



Industry  
Canada

Industrie  
Canada



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

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**Fourth Quarter 2003**

Micro-Economic Analysis Directorate, Policy Sector, Industry Canada

This document is based on data up to March 24 and is also available on the Internet at  
[http://strategis.ic.gc.ca/epic/internet/ineas-aes.nsf/vwGeneratedInterE/h\\_ra01867e.html](http://strategis.ic.gc.ca/epic/internet/ineas-aes.nsf/vwGeneratedInterE/h_ra01867e.html)

Canada

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# Overview

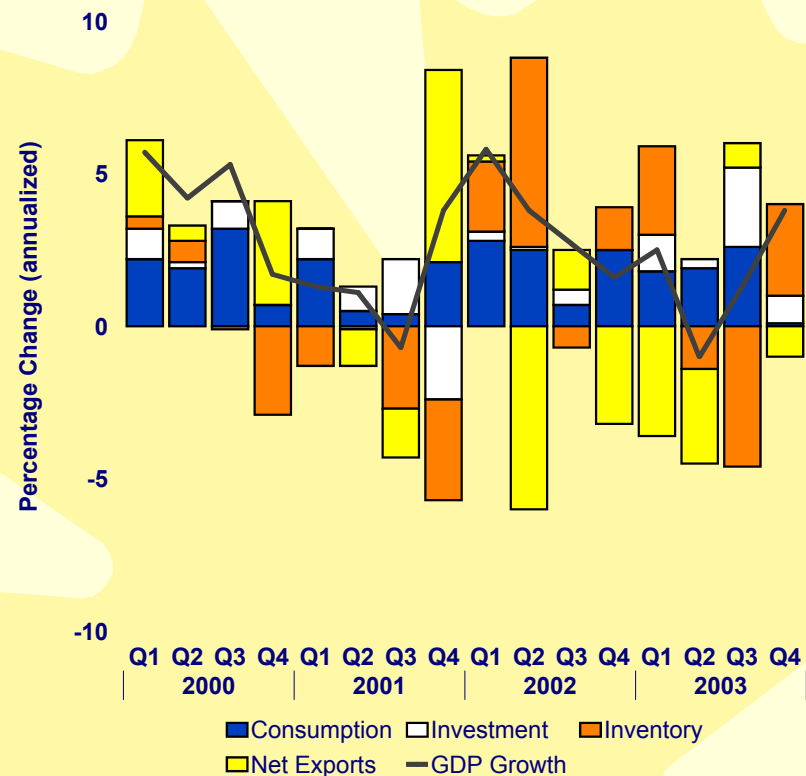
## Real GDP growth accelerated in the fourth quarter...

Real Gross Domestic Product (GDP) grew 3.8% (annualized), following an increase of 1.3% in the third quarter. The acceleration of growth, however, was mainly driven by a replenishment of inventories as the growth in final domestic demand moderated to 1.2% from 5.8% in the third quarter. This was largely due to a marked slowdown in real consumer spending, led by a sharp reduction in purchases of automobiles. For 2003, real GDP growth was 1.7%, down from 3.3% in 2002.

Corporate profits rose further in the fourth quarter and hit a record high in 2003. Boosted by strong job creation in the fourth quarter, personal income also continued to grow.

Manufacturing output grew 8.1% in the fourth quarter after four consecutive quarterly declines. Manufacturing employment has also recovered somewhat since its recent low in September 2003, but as of February this year it was 3.6% (85,000 jobs) lower than its peak in August 2002.

