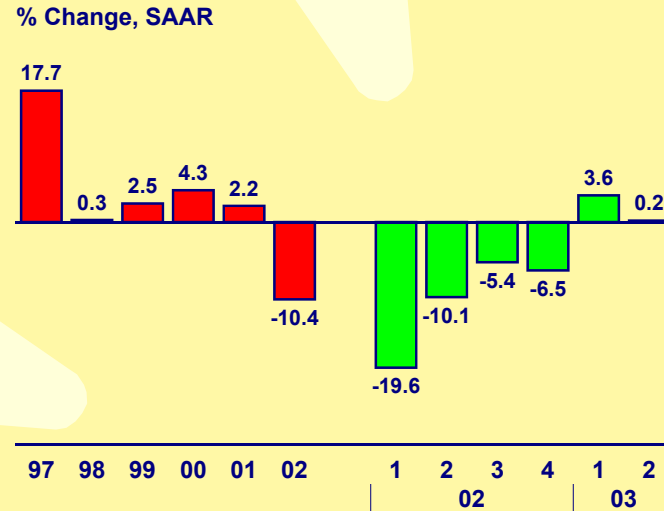


Source: Statistics Canada

**...and non-residential construction posted small growth**

Following six consecutive negative quarters, non-residential construction rebounded in the first quarter of 2003 and rose 0.2% in the second quarter.

**Real Non-residential Construction Growth**



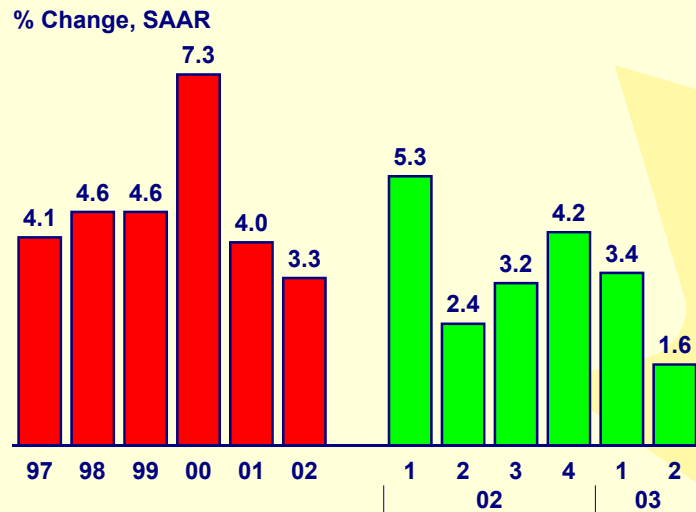
Source: Statistics Canada

**Domestic Scene**

*Income Side*

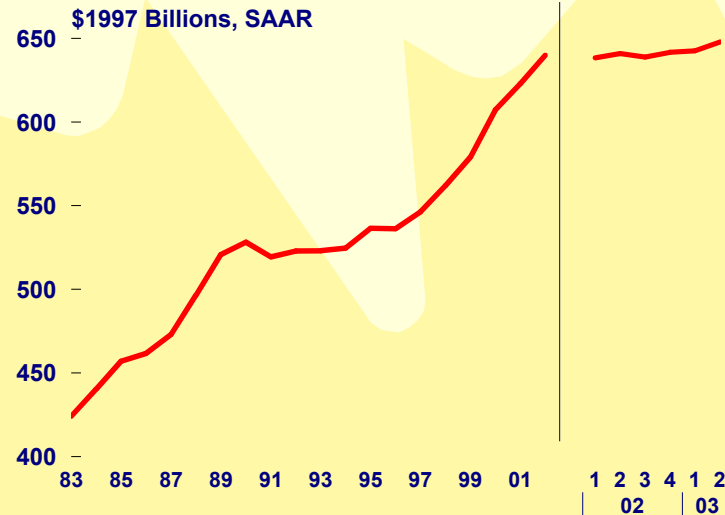
## Personal income growth continued in the second quarter...

### Growth in Personal Income



Source: Statistics Canada

### Real Personal Disposable Income\*



\*Converted to real dollars using the chain price index for personal expenditure on goods and services.  
Source: Statistics Canada and Industry Canada

Personal income growth moderated to 1.6% in the second quarter, from 3.4% in the first. The deceleration in personal income was the result of slower growth in unincorporated business income, and major downturns in investment income and non resident transfers, which offset significant gains in corporate and government transfers.

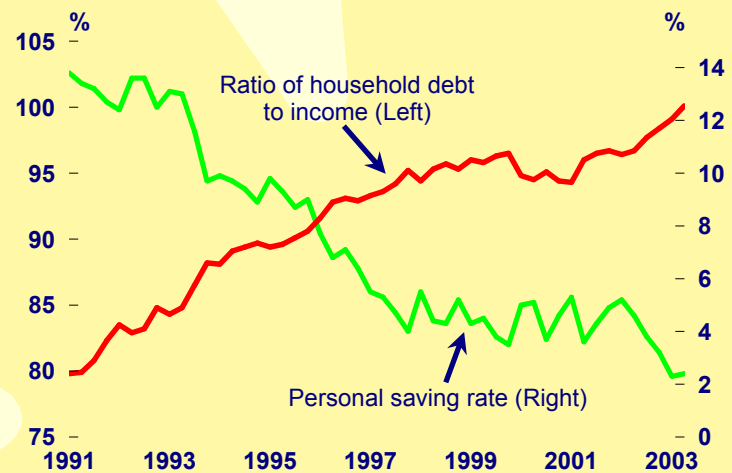
Personal disposable income rose by 2.6%, down from 3.1% in the first quarter. Real personal disposable income growth, on the other hand, surged to 3.4% from 0.6% in the first quarter. Real disposable income per capita is now 14.1% above its low point reached in the second quarter of 1996.

## *...and the savings rate rose*

With personal income growth exceeding that of consumer expenditure, the personal savings rate edged up slightly to 2.4% in the second quarter from 2.3% in the first, following four straight quarterly declines.

The household debt-to-income ratio experienced its fifth consecutive increase, rising a full percentage point to a record 100.1%, due to the continuously higher rate of growth of consumer and mortgage debt relative to personal disposable income. The rise in mortgages is consistent with a strong housing market.

### Personal Debt and Savings Rate



Source: Statistics Canada

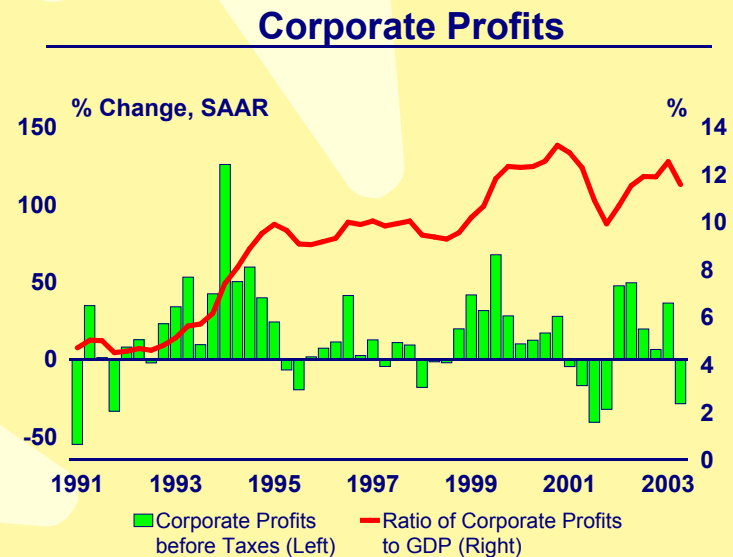


## Corporate profits retreated

Following five consecutive quarters of growth, including a record level obtained in the first quarter, corporate profits fell (7.3%) in the second quarter.

- Profits were sharply down in the oil & gas extraction industry as crude oil prices declined almost 20% with easing of supply concerns. Manufacturing also reported a drop in profits.
- On the positive side, financial industries registered an overall 3.7% profit increase, led by strong gains in insurance company profits.

The profit share of GDP declined to 11.6% in the second quarter from 12.5% in the previous quarter, but remained above the 10-year average of 10.2%.



Source: Statistics Canada

**Domestic Scene**

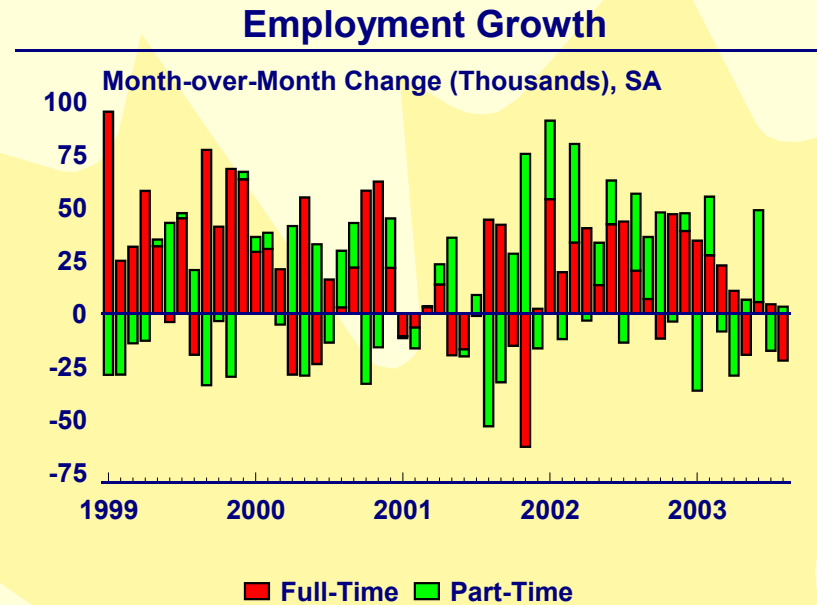
***Labour Situation***

## ***Labour market conditions weakened further in recent months...***

In August, employment edged down by 19,000. This was the fifth monthly decline in 2003. In the first eight months of 2003, 52,000 jobs have been created, compared to 398,000 a year earlier.

- Job losses in August were all in full-time employment (22,000). However, 63,000 full-time jobs have been created since the start of 2003.

U.S. employment conditions remained weak in August. Non-farm employment decreased by 93,000, following the loss of 49,000 jobs in July. The unemployment rate edged down 0.1 percentage point to 6.1% .



Source: Statistics Canada

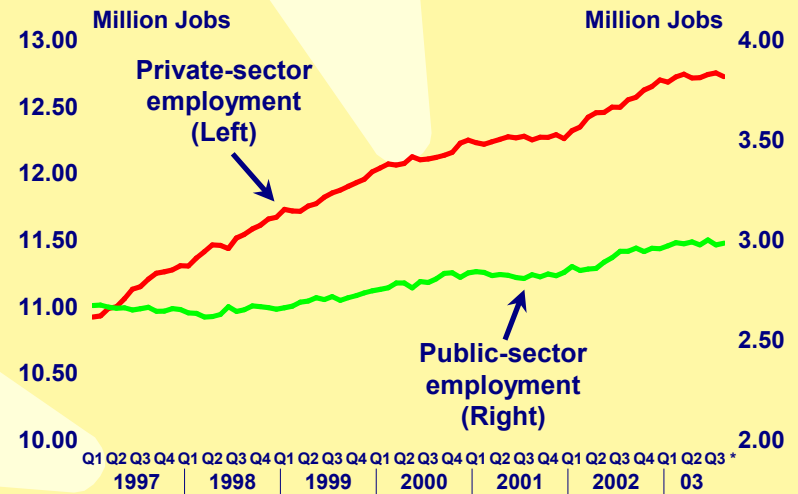
According to Statistics Canada, the blackout in Ontario is unlikely to have impacted the employment or unemployment estimates. People employed at any time during the week of August 10 to 16, the Labour Force Survey reference week, are considered 'employed' even if they were laid off after the power outage. The number of full-time and part-time workers is based on the usual hours worked, which would not be affected by the blackout. However, 1.3 million people missed work between August 14 and 16 resulting in the sharpest drop on record in hours worked (-5.9%).

