The Economy in Brief

DEPARTMENT OF FINANCE MARCH 2001

Overview

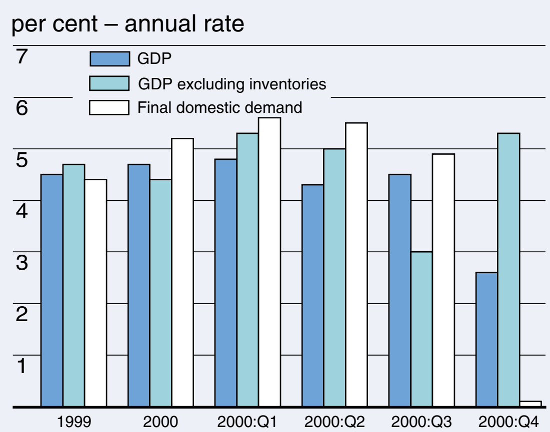
- In the fourth quarter of 2000 real gross domestic product (GDP) continued to expand, although at a slower pace of 2.6% compared to increases above 4% in the previous five quarters. Growth for the year 2000 was 4.7%.
- Real final domestic demand (spending by consumers, business and government on goods, services, housing, plant and equipment) in the fourth quarter was largely unchanged from its third-quarter level. Firms sharply reduced their inventory accumulation, with real GDP excluding inventories rising 5.3%. Domestic demand shifted toward Canadian-made goods and services, with production outside Canada satisfying a smaller part of domestic demand than in the previous quarter. This boosted Canadian output while reducing real imports by 9.8%. Finally, foreign demand grew less rapidly than in the previous quarter, with real exports rising 1.0%.
- The nominal trade surplus jumped to a record level as the real trade surplus doubled its third-quarter level. The gain in the nominal surplus, however, was moderated by a loss in the terms of trade (export prices rose less than import prices). The fourth-quarter current account reached a record $23.4 billion, or 2.2% of nominal GDP. For 2000 as a whole the surplus was $18.9 billion, or 1.8% of nominal GDP, shattering the previous record for a calendar year.
- Despite no gain in January, employment was more than 750,000 above the level at the end of 1998. The unemployment rate in January 2001 was 6.9%.

Real GDP growth continuing but at a slower pace[1]

In the fourth quarter of 2000 the Canadian economy continued its expansion, although at a slower pace than in the previous five quarters. This was the 22nd consecutive quarterly gain and the longest uninterrupted string of advances since the mid-1960s. Real final domestic demand was largely unchanged from its third-quarter level but shifted toward Canadian-produced goods and services, boosting Canadian output while reducing imports (Chart 1). Given slower demand growth, firms sharply reduced their inventory accumulation, with real GDP excluding inventories rising 5.3%.

[1] Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, March 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:Q2	2000:Q3	2000:Q4	Most recent	
Real gross domestic product	4.5	4.7	4.3	4.5	2.6		–
GDP excluding inventories	4.7	4.4	5.0	3.0	5.3		–
Final domestic demand	4.4	5.2	5.5	4.9	0.1		–
Government expenditure	2.8	3.9	5.1	2.5	0.9		–
Consumer expenditure	3.5	4.0	3.6	5.0	2.3		–
Residential investment	6.6	1.6	-10.9	7.9	-0.5		–
Business fixed investment	10.5	14.0	20.6	7.1	-9.3		–
Non-residential construction	2.0	4.8	1.3	-1.6	4.4		–
Machinery and equipment	15.6	18.9	31.1	11.4	-15.0		–
Business inventory change[1]	-0.2	0.3	-0.6	1.5	-2.6		–
Trade balance[1]	0.4	-0.7	-0.7	-1.6	4.7		–
Exports	10.0	9.6	9.6	2.0	1.0		–
Imports	9.4	12.0	12.1	6.0	-9.8		–
Current account balance							
(nominal $ billion)	-3.4	18.9	15.2	18.5	23.4		–
(percentage of GDP)	-0.4	1.8	1.5	1.8	2.2		–
Real personal disposable income	2.7	3.8	3.4	-0.1	7.8		–
Profits before taxes	23.7	23.4	7.1	7.5	10.4		–
Costs and prices (%, y/y)							
GDP price deflator	1.6	3.6	3.8	3.6	3.2		–
Consumer price index	1.7	2.7	2.4	2.7	3.1	3.0	Jan-2001
CPI – excluding food and energy	1.5	1.5	1.4	1.5	1.7	2.0	Jan-2001
Unit labour costs	0.5	2.4	2.5	2.4	2.7		
Wage settlements (total)	2.2	2.5	2.5	2.3	2.9	3.1	Dec-2000
Labour market							
Unemployment rate (%)	7.6	6.8	6.7	6.9	6.9	6.9	Jan-2001
Employment growth	2.8	2.6	1.7	1.0	3.0	0.1	Jan-2001
Financial markets (average)							
Exchange rate (cents U.S.)	67.32	67.34	67.56	67.47	65.55	65.02	6-Mar-2001
Prime interest rate (%)	6.44	7.27	7.33	7.50	7.50	6.75	7-Mar-2001