### 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

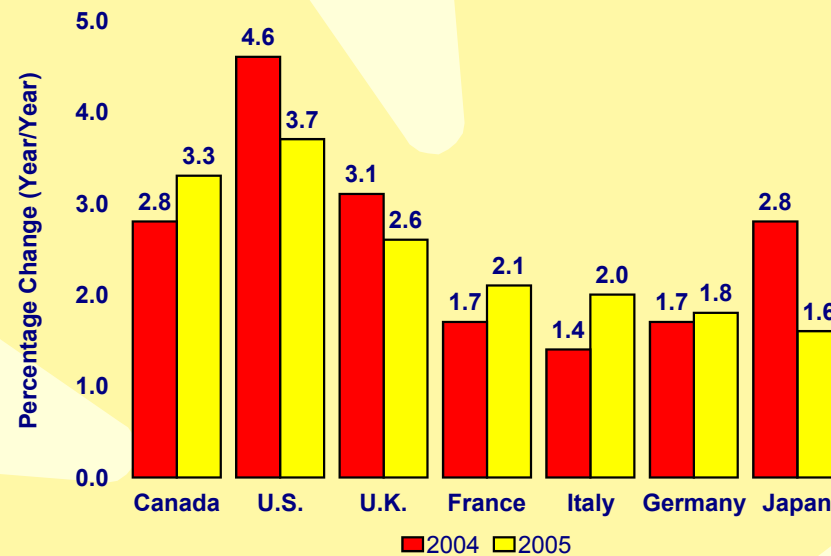
**...and the economic situation is expected to improve further**

In the United States (U.S.), real GDP growth moderated to 4.1% from 8.2% in the third quarter, leading to 3.1% growth in 2003. However, despite a modest recovery in recent months, employment conditions have remained weak, as companies continued to improve their productivity performance. Labour productivity in the business sector rose 4.5% in 2003 and 4.9% in 2002. By contrast, in Canada, labour productivity changed little in 2003 as employment continued to grow (1.5%).

The Bank of Canada has lowered its overnight lending rate by a cumulative 100 basis points since mid-July, to 2.25 percent on March 2. Meanwhile, the Federal Reserve has kept its Fed Funds rate at 1.0 percent.

The March Consensus forecast projects Canada's real GDP growth to rise from 1.7% in 2003 to 2.8% in 2004, supported by low interest rates and strong growth in the U.S. (4.6%).

**Real GDP Growth Outlook**



Source: Consensus Forecasts (U.K.), March 2004  
Consensus Economics Inc.



**Domestic Scene**

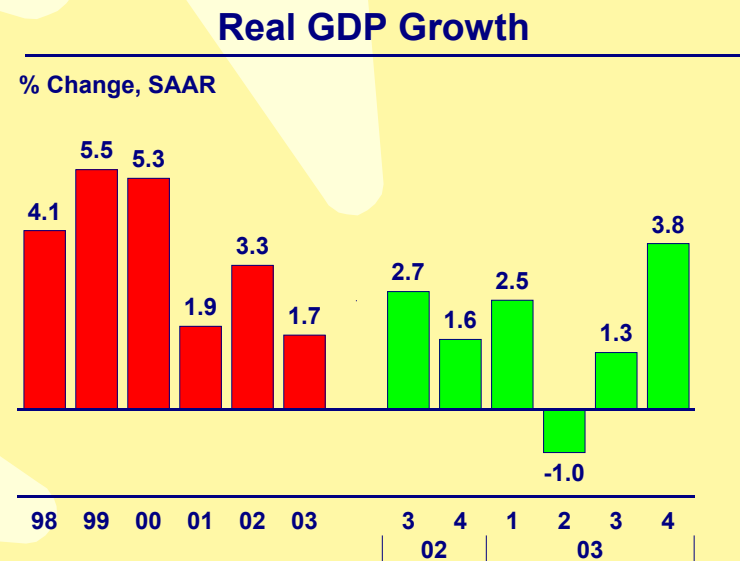
*Real Economic Activity*

## ***The economy ended the year on a strong note...***

Real GDP grew by 3.8% in the fourth quarter, up from 1.3% in the third quarter and the fastest rate since the second quarter of 2002.

- The acceleration was attributable to inventory replenishment and strong export growth. Final domestic demand slowed to 1.2% in the fourth quarter from 5.8% in the third quarter.

For 2003, real GDP growth was 1.7%, down from 3.3% in 2002.



Source: Statistics Canada

In March, the consensus forecast for real GDP growth in 2004 was lowered to 2.8% from 2.9% in February, but growth is still expected to strengthen to 3.3% in 2005.