**...as job losses in the private sector overwhelmed gains in the public sector and in self-employment**

**Paid employment fell (38,000) in August, as a small increase in public sector employment (+9,000) was accompanied by job losses in the private sector (46,000). For the first eight months of the year, paid employment is down slightly, as job losses in the private sector (35,000) more than offset job gains in the public sector (28,000).**

**Self-employment was up 19,000 in August and has accounted for the creation of 59,000 jobs since the beginning of 2003.**

**Employment: Private vs. Public**



\*Data for 2003Q3 includes July and August only.

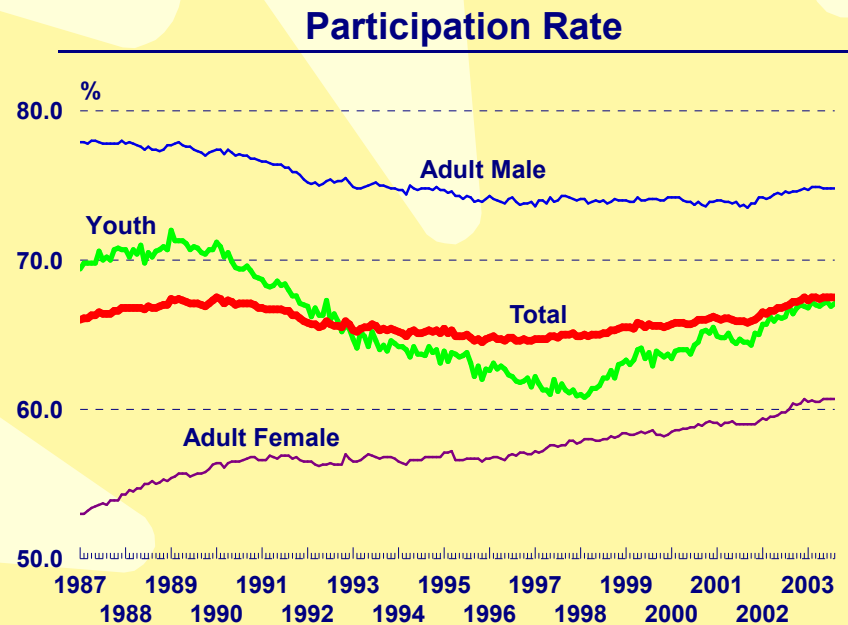
Source: Statistics Canada

## ***The labour force increased, leaving the participation rate at a record high...***

The labour force increased by 25,000 in August, leaving the participation rate at 67.5%, the highest level on record. It is 4.7% above the low of 64.5% posted in November 1995.

The participation rate has been trending up, particularly since mid 2001. The increase is consistent with much improved economic conditions in Canada, which led the G-7 in terms of growth in output and employment over the 1997-2002 period. This has enticed more Canadians to enter the labour force, particularly youth whose participation rate has increased from 60.8% in February 1998 to 67.1% in August 2003.

The rate for adult men has recovered from a low of only 73.5% in September 2001, to 74.8% in August 2003. The adult female participation rate has continued its long-term trend, reaching 60.7% in August.



Source: Statistics Canada

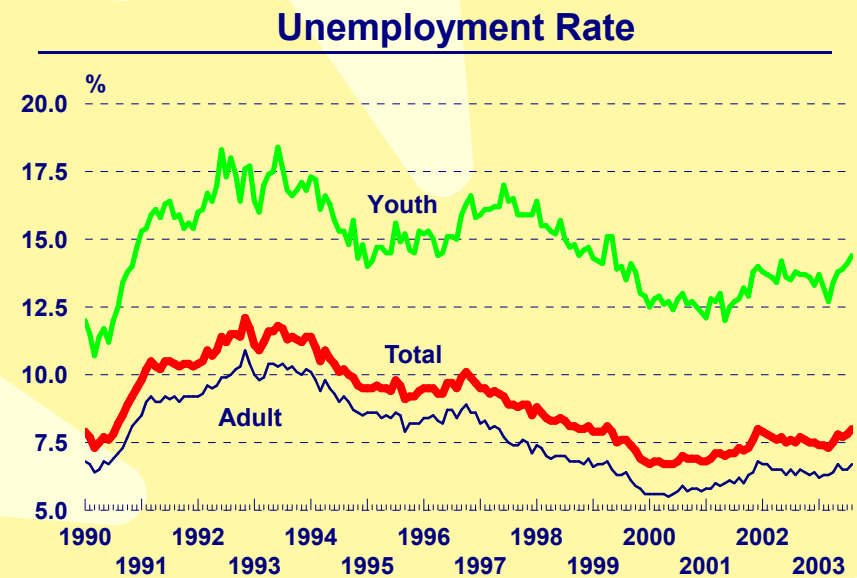
**and pushing up the unemployment rate to 8.0%**

The unemployment rate rose by 0.2 percentage point to 8.0% in August, equal to its recent peak in December 2001.

Youth lost 3,000 jobs in August, bringing job losses for the first eight months of 2003 to 12,000, all full-time jobs.

The youth unemployment rate rose 0.3 percentage point to 14.4%.

The adult unemployment rate was up by 0.2 percentage point for both adult men (to 7.0%) and adult women (to 6.4%).



Source: Statistics Canada

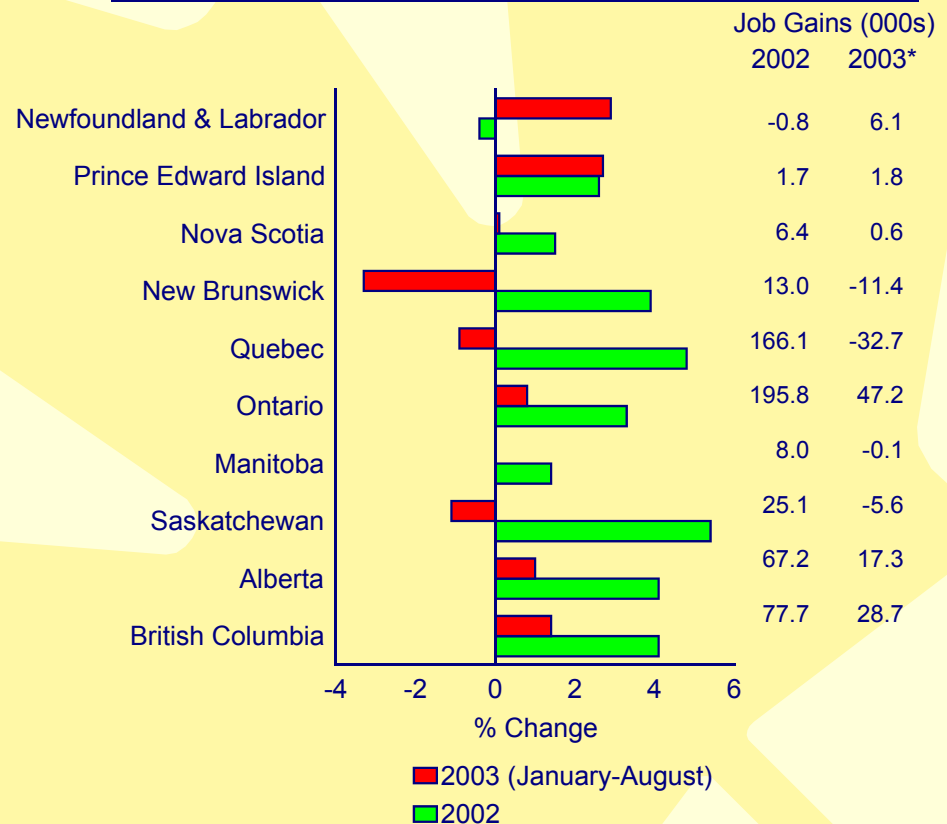
## Only four of the provinces posted job gains in August...

British Columbia posted the largest job gains in August (7,000). Services more than accounted for the overall growth, led by accommodations & food services and transportation & warehousing. Newfoundland & Labrador, Manitoba and Prince Edward Island posted small increases.

All other provinces posted job losses, led by Quebec (13,000), New Brunswick (7,000) and Ontario (6,000).

All provinces, except Newfoundland & Labrador, posted sizeable employment growth in 2002. So far this year, the largest job gains have been in Ontario and British Columbia, while the largest job losses have been in Quebec and New Brunswick.

### Employment Growth by Province



\*Figures for 2003 are year-to-date (January-August)  
Source: Statistics Canada

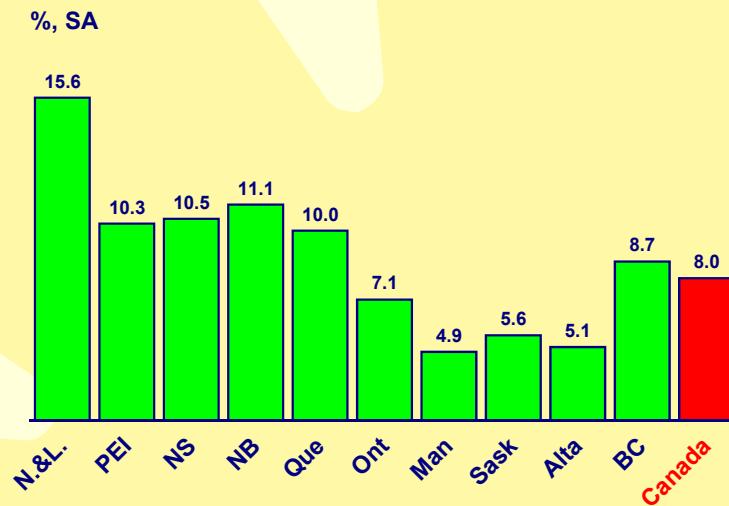
**...and the unemployment rate increased in six provinces**

In August, job losses pushed up the unemployment rate in Nova Scotia (1.3 percentage points), Quebec (0.9), New Brunswick (0.6), Saskatchewan (0.1) and Alberta (0.2).

The increase in the labour force was solely responsible for the increase of the unemployment rate in British Columbia (0.1).

Job gains pushed the unemployment rate down in Newfoundland & Labrador (0.2), Prince Edward Island (0.1) and Manitoba (0.2). Ontario's unemployment rate fell slightly (0.1), reflecting a larger decline in labour force than employment.

**Unemployment Rates: August 2003**



Source: Statistics Canada



**Domestic Scene**

***Sectoral Overview***

## Output in goods-producing industries, except construction, contracted in the second quarter...

Goods-producing industries declined 4.5% (annualized) in the second quarter, following a gain of 2.4% in the first. The decline was widespread, due in part to special factors, such as SARS and mad cow disease.