[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.

Consumer spending growth flattens

Real consumer expenditure advanced modestly from its third-quarter level, rising 2.3%, half the pace in the previous quarter. Consistent with a shift in demand toward domestic products, spending on services grew more rapidly than in the previous quarter while that on import-intensive durables dropped 6.8%. Spending on motor vehicles fell sharply compared to the third quarter, when manufacturers had been offering incentives to boost vehicle sales.

Personal income growth was much stronger than in the third quarter. Labour income grew more robustly as employment growth quickened. Personal investment income jumped, partly due to federal pay equity interest disbursements. Further, real personal disposable income was up 7.8%, posting its largest increase since 1989, while real personal disposable income per capita rose to its highest level ever. The personal savings rate rose to 3.5% from 2.3% in the third quarter.

Business fixed investment falls

Business spending on plant and equipment in the fourth quarter was 9.3% less than in the third. Investment in import-intensive machinery and equipment fell 15.0% after rising 11.4% in the third quarter. Declines were widespread, including automobiles, trucks, other transportation equipment, telecommunications equipment and computers. However, non-residential construction, which is largely satisfied by domestic production, increased 4.4% after falling in the third quarter, with gains in building and engineering projects.

Residential investment edged down 0.5% in the fourth quarter following a gain of 7.9% in the third. Growth in new construction activity dipped with housing starts, dropping 0.8%. Ownership transfer costs registered a similar modest loss while spending on renovations was largely unchanged.

Inventory correction is underway

Inventory accumulation in the fourth quarter was much more modest than in the third, subtracting significantly from GDP growth. Business inventories increased $4.1 billion after rising $10.1 billion in the previous quarter. The smaller accumulation largely reflected a run-down of motor vehicle stocks and a more modest buildup among other manufactured goods. But with sales growth just below that of inventories, the inventory-to-sales ratio was up slightly from its record low in the third quarter.

Switch in domestic demand boosts Canadian production

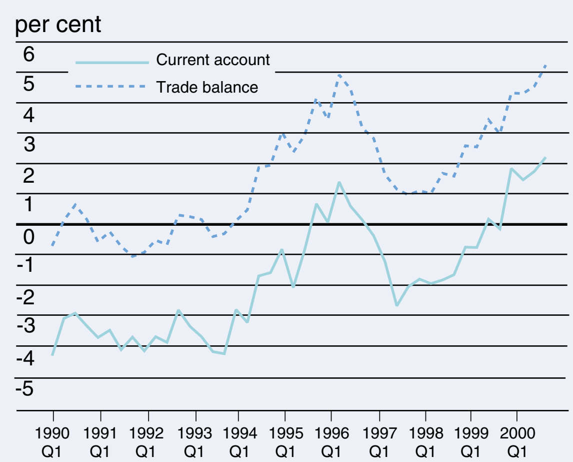
Domestic demand, while mostly unchanged in the fourth quarter, shifted toward Canadian-produced goods and services, pushing down real imports by 9.8%. The decline was largely in machinery and equipment, reflecting reduced business investment, and automotive products, consistent with lower motor vehicle sales in Canada and the United States.