**...despite a sharp slowdown in consumer spending**

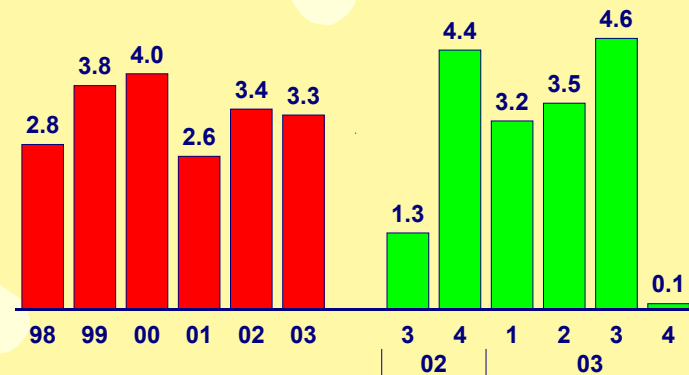
Consumer spending growth slowed from 4.6% in the third quarter to 0.1% in the fourth, the smallest quarterly growth rate since the fourth quarter of 1995.

- The slowdown mainly reflected a decline of 17% in spending on durables.

For the year, consumer spending grew by 3.3%, little changed from 3.4% in 2002. An acceleration in spending on services (4.1%) in 2003 compensated for a slowdown in spending on durables (2.3%).

**Real Consumer Expenditure Growth**

% Change, SAAR



Source: Statistics Canada



## *The non-farm inventory build-up resumed in the fourth quarter,...*

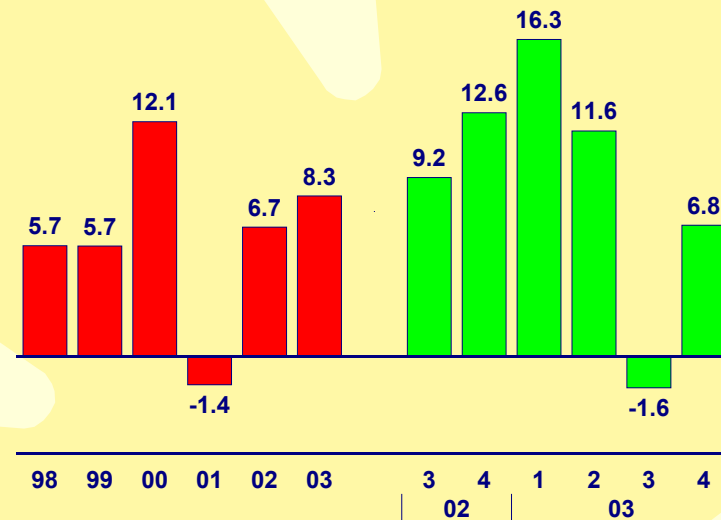
Businesses increased real non-farm inventories by \$6.8 billion in the fourth quarter, following a reduction of \$1.6 billion in the third quarter.

- The total (farm and non-farm) inventory build-up contributed 3.0 percentage points to real GDP growth in the fourth quarter.
- Inventories of wholesalers and retailers rose partly because of slower motor vehicle sales. Manufacturing inventories were virtually unchanged.

Higher inventories combined with lower sales pushed the inventory-to-sale ratio up to 0.69 in the fourth quarter from 0.68 in the third.

### Non-farm Business Inventory Investment

\$1997 Billion, SAAR



Source: Statistics Canada

**...exports recovered strongly,...**

Real exports rose 13.5% in the fourth quarter, the fastest pace since the first quarter of 2000. This followed four straight quarterly declines.

- Driving the rebound were exports of industrial goods & materials, automotive products and energy products.

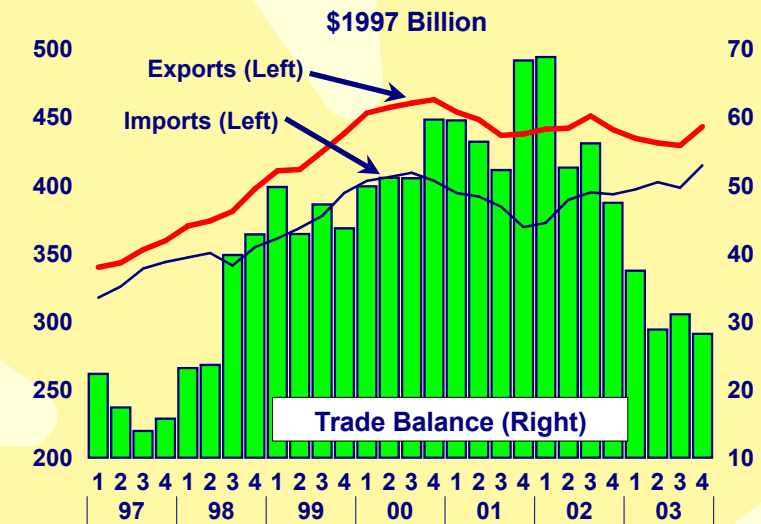
Real import growth was also strong, up 17.8%.