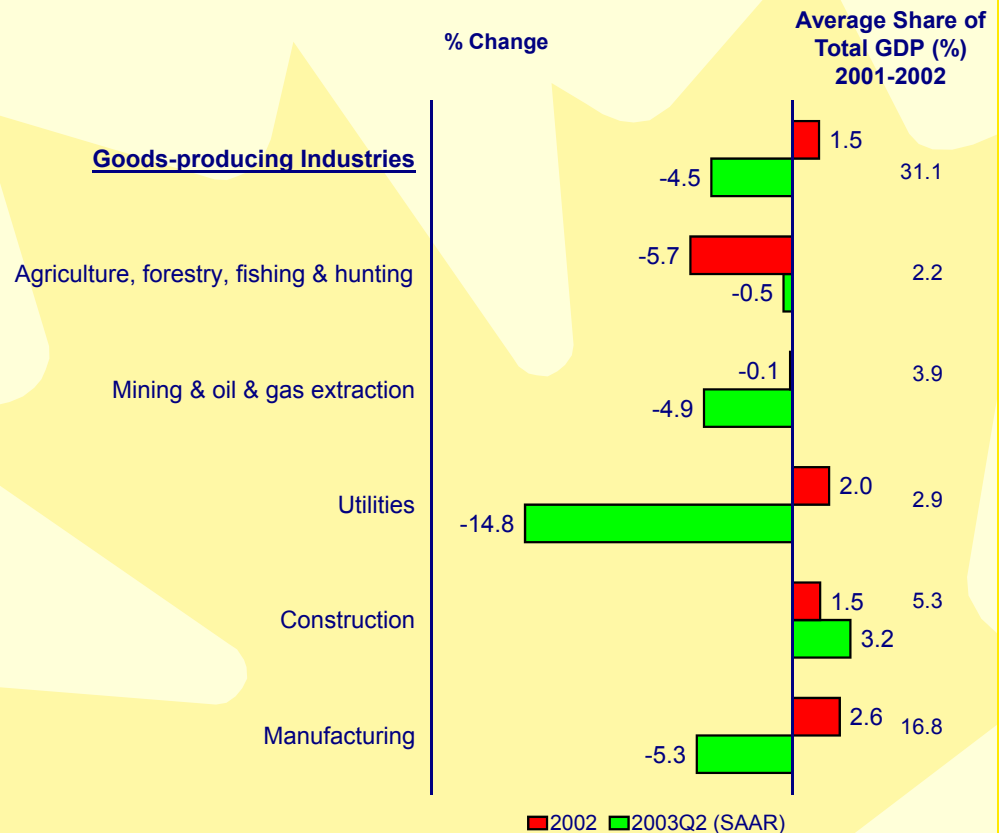
The sharp appreciation of the dollar since the beginning of the year, together with weak global economic conditions, has hit Canadian Manufacturing industries. Manufacturing output fell 5.3%, following a 0.7% drop in the first quarter.

- 16 of the 21 major groups reported decreases, particularly the Machinery group (10.4%), Electrical Equipment (9.3%) and Computers and Electronics (9.2%).

Lower industrial activity led Utilities to cut their output in the second quarter, partly explaining the sector's 14.8% drop in output.

The Construction sector posted a 3.2% gain this quarter, due to low interest rates and strong demand for housing.

Real GDP Growth by Industry: 2003Q2



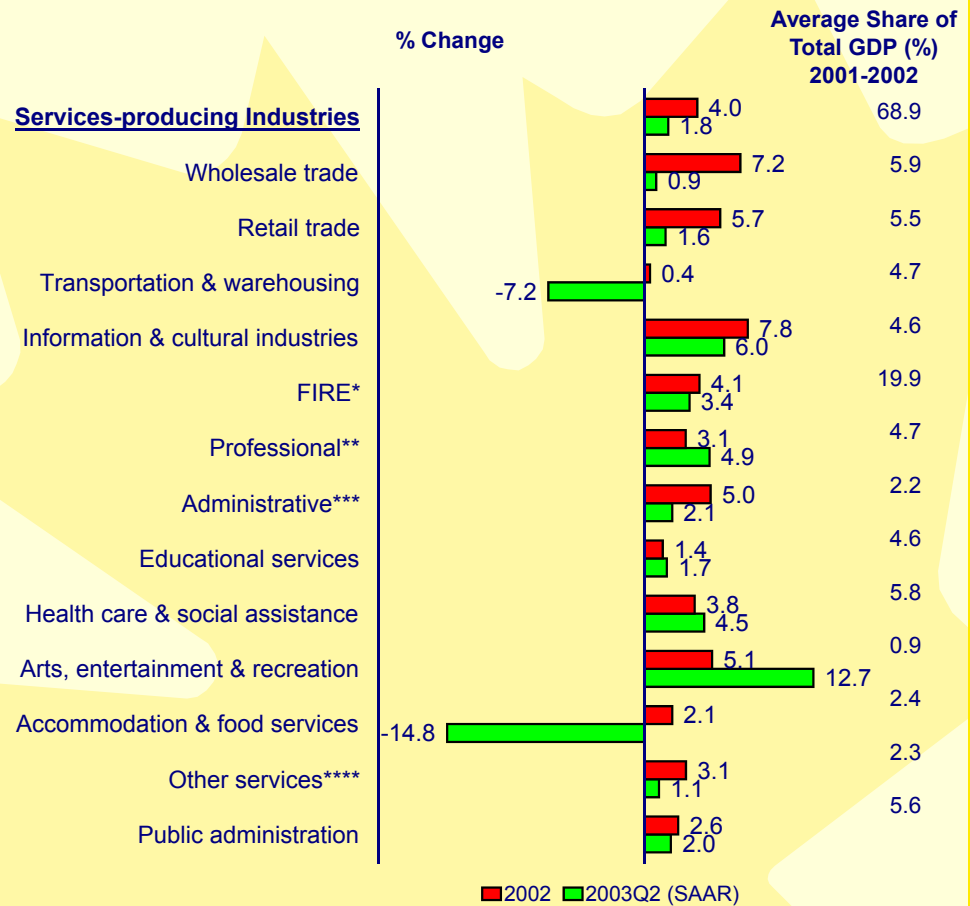
Source: Statistics Canada

**...while most of the service sector continued to grow**

Output growth in the Service sector slowed to 1.8% from 2.6% in the first.

- Output in the Arts, Entertainment & Recreation sector jumped 12.7%. The impact of SARS on the sector appeared limited to April's results (-5.6%), as the sector posted growth in both May (9.9%) and June (23.3%). Information and Cultural industries also posted strong growth.
  - Output in the Accommodation & Food Services industries fell 14.8% in the second quarter. This reflected a large drop in output in April (37.1%), which was followed by some recovery in both May (10.9%) and June (4.1%).
  - Moreover, lower exports negatively affected Transport & Warehousing industries, where output fell 7.2%.
- The industry recovered somewhat in June (5.7%), following double-digit declines in both April and May.

**Real GDP Growth by Industry: 2003Q2**



\* Includes Finance & insurance, real estate & renting & leasing & management of companies & enterprises  
 \*\* Includes Professional, scientific & technical services  
 \*\*\* Includes Administrative & support, waste management & remediation services  
 \*\*\*\* except public administration

Source: Statistics Canada

## Corporate operating profits edged down in the second quarter

Corporate profits fell 7.3% in the second quarter of 2003, but are still up 11.7% from the same period last year. Lower profits were due to weaker economic conditions, lower oil prices, and a stronger Canadian dollar.

- Profits in the Mineral Fuels sector fell 31.4%, as crude oil prices fell 20% on easing of supply concern. However, profits were still 39.9% higher than a year ago.
- In the Manufacturing sector, profits fell by 10.0%, following an increase of 5.5% in the first quarter. The declines were concentrated in petroleum & coal, primary metals and motor vehicle industries.
- Profits declined 24.4% in the Transportation & Warehousing sector, as transportation carriers felt the effect of the weaker economy .

Profits in the Financial sector rose by 3.7% in the second quarter, the third consecutive quarterly increase.

- The increase was driven by a rise of 17.8% in insurance company profits.

### Corporate Operating Profits, 2003Q2

	2003Q2 Level (\$M)	Difference		
		03Q1-03Q2 (\$M)	02Q2-03Q2 (%)	
<b>Total - All Industries</b>	<b>40,425</b>	<b>-3,170</b>	<b>-7.3</b>	<b>11.7</b>
<b>Total Non-Financial</b>	<b>30,705</b>	<b>-3,513</b>	<b>-10.3</b>	<b>10.4</b>
Agriculture, forestry, fishing & hunting	491	16	3.4	4.0
Mineral fuels	4,463	-2,041	-31.4	39.9
Mining except mineral fuels	233	19	8.9	-0.4
Utilities	796	1	0.1	-8.9
Construction	636	-182	-22.2	191.7
Manufacturing industries	9,460	-1,052	-10.0	-1.9
Wholesale trade industries	3,233	193	6.3	22.5
Retail trade industries	2,227	-109	-4.7	9.1
Transportation and warehousing	1,081	-349	-24.4	-7.9
Information and cultural industries	2,091	84	4.2	2.8
Real estate, rental and leasing	3,437	79	2.4	19.0
Professional/Scientific	652	-92	-12.4	8.8
Management of companies	2,788	-79	-2.8	-15.9
Other services to business	403	-46	-10.2	-22.1
Education services	-27	-1	3.8	17.4
Health care and social assistance	577	26	4.7	16.8
Arts, entertainment and recreation	104	-39	-27.3	10.6
Accommodation and food services	384	-17	-4.2	-33.6
Other services	464	-4	-0.9	236.2
<b>Total Financial</b>	<b>9,720</b>	<b>343</b>	<b>3.7</b>	<b>15.9</b>
Depository credit intermediation	4,198	96	2.3	29.7
Non-depository credit intermediation	1,398	22	1.6	3.5
Insurers	1,731	262	17.8	82.6
Funds and other financial vehicles	177	2,109*	na	na
Other financial intermediaries	2,393	-36	-1.5	-16.0

\* Funds and other financial vehicles recorded a loss of \$1,932 in the first quarter of 2003.

Source: Statistics Canada

## Capital spending plans are revised up in 2003

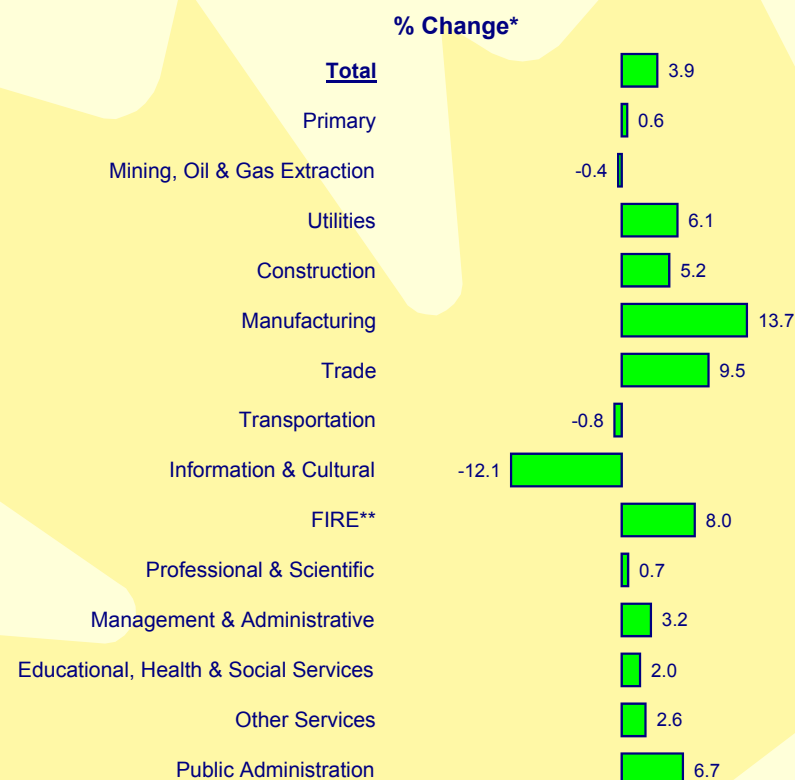
The July survey of private and public investment intentions (conducted from April to June 2003) reported that investment in Plant & Equipment is expected to increase 3.9% in 2003, revised up from an increase of 0.8% anticipated in February.