Foreign demand for Canadian products, as reflected in real exports, grew more slowly than in the third quarter. While exports of machinery and equipment actually grew more strongly than in the previous quarter, other major categories saw declines that largely offset that gain. This is consistent with the further slowing of U.S. economic growth in the fourth quarter. In particular, there was a substantial decline in Canadian exports of automotive products, as motor vehicle sales fell over 25% in the United States in that quarter.

A record current account surplus

With real exports rising modestly and real imports falling substantially, the real trade balance doubled. The terms of trade, however, deteriorated as export prices rose less than import prices. These developments produced a $7.7-billion improvement in the nominal trade surplus relative to the third quarter and a new record level (Chart 2). However, a nearly $3-billion deterioration in the investment income deficit (including retained earnings) partially offset the gain in the trade surplus. Overall, the current account surplus rose to a record $23.4 billion, or 2.2% of nominal GDP. And the $18.9-billion surplus in 2000 (or 1.8% of nominal GDP) was also an annual record and a substantial improvement from deficits of 1.8% of nominal GDP in 1998 and 0.4% in 1999.

Chart 2
Current account as a percentage of nominal GDP



Inflation remains subdued

Underlying price and cost pressures remain subdued. The implicit and chain price indices for GDP advanced in the fourth quarter to levels 3.2% and 4.4% higher than a year earlier. The size of these increases partly reflected the temporary impacts of higher energy prices. And while consumer price inflation was 3.0% in January on a year-over-year basis and down slightly from December, the increased pace in recent quarters is again largely due to higher energy prices. Underlying CPI inflation, which excludes food and energy, was 2.0% in January on a year-over-year basis.

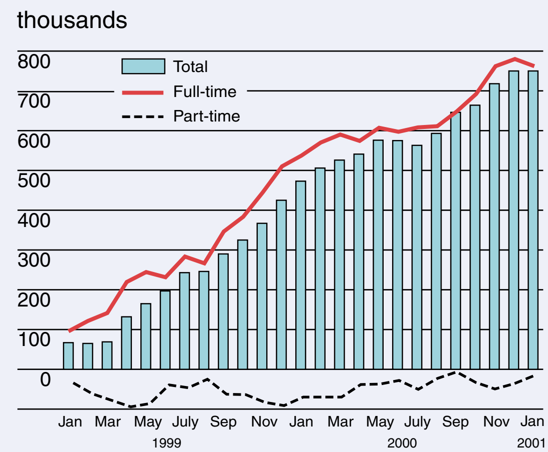
Labour productivity declined in the fourth quarter for the first time in over a year: output per employed person fell 0.4% while output per hour worked was down 0.6%. Nonetheless, labour productivity was nearly 2% higher than a year earlier. As a result, year-over-year unit labour cost growth rose modestly to 2.7%.

Pre-tax corporate profits increased for the ninth consecutive quarter and more quickly than in the third quarter, rising 10.4% to a level 13.9% above that of a year earlier. Gains were notable for the oil and gas extraction industry, reflecting energy price increases during the year, and for electronics and computer manufacturers, even though demand growth softened late in the year.

Unemployment remains low

Fourth-quarter employment growth picked up, rising 3.0% after gaining only 1.0% in the third quarter. While employment growth paused in January, nearly 325,000 net new jobs were created in 2000. The increase since the end of 1998 stands at over 750,000 (Chart 3). Full-time jobs have accounted for the total gain. The unemployment rate in January 2001 was 6.9%.

Chart 3
Cumulative employment growth since December 1998



The Canadian dollar relatively stable

After trading below 65 cents U.S. in late November, the value of the Canadian dollar rose to nearly 67 cents U.S. in early February before retrenching and closing at 65.02 cents U.S. on March 6.

In response to weakening economic growth, in January the U.S. Federal Reserve twice lowered its target for the Federal Funds rate by 50 basis points each time. The Bank of Canada lowered its Bank Rate by 25 basis points on January 23 and another 50 basis points on March 6. Long-term interest rates in the United States have remained stable since the cuts to the Federal Reserve's target rate, although they are somewhat below those in late November. Short rates have dropped more than one percentage point since late November. Long rates have also been stable in Canada while short rates have fallen less than in the United States. As a result, interest rates in Canada are generally above those in the United States, although the spread for short rates is small.

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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