- Imports of automotive products, industrial goods & materials and increased spending abroad by travelling Canadians led the rise.

The real trade balance fell from \$31.0 billion in the third quarter to \$28.2 billion in the fourth.

Despite a sharp recovery in the fourth quarter, real exports fell 2.1% in 2003 while imports grew 4.0%.

**Real Exports and Imports of Goods & Services**



Source: Statistics Canada

*...housing activity remained robust,...*

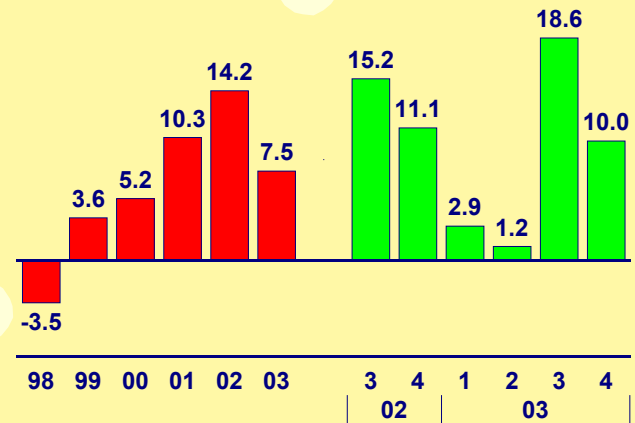
Residential investment remained strong in the fourth quarter, rising 10.0%, after an increase of 18.6% in the third quarter.

- Investment in new housing construction increased as low interest rates continued to fuel demand for new housing. Activity in the resale market softened, however.

In 2003, growth in residential investment was 7.5% after remarkable growth of 10.3% and 14.2% in 2001 and 2002, respectively.

### Real Residential Construction Growth

% Change, SAAR



Source: Statistics Canada

**...as did non-residential construction,...**

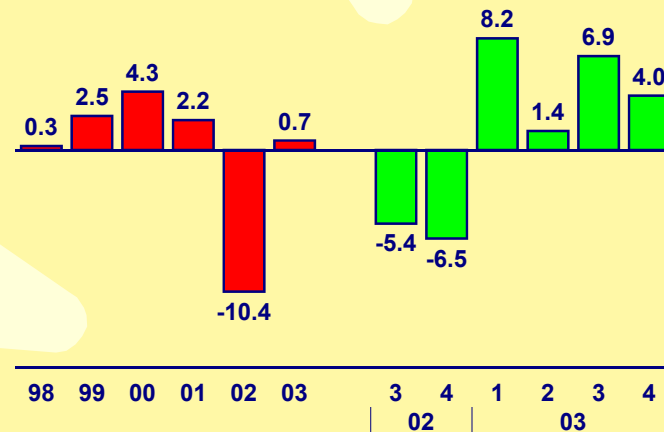
**Non-residential construction investment increased by 4.0% in the fourth quarter, down from 6.9% in the previous quarter.**