Helped by a stronger dollar, manufacturing industries now expect an investment increase of 13.7% in 2003, restoring nearly the entire decline recorded in 2002. The highest increase should be coming from motor vehicle manufacturing, paper mills and aluminium production.

Investment in Mining and Oil & Gas Extraction is expected to remain essentially unchanged. This is a better prospect than in February when a 8.9% decline was anticipated.

There is still no sign of renewed capital spending in the information and communication technology (ICT) sector, as a decline of 25.7% is anticipated in the manufacturing components.

### 2003 Revised Investment Intentions by Industry (Plant and Equipment)



\* Comparison between the revised intentions for 2003 and the preliminary actuals for 2002

Note: Primary includes Agriculture, Forestry, Fishing and Hunting; Trade includes Wholesale Trade and Retail Trade; Transportation includes Warehousing; \*\*FIRE represents Finance, Insurance, Real Estate, and Rental and Leasing; Professional & Scientific include Technical services; Management and Administrative includes Waste Management and Remediation services; Other Services include Arts, Entertainment, Recreation, Accommodation and Food services

Source: Statistics Canada Survey of Public and Private Investment Intentions

## Employment in the Service sector declined in August

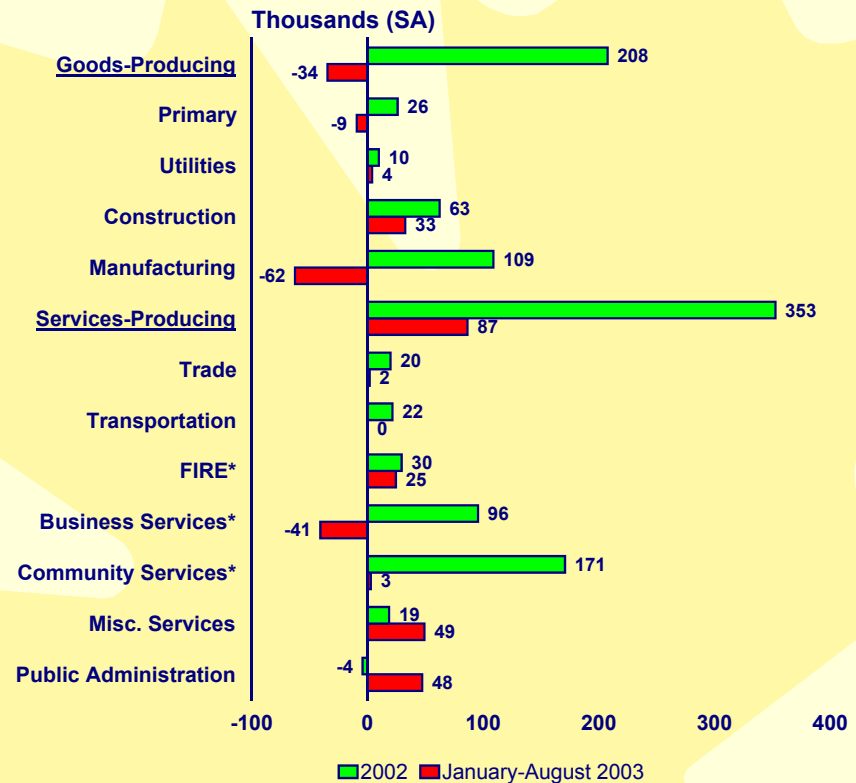
Employment in the Service sector decreased by 23,000 jobs in August, reducing job creation in the sector to 87,000 this year. The largest losses were posted by management, administration & other support and health care & social assistance. Public administration and accommodations & food services posted the largest gains.

- In 2003, employment growth in the service sector has been significantly weaker than in 2002, when 353,000 jobs were created. Business and educational services have actually declined in 2003.

Employment in the Goods sector edged up by 4,000 in August, but has lost 34,000 jobs since December. The overall increase was mainly due to construction (+11,000 jobs). Only 1,000 new jobs were lost in manufacturing. This sector has lost 62,000 jobs since December as a result of the sharp appreciation of the loonie and the earlier weakness in the U.S. economy.

- In 2002, employment in the Goods sector increased by 208,000 and in manufacturing by 109,000.

### Job Growth by Industry



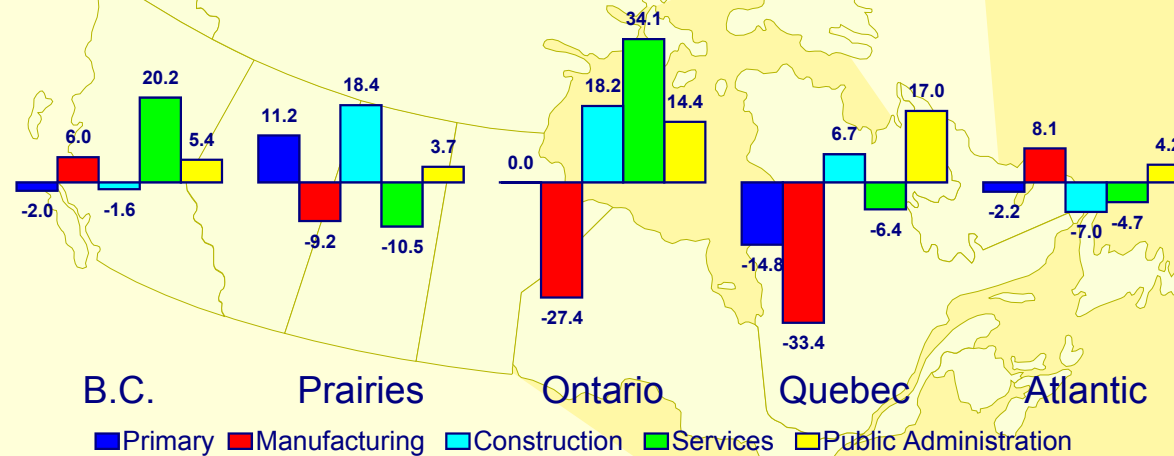
\* FIRE: Finance, Insurance, Real Estate and Leasing  
 Business Services: Management, Administrative, Professional, Scientific & Technical Services  
 Community Services: Educational Services, Health & Social Assistance.

Source: Statistics Canada

## In 2003, gains have been concentrated in Ontario

### Job Creation

Thousands  
Seasonally adjusted  
January - August 2003  
Source: Statistics Canada



On a year-to-date basis, manufacturing employment decreased in Quebec (-33,000), Ontario (-27,000) and the Prairies (-9,000). Atlantic Canada and British Columbia were the only regions to post manufacturing employment increases. Primary sector employment in Quebec and British Columbia was driven down by losses in agriculture. Construction employment fell in all regions, except Ontario and Quebec.

Employment gains in Services were solely due to gains in Ontario, British Columbia and the Prairies. Meanwhile, employment in public administration posted gains in all regions.

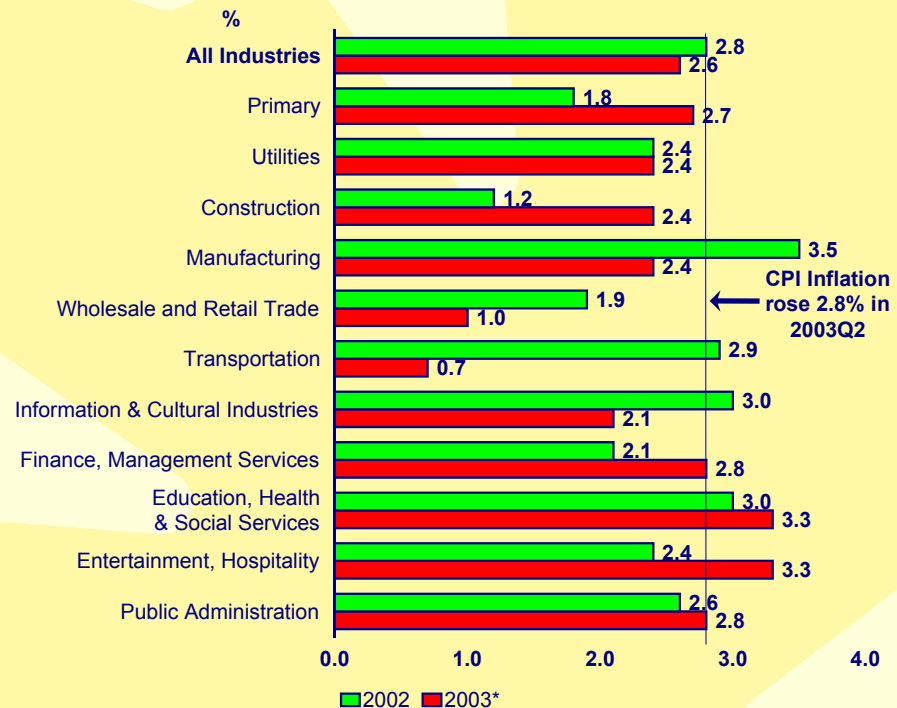
## Wage settlements remained below inflation in most industries

Wage settlements averaged 2.6% in the first six months of 2003, down slightly from the 2002 average, and 0.2 percentage point below the CPI inflation.

- Settlements in 9 of 11 industry groups were at or below the CPI inflation.
- Education, Health & Social Services and Entertainment & Hospitality posted the highest growth in wage settlements.

Public-sector wage settlements (+3.1%) were sharply higher than those in the Private sector (+1.2%) for the January to June period. However, private sector settlements were moderated significantly by the three Air Canada agreements in June, which provided 28,530 employees with a wage freeze or wage reduction averaging -0.5% over the life of the contracts.

### Wage Settlements by Industry



Effective average annual adjustments in base wage rates from major collective bargaining agreements.

\* 2003 data cover agreements reached over the January to June period.

Source: Human Resources Development Canada



## Capacity utilization fell in most industries in the second quarter

Capacity utilization fell 1.3 percentage points to 81.2% in the second quarter. This drop reflected the negative impact of SARS, mad cow disease and the appreciating Canadian dollar on output in several industries.

The capacity utilization rate in the Manufacturing sector declined to 82.5%, the third consecutive decline.

- The decline was broad-based, as 15 of 21 manufacturing groups posted decreases, particularly Clothing, Transportation Equipment, Wood Products and Primary Metals. Among the industries reporting increases were Chemical Products and Petroleum & Coal Products.

