United States

The U.S. economy continued to expand at a solid pace during the first three quarters of 2005. Consumer confidence and labour markets were negatively impacted by energy price spikes and hurricanes which struck the Gulf Coast in August and September, but relatively strong momentum appears to have enabled the U.S. economy to weather these impacts largely unscathed. After growing by 3.8% and 3.3% at annualized rates in the first and second quarters respectively, real GDP expanded by a further 3.8% in the third quarter. Growth continued to be broad-based with gains in consumer spending, M&E investment, exports, military spending and residential investment.

Labour markets continue to show signs of improvement—employment increased by 1.7% during the first nine months and the unemployment rate declined to 5.1% in September, down from 5.4% at the end of 2004.

With the U.S. economy expanding and labour markets improving, the Federal Reserve Board (Fed) continued to raise interest rates throughout the first three quarters of 2005 in an attempt to slow future growth and head off potential inflationary pressures. Since June 2004, when interest rates were at historically low levels, the Fed has slowly raised the Federal funds rate with twelve successive 0.25 percentage point increases to its current rate of 4.00%. Forecasters are expecting the Federal Reserve Board to continue to raise rates throughout the remainder of 2005 and beyond, as inflationary pressures—due to high energy prices and a closing output gap—continue to be a concern.

The U.S. current account deficit is expected to rise to over 6% of GDP in 2005 driven by high oil prices and strong domestic demand. Despite the current account deficit, the U.S. dollar managed to rebound somewhat during the first three quarters of 2005. Capitalizing on widening interest rate differentials with Europe and Japan, the U.S. dollar has appreciated by 6.7% against major currencies since the start of the year on a trade weighted basis.

It is expected that hurricane Katrina will reduce real GDP growth in the final quarter of 2005, however, rebuilding efforts are expected to increase real GDP growth in the first two quarters of 2006. The Federal Reserve Board doesn't expect this particular disaster to have a negative impact on economic growth in the long-term.

It is expected that U.S. economic growth will be 3.5% in 2005 but slow to 3.3% in 2006 mainly due to a projected cooling of consumer spending and housing markets as interest rates continue to rise.

Canada

The Canadian economy continued to grow into the first half of 2005—real GDP increased by 2.1% and 3.2% in the first and second quarters respectively. Economic growth was led by gains in net exports, consumer spending, and business investment.

Labour markets continued to improve with employment up by 1.4% during the first nine months of this year compared to the same time period in 2004. The seasonally adjusted unemployment rate was 6.7% in September 2005 down from 7.0% at the end of last year.

Canadian interest rates remained relatively stable in the first half of 2005 as the economy adjusted to the appreciation of the dollar and rising energy prices. In recent months, however, improvements in exports and manufacturing shipments indicate that the economy is adjusting well. With the unemployment rate near 30 year lows and the economy operating near full capacity, the Bank of Canada raised the overnight rate by 0.25 percentage points twice since September 1st. At the end of October the overnight rate stood at 3.00%.

Canadian Dollar

Bank of Canada

The Canadian dollar has out-performed all other major currencies so far this year. As of the end of October the Canadian dollar was hovering near 85 cents U.S., up from roughly 81 cents at the start of the year. Most forecasters think that the Canadian dollar will remain in the 85 to 90 cent U.S. range in the coming quarters, supported by rising interest rates.

Most forecasters expect average annual real GDP growth to be around 2.9% and 3.0% respectively in 2005 and 2006. However, a slowing expansion in the U.S. economy is likely to impact growth in Canada during the second half of next year.