In the non-manufacturing sectors, utilization rates posted sharp declines in the Forestry & Logging sector and Electric Power Generation. The Construction sector posted the only increase.

### Capacity Utilization<sup>1</sup> : Non-farm Goods-producing Industries

	Level (%) 2003Q2	Change (% points) Q/Q	Y/Y	10-year Average
<b>Total Industrial</b>	<b>81.2</b>	<b>-1.3</b>	<b>-1.1</b>	<b>82.6</b>
Forestry & logging	77.6	-6.2	-1.3	80.1
Mining & oil & gas extraction	71.0	-1.3	-1.0	77.9
Electric power *	83.8	-4.7	-4.7	84.3
Construction	85.1	0.6	0.8	82.5
<b>Total Manufacturing</b>	<b>82.5</b>	<b>-1.2</b>	<b>-1.1</b>	<b>83.7</b>
Food	79.2	-0.9	-2.8	80.7
Beverage & tobacco products	78.4	1.3	-1.0	80.8
Textile mills	75.2	0.6	-1.9	81.4**
Textile product mills	74.7	-2.4	-5.8	79.1**
Clothing	77.3	-5.0	-4.0	82.7
Leather & allied products	64.3	-2.5	-7.1	74.1
Wood products	96.0	-3.8	2.0	87.4
Paper	93.5	0.1	4.0	90.4
Printing & related support activities	72.3	0.8	-2.6	77.6
Petroleum and coal products	95.6	2.3	-1.5	92.8
Chemical	85.2	1.2	5.0	82.5
Plastic & rubber products	86.4	-2.1	-2.8	84.5
Non-metallic mineral products	89.0	-0.2	5.8	79.5
Primary metal	90.6	-2.6	0.0	90.5
Fabricated metal products	83.4	-1.1	-1.2	81.2
Machinery	77.0	-2.0	-2.4	81.2
Computer & electronic products	61.0	-1.6	-7.2	79.6
Electrical equipment	72.3	-0.9	-2.3	83.3
Transportation equipment	86.0	-1.7	-2.7	86.1
Furniture & related products	80.3	-1.5	-1.6	81.7
Miscellaneous manufacturing	79.9	-2.9	-2.6	82.4

\* Electric power generation, transmission & distribution

\*\* Represents available data between 1997Q1-2003Q2

<sup>1</sup> Capacity utilization rates have been revised back to the first quarter of 2001 to include revisions in the source data.

Source: Statistics Canada



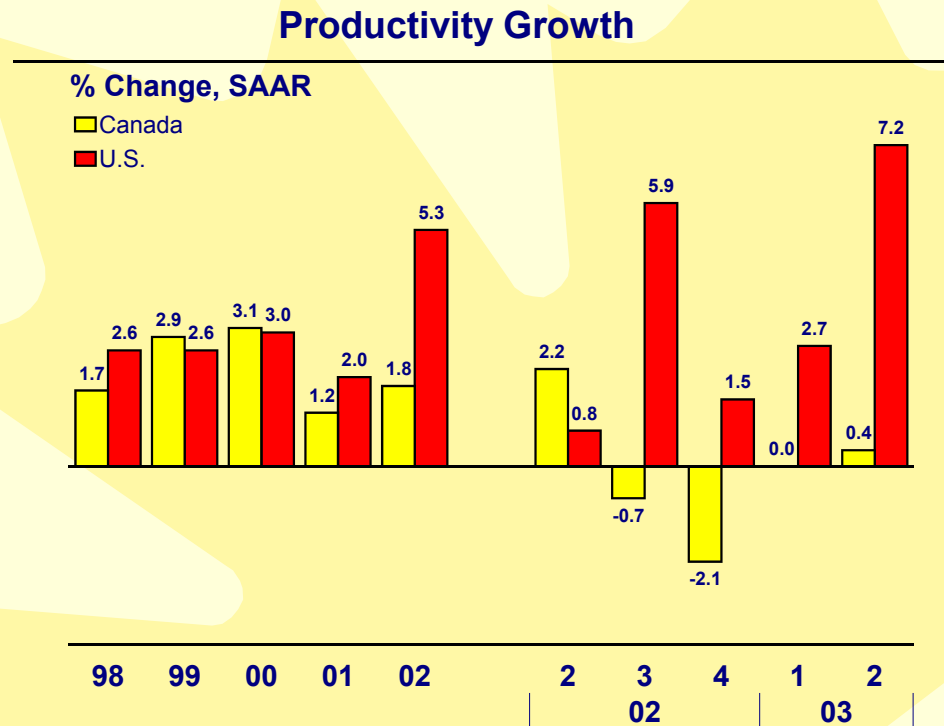
**Domestic Scene**

***Productivity & Competitiveness***

## **Labour productivity grew slightly in Canada, while it rose sharply in the U.S. ...**

Labour productivity in the business sector edged up 0.4% at an annualized rate in the second quarter. The number of hours worked fell (-2.4%) more than output (-1.9%). Output and hours worked in the second quarter have both declined for the first time since the third quarter of 2001, a period that corresponds to the events of September 11. The declines put an end to six consecutive quarterly increases in output and hours worked.

Meanwhile, business sector labour productivity in the U.S. rose 7.2% in the second quarter as output grew (4.2%) and hours worked fell (-2.7%).

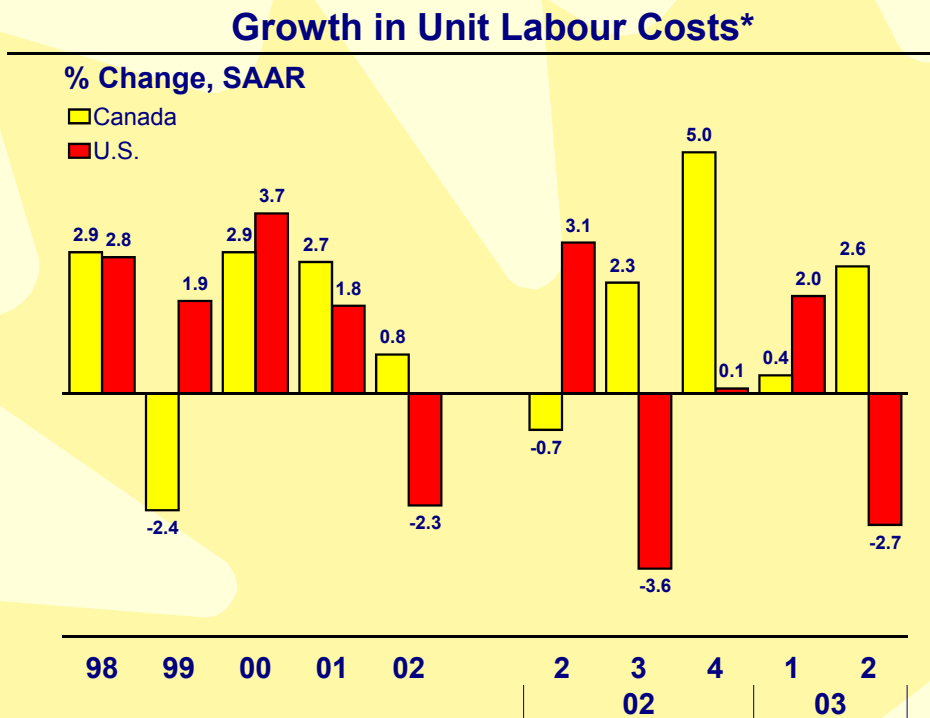


Source: Industry Canada calculations

**...resulting in unit labour costs to increase in Canada, but fall in the U.S.**

**Canadian businesses hourly wages increased more (3.0%) than labour productivity in the second quarter. As a result, unit labour costs of businesses rose 2.6%.**

**In contrast, unit labour costs in the U.S. decreased 2.7% in the second quarter, as hourly compensation increased (4.3%) less than labour productivity.**



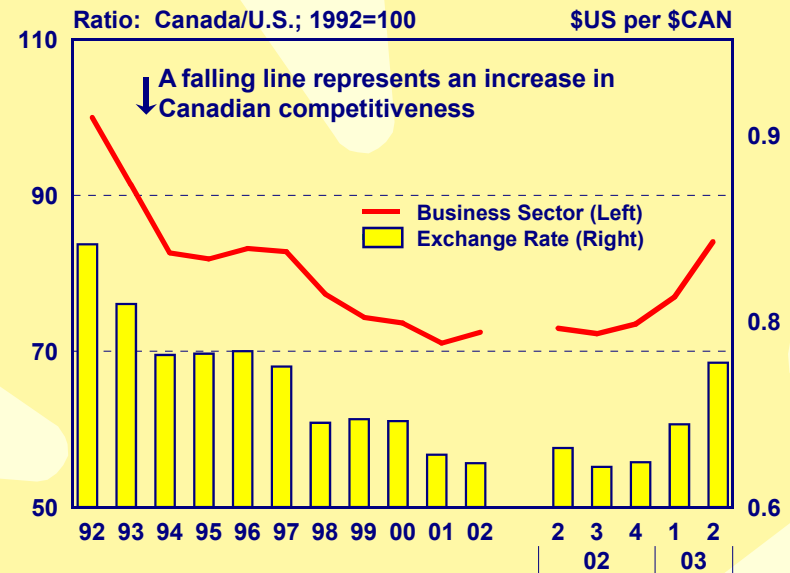
\* For the business sector  
 Source: Statistics Canada, Bureau of Labour Statistics and Industry Canada calculations.

## **The appreciation of the Canadian dollar continued to be the major factor eroding Canada's competitiveness**

As a consequence of the surge in the value of the Canadian dollar (from US¢67.1 in the first quarter to US¢72.3 in the second quarter) and a larger increase in labour productivity south of the border, Canada's business sector competitiveness fell sharply relative to its American counterpart during the second quarter.

- Canada's unit labour costs (measured in U.S. dollars) surged 38.9%, compared with a decline of 2.7% in the United States.
- The competitiveness index has risen to levels not seen since 1997, solely due the Canadian dollar reaching its 1997 level.

### **Unit Labour Cost Comparison (\$US)**



Source: Industry Canada calculations based on data from the U.S. Bureau of Labour Statistics and Statistics Canada

**Domestic Scene**

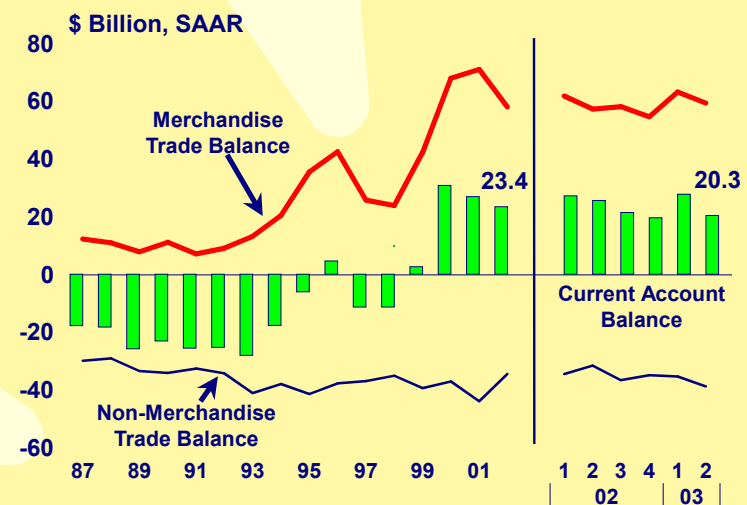
*International Accounts*

## Current account surplus fell in the second quarter...

The current account surplus fell by \$1.8 billion to \$5.1 billion (\$20.3 billion annualized) in the second quarter. The lower surplus was due to deteriorating balances for the goods and investment income. The appreciation of the Canadian dollar, which by the end of the quarter was worth over \$0.74 U.S., played a role in these developments.

In the first half of 2003, the current account surplus was \$1.2 billion lower than in the first half of 2002.

### Current Account & Trade Balances



The merchandise trade balance represents net exports of goods.

The non-merchandise trade balance represents net exports of services plus net receipts of investment income and transfers.

Source: Statistics Canada

**...largely reflecting a deterioration in merchandise trade and investment income balances**

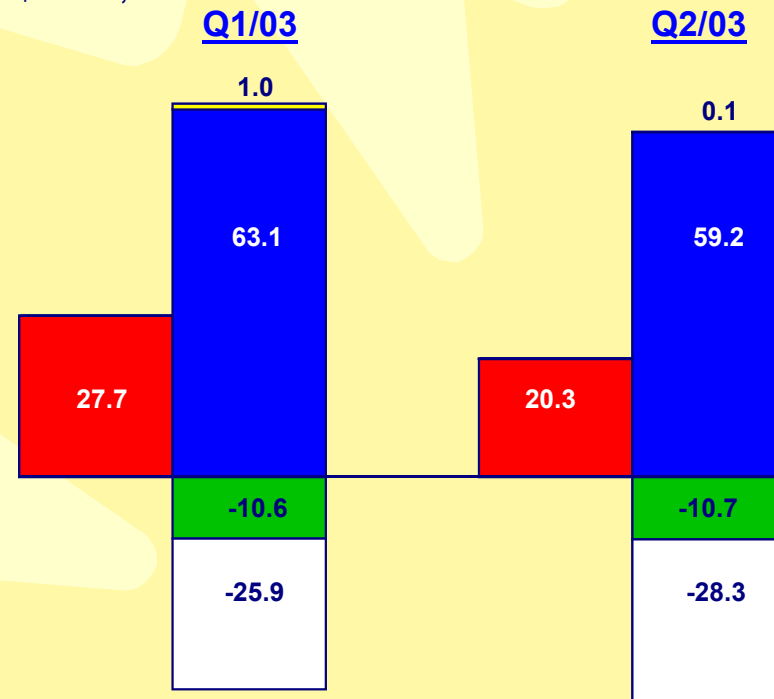
The merchandise trade surplus declined by \$1.0 billion to \$14.8 billion in the second quarter, as exports (\$59.2 billion annualized) fell more than imports.

The deficit on investment income increased by \$0.6 billion to \$7.1 billion, as profits to foreign direct investors in Canada rebounded, particularly in the finance and insurance sector.

The deficit in services was essentially unchanged at \$2.7 billion in the second quarter. Current transfers were virtually balanced.

**Main Components of the Current Account**

\$ Billion, SAAR



- Current Account Balance
- Merchandise Trade Balance
- Balance on Services
- Net Investment Income
- Net Transfers

Source: Statistics Canada



## Merchandise exports sank to their lowest level since the first quarter of 2001...

Merchandise exports posted a decrease of 6.9% in the second quarter, following a loss of 0.3% in the first. This was due to decreases in energy prices along with lower exports of machinery, automotive, agricultural (due to the mad cow disease) and lumber products.

In July, exports increased 0.5%, led by automotive (+3.5%) and energy (+5.2%) products, the first monthly increase in four months.

In the first half of 2003, compared to the same period in 2002, export gains by energy, reflecting largely the recovery in prices, nearly offset losses in all other sectors. Regionally, lower exports to the U.S. more than offset higher exports to all other regions.

### Merchandise Exports, January to June 2003

	\$ Billion	% Change Jan.-June/02 - Jan.-June/03
<b>Total</b>	<b>201.4</b>	<b>-1.3</b>
<u>By Trade Partner</u>		
U.S.	167.4	-2.1
Japan	5.2	5.4
E.U.	12.0	3.9
All Others	16.9	1.4
<u>By Principal Commodity</u>		
Agricultural & Fishing Products	14.4	-7.2
Energy Products	32.1	45.2
Forestry Products	16.7	-11.8
Industrial Goods & Materials	33.0	-5.6
Machinery & Equipment	45.7	-5.8
Automotive Products	44.2	-8.2
Other Consumer Goods	8.6	-0.5

Source: Statistics Canada

**...while merchandise imports posted a smaller decline**

Merchandise imports fell 4.6% in the second quarter, after declining 1.4% in the first. The reduction was largely due to lower imports of machinery (e.g. aircraft, engines & parts) and automotive products.

In July, imports rose 1.2% on surging aircraft and a rebound in automotive imports. The top four (in terms of value of imports) of the seven major commodity groupings posted higher imports than in June, halting three months of declines.

In the first six months of 2003 compared to the same period in 2002, imports rose 0.5%, led by higher imports of energy. Regionally, lower imports from the U.S. and Japan nearly offset gains with all other regions.

**Merchandise Imports, January to June 2003**

	\$ Billion	% Change Jan.-June/02 - Jan.-June/03
<b>Total</b>	175.2	0.5
<b>By Trade Partner</b>		
U.S.	122.6	-2.4
Japan	5.7	-0.5
E.U.	18.0	2.1
All Others	28.9	13.8
<b>By Principal Commodity</b>		
Agricultural & Fishing Products	11.1	3.4
Energy Products	10.3	39.4
Forestry Products	1.5	-0.5
Industrial Goods & Materials	33.6	-1.4
Machinery & Equipment	49.6	-5.3
Automotive Products	39.8	1.0
Other Consumer Goods	23.4	3.3

Source: Statistics Canada

## Foreign investors returned to purchase Canadian bonds and stocks in the second quarter

In the second quarter, Canadians invested \$1.6 billion abroad, while foreigners reduced their holdings of Canadian assets by \$10.0 billion.

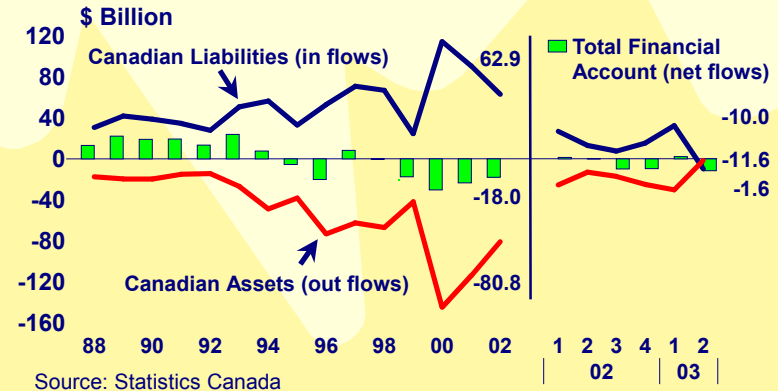
### Direct Investment

At \$2.8 billion, Canadian direct investment abroad was \$2.4 billion lower than in the first quarter. Foreign direct investment of \$5.1 billion flowed into Canada, following an inflow of \$3.5 billion in the first quarter. Nearly all of the investment, from both sides of the border, went to existing affiliates for working capital purposes, with little going to acquisitions.

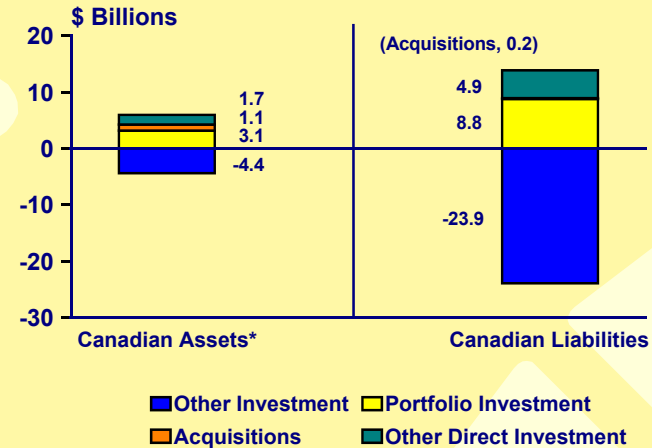
### Portfolio Investment

Canadians purchased \$2.7 billion foreign bonds (solely U.S. treasury bonds) in the second quarter, bringing their purchases for the first half of 2003 to \$6.3 billion, equal to the total for 2002. Moreover, Canadians purchased \$0.5 billion of foreign stocks, whereas in the first quarter they sold \$2.7 billion. Foreign investors bought \$6.4 billion of Canadian bonds (mostly denominated in foreign currency), two-thirds of the investment of the first quarter. They also bought \$2.9 billion of Canadian stocks, compared to selling \$0.3 billion in the first quarter.

### Financial Account (Net Flows)



### Financial Account Components Q2/2003



\* Reverse of BOP sign  
Source: Statistics Canada

G-5

**Domestic Scene**

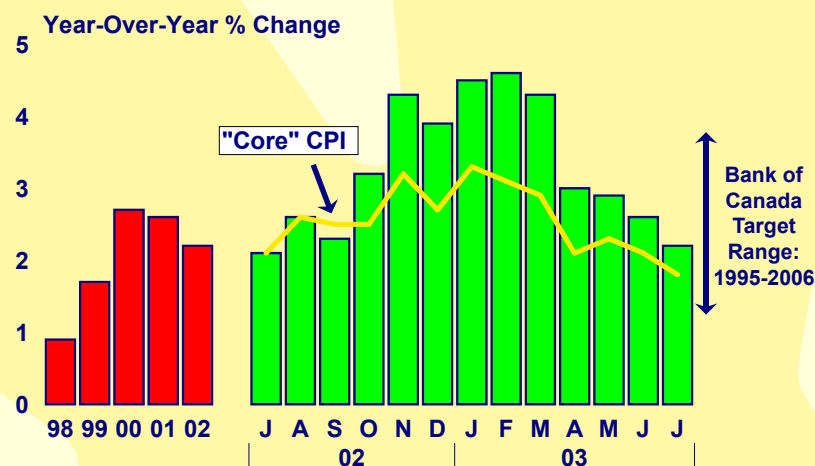
***Price Movements***

## ***Inflation eased to a one-year low in July...***

The year-over-year change in the Consumer Price Index was 2.2% in July, down from a high of 4.6% in February when fuel oil, gasoline and tobacco product recorded large price increases. Smaller rises in these prices combined with declines in the prices for household furnishings, recreation and clothing prices have contributed to dampen inflation in recent months.

"Core" inflation – which excludes the most volatile components of the overall CPI and indirect taxes, and is the target for monetary policy – fell from 2.1% to 1.8%, below the midpoint of the official 1-3% target range. This was the lowest rate since January 2002.

### **Consumer Price Index**



In May 2001, Bank of Canada and the Finance Department announced the renewal of the inflation target for monetary policy until 2006. The Bank also refined its measure for the underlying trend in inflation as measured by "core" inflation.

The "Core" CPI excludes prices for: fruit, fruit preparations and nuts; vegetables and vegetable preparations; gasoline; fuel oil; natural gas; mortgage interest; inter-city transportation; and tobacco products. It also excludes the effect of changes in indirect taxes.

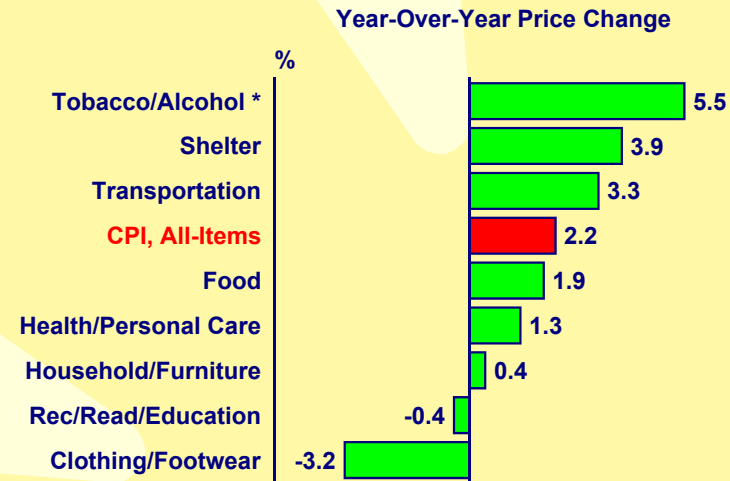
Source: Statistics Canada & Bank of Canada

**...as most components posted smaller increases than in the previous month**

CPI inflation fell from 2.6% in June to 2.2% in July. Transportation prices posted a smaller year-over-year increase than in June, tempered by a smaller increase in car insurance premiums and a decline in gasoline prices. Alcohol & tobacco product prices posted their smallest rise in more than two years while recreation, reading & education prices fell for the first time in 50 years. This reflected a fall in recreation costs amid subdued demand for travel services.

Energy also contributed to the moderation, as a drop in electricity prices more than offset a large rise in natural gas prices.

**Components of CPI: July 2003**



\* Increases in provincial and federal sales taxes on cigarettes between November 2001 and July 2002 pushed the Tobacco & Alcohol price index well above its prior level. Therefore, the impact of taxes was completely eliminated in July 2003. The year-over-year increase in the index between November 2001 and June 2003 ranged between 9.9% and 22.8%.

Source: Statistics Canada

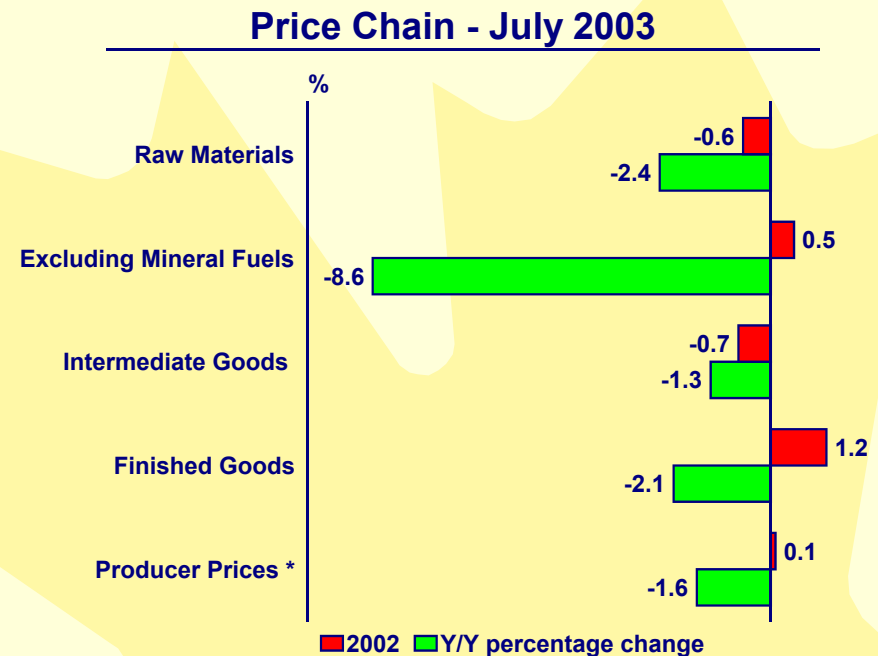
## The appreciation of the Canadian dollar helps lower industrial prices

Industrial product prices – those received by producers at the factory gate – fell 1.6% from the previous year due to the stronger Canadian dollar \*. This followed a drop of 2.6% in June.

- Motor vehicle, lumber and communications prices contributed to the decline.
- On a monthly basis, prices increased by 1.3%, putting an end to four monthly declines. This reflected increases in motor vehicle, lumber and paper product prices.

Raw material prices fell by 2.4% on a large decline in non-mineral-fuel prices. This was the second decline in 12 months.

- Animals & animal products prices largely contributed to the decline.
- On a monthly basis, prices were down 1.5% on a large decline in beef product prices following the discovery of the case of bovine spongiform encephalopathy (BCE) in May.



Source: Statistics Canada

\* The increase in the value of the Canadian dollar relative to the U.S. currency so far this year has caused a decline in the prices received by producers of exported products quoted in U.S. dollars - particularly, motor vehicles, pulp, paper and wood products. Excluding the effect of the exchange rate, the IPPI would have increased by 1.0%. On a month-over-month basis, however, the recovery in the U.S. dollar led to higher prices. Without the exchange rate effect, the monthly increase in July would have been 0.1% instead of 1.3%.

**Domestic Scene**

*Financial Variables*

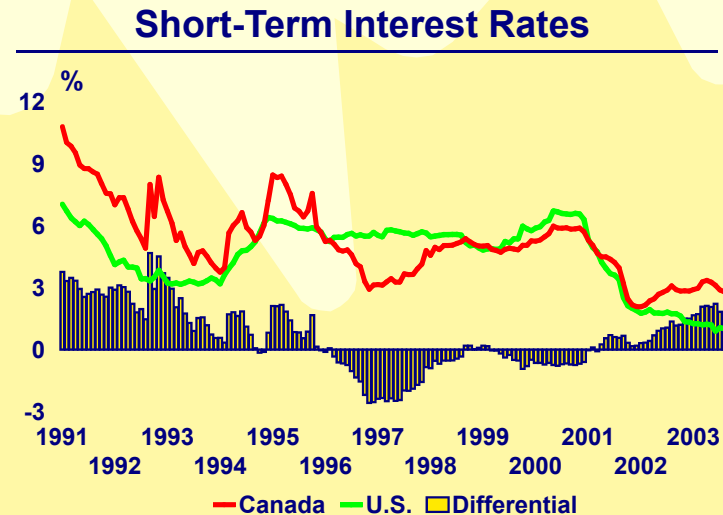


## ***The Bank of Canada reduced interest rates as growth and inflation slowed***

After having maintained its policy rate at 3.25% for three months, the Bank of Canada reduced the overnight rate in mid-July and again in early September by a total of 50 basis points (bps) to 2.75%. These reductions occurred amid weakening economic conditions and falling core inflation.

In the U.S., the Federal Reserve left its federal funds rate unchanged at 1.0% on September 16 on the basis that favourable borrowing conditions and high productivity were supporting the economic recovery. Because of the risk of a fall in inflation, the Fed indicated that rates could remain low for some time.

In light of these developments, the spread between the Canadian 90-day corporate paper rate and its U.S. counterpart narrowed to 165 bps on September 10 from 222 bps at the end of June.



Last data point plotted: September 10, 2003

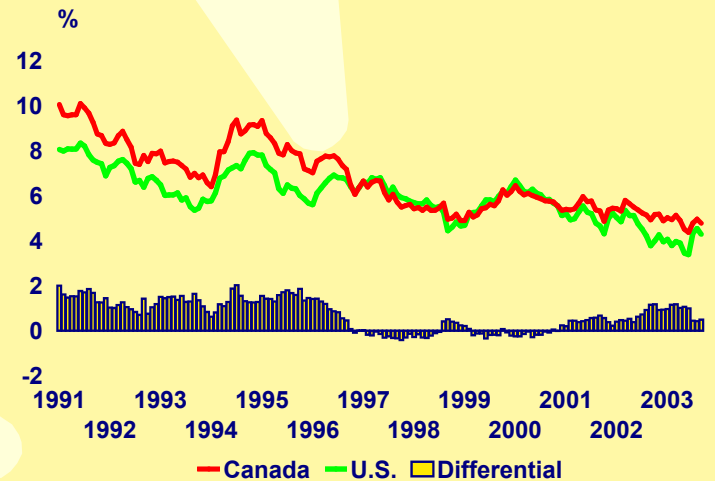
Source: Bank of Canada, 90-day prime corporate paper, last Wednesday in the month

## ***Bond yields rebounded from the mid-June lows***

Long-term bond yields have risen in the past few months amid expectations of an acceleration in economic activity in North America. In the U.S., concerns about a large and growing fiscal deficit have also helped push U.S. treasury yields higher.

- After hitting a low of 4.0% on June 13, the 10-year Canadian bond yield increased to 4.8% on September 10.
- The faster increase in U.S. interest rates helped reduce the Canada-U.S. 10-year yield differential to 49 bps on September 10, down from 89 bps in mid-June.

### **Long-Term Interest Rates**



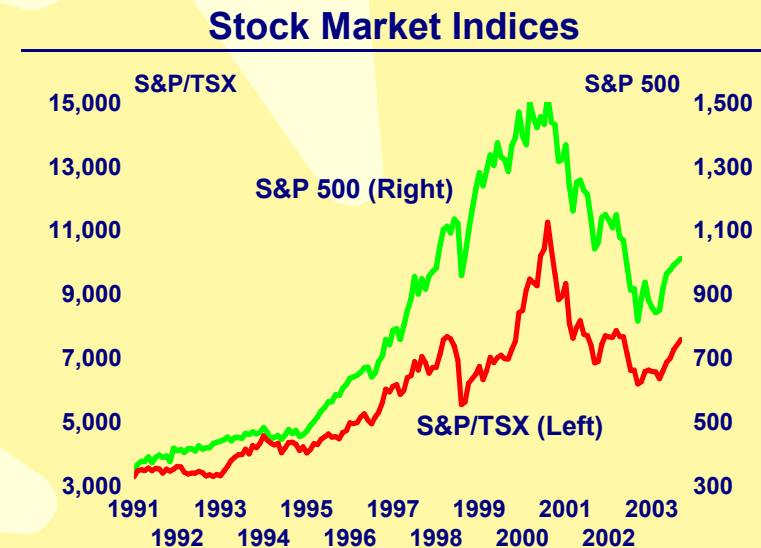
Last data point plotted: September 10, 2003

Source: Bank of Canada, 10-year Government bond, last Wednesday in the month

## Equity markets continued their ascent

Optimism about a pick-up in North American economic activity and the low returns on bonds have pushed stock market indices higher in the past few months. In line with the improving outlook, technology and natural resource stocks in particular posted healthy gains.

- After reaching a low of 6229 in early March, the S&P/TSX index increased by 1342 points (+22%) to 7571 on September 10. In the U.S., the S&P 500 moved from 801 to 1011 over the same period, a 210 points (+26%) gain.



Last data point plotted: September 10, 2003

On May 1st, Canada's main equity index was renamed the Standard & Poor/Toronto Stock Exchange index (S&P/TSX).

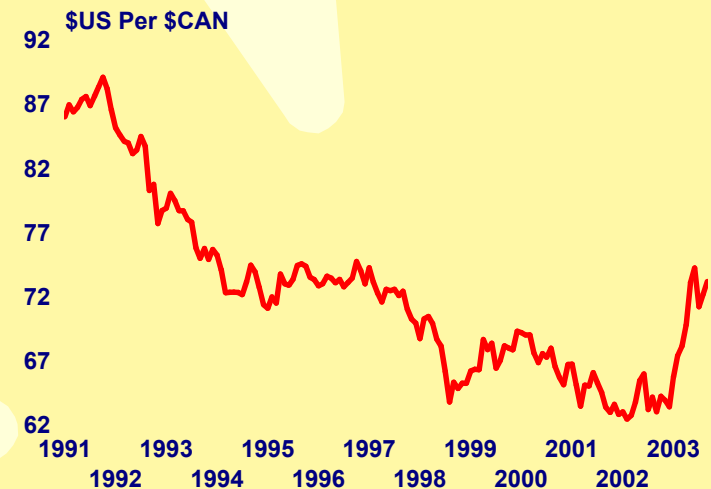
Source: Statistics Canada

## ***The Canadian dollar remains below its summer high despite a recovery in recent weeks***

After a rise of US11¢ from the beginning of the year to early June, the Canadian currency gave back some of its gains due in part to a narrower Canada-U.S. short-term interest rate gap. A weakening of the U.S. currency in recent weeks helped strengthen the Canadian currency.

- The Canadian currency increased 17% from US63.8¢ at the start of 2003 to US74.9¢ on June 13. It retreated subsequently to a recent low of US70.6¢ late in July before recovering to close at US73.2¢ on September 10.

### **Canada-U.S. Exchange Rate**



Last data point plotted: September 10, 2003

Source: Bank of Canada

**Domestic Scene**

***Fiscal Track***

## ***Towards a sixth budget surplus in 2022-03***

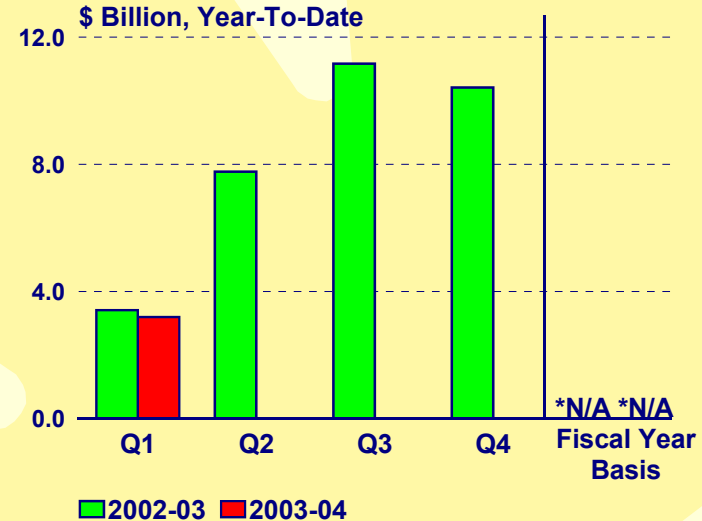
The federal government expects a sixth consecutive surplus for the fiscal year 2022-03. According to the Minister of Finance, the surplus for 2022-03 will be about equal to the \$3-billion Contingency Reserve that was incorporated in the 2023 budget. The surplus will be used to further reduce federal debt, bringing the total reduction to more than \$50 billion since 1997-98. The Minister of Finance also expects to balance books this year and next.

The budget surplus for the first quarter of fiscal year 2023-04 (April to June) was estimated to be \$3.2 billion, down \$0.2 billion from the \$3.4 billion surplus reported the same period last year.

- In the first quarter of fiscal year, program spending was up \$2.3 billion while revenues increased \$1.5 billion and public debt charges were down \$0.6 billion.

All provinces, except B.C., P.E.I. and Nfld & Lab., are expected to record balanced budgets or surpluses in 2023-04. The three territories are expected to post deficits.

### **Federal Budgetary Balance**



Source: Department of Finance Canada  
\* Fiscal year data for 2022-2023 and 2023-2024 are not yet available.

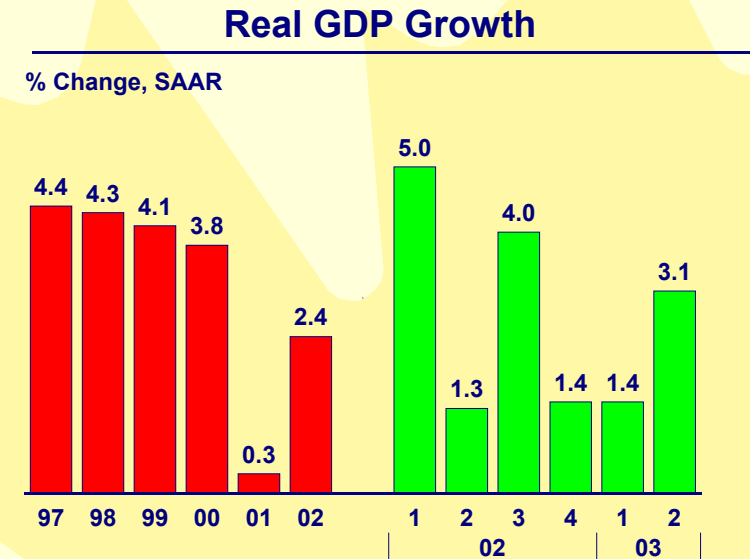
## **U.S. Developments**

***Real Economic Activity***

## ***The U.S. economy surged ahead in the second quarter...***

Real GDP increased at an annualized rate of 3.1% in the second quarter, up from 1.4% in the first quarter.

- Consumer spending was the main source of growth in the second quarter. Spending on durable goods, which contracted in the previous two quarters, increased 24.1%. A sharp increase in national defence spending and a slight pick-up in private investment added to growth.
- Net exports shave 1.2 percentage points off GDP growth, as imports grew 7.9% and exports declined. A reduction in inventories also partially offset growth.



Source: U.S. Department of Commerce

Recent indicators, including retail sales, new orders of durable goods, and housing starts, point to a strengthening of the U.S. economy in the third quarter. Meanwhile, inflation remains low helped by strong productivity gains in the second quarter. These positive developments have led analysts to revise their outlook for real GDP growth this year to 2.6%, up from 2.3% in June.



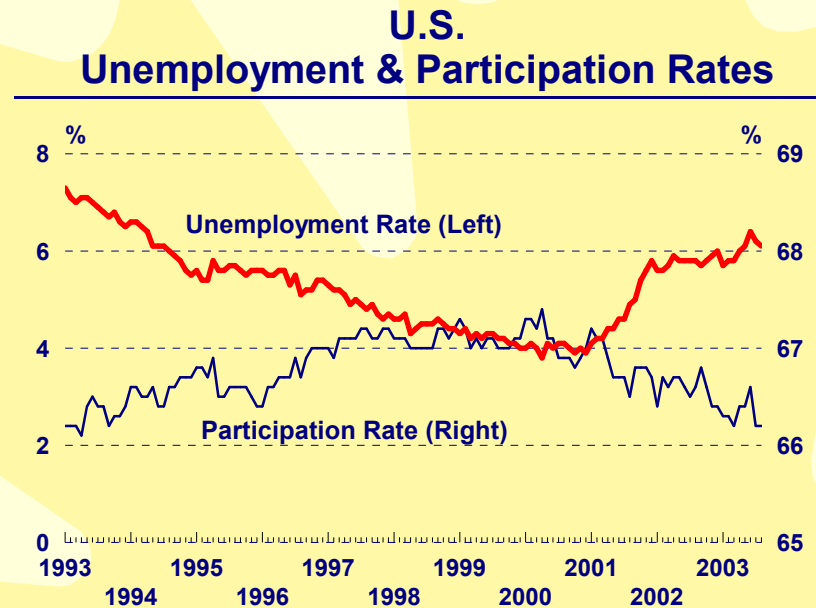
**...but the labour market remained weak**

Despite the strong gains in output, the U.S. economy shed 181,000 jobs in the second quarter, following a loss of 114,000 jobs in the first quarter.

- Reductions in employment were widespread in manufacturing, the public sector, and professional and business services.

As of August, job losses so far this year totalled 437,000. This is on the heels of job losses of 1.78 million in 2001 and 463,000 in 2002.

The unemployment rate averaged 6.2% in the second quarter, up from an average of 5.8% in the first. In August, despite further job losses, the rate edged down to 6.1%.



Source: Bureau of Labour Statistics

The image features a light yellow background with several darker yellow, abstract, leaf-like shapes scattered across it. A prominent, thick yellow border frames the entire scene. In the center, the word "Annex" is written in a bold, red, sans-serif font. This text is enclosed within a double-line rectangular border, where the inner line is blue and the outer line is red.

**Annex**

## ***Unforeseen shocks have impacted the Canadian economy***

The Canadian economy has been hit by a number of unanticipated shocks in 2003. The impact of some events -- SARS and an isolated case of mad cow disease in Alberta -- has diminished, but the impact of the blackout in Ontario and the forest fires in British Columbia will be significant in the third quarter.

The power outage in August adversely affected tourism, hospitality and (air) transportation. These industries had already faced a challenging year in Ontario. In addition, motor vehicles manufacturers and oil refineries reduced production during the week following the blackout. Altogether, analysts expect the blackout to reduce real national GDP growth in the third quarter by 0.5 to 1.0 percentage point (annual rate), from what it would have been.

Also in August, forest fires in British Columbia impacted two of the province's largest industries: forestry and tourism. Logging activity faced a sharp reduction, sawmills short on lumber supplies ceased operations, and a closure of provincial parks undoubtedly affected vacation plans. On the upside, expenditures on fire-fighting (estimated at \$545 million) added to GDP in the third quarter, and higher lumber prices resulting from reduced production may increase the value of forestry exports. Despite these upside spin-offs, the fires are expected to reduce third quarter GDP in British Columbia by as much as 1.0 percentage point, which translates to about 0.1 or 0.2 percentage point nationally.

In light of these developments, Consensus Economics revised Canada's growth outlook for 2003 to 2.0% from 2.3% in June. Nonetheless, they expect positive growth in the range of 2.0% to 3.0% in the third quarter.

## ***For Further Information***

We welcome your questions, comments and suggestions? You can reach us by ...

***sending us a letter:***

**Hossein Rostami  
Director  
Micro-Economic Analysis  
Industry Canada  
235 Queen Street, Room 540G  
Ottawa, Ontario K1A 0H5**

***e-mailing:***

**Rostami.Hossein@ic.gc.ca**

***phoning:***

**(613) 995-8452**

***or faxing us at:***

**(613) 952-1936**

The *Micro-Economic Monitor* is prepared on a quarterly basis by the Micro-Economic Analysis Directorate of Industry Canada. The Monitor provides a quick and easy-to-read update on Canada's economic performance. It also provides topical in-depth reports on current economic issues from a micro-economic perspective. This report uses data available as of September 12, 2003.

The current analysis update was prepared by Eric Chalifoux, Stéphane Crépeau, Anik Dufour, Kevin Koch, Joseph Macaluso, Arif Mahmud, Sue Moore, François Poitras, François Rimbaud, and Marc Vachon under the direction of Hossein Rostami. Translation has been provided by Lucie Larocque and Sue Hopf is responsible for administrative support.

**ISSN 1206-260X**