**- Higher outlays on engineering construction were partly offset by a decline in spending on building construction.**

**In 2003, non-residential construction investment rose 0.7% after a decline of 10.4% in 2002.**

### Real Non-residential Construction Growth

% Change, SAAR



Source: Statistics Canada

**...but investment in Machinery and Equipment slowed**

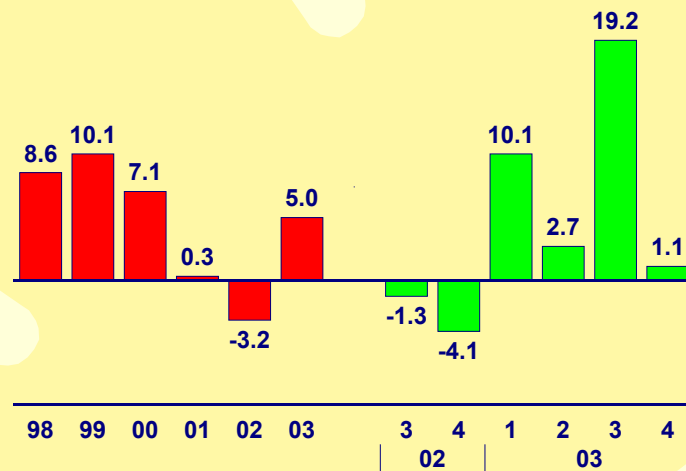
Investment in Machinery and Equipment (M&E) rose only 1.1% in the fourth quarter, after increasing to a two-year high of 19.2% in the third quarter.

- Higher spending on telecommunications equipment and industrial machinery was largely offset by lower spending on trucks and transportation equipment.

In 2003, M&E investment increased 5.0% following a decline of 3.2% in 2002. The sharp appreciation of the Canadian currency in 2003 lowered M&E prices, stimulating investment.

**Real Machinery & Equipment Investment**

% Change, SAAR



Source: Statistics Canada

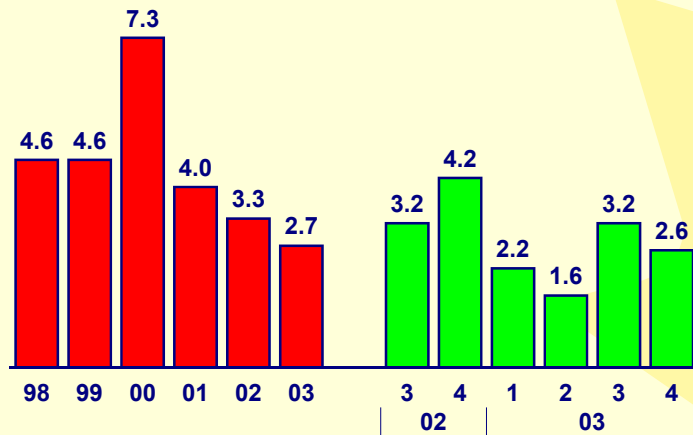
**Domestic Scene**

***Income Side***

## Personal income growth moderated in the fourth quarter,...

### Growth in Personal Income

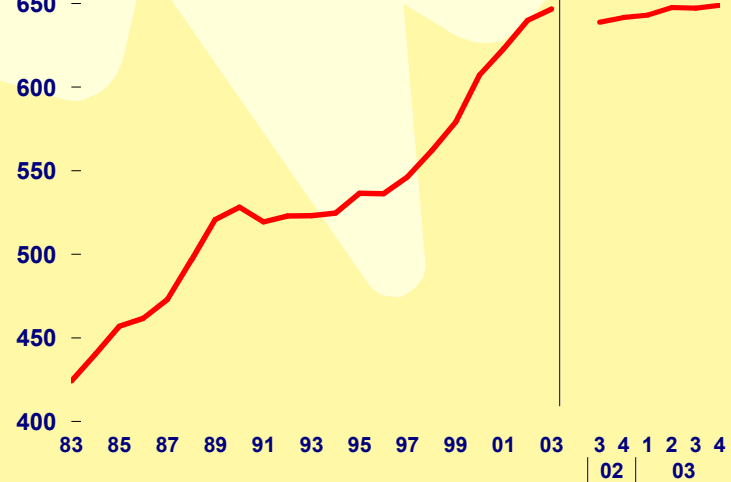
% Change, SAAR



Source: Statistics Canada

### Real Personal Disposable Income\*

\$1997 Billions, SAAR



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

Personal income rose 2.6% in the fourth quarter, following an increase of 3.2% in the third. Investment income fell 4.2% this quarter after rising 4.8% in the third quarter. Labour income, however, grew 3.5% in the fourth quarter due to strong employment growth (3.6%), up from a 2.2% rise in the previous quarter.

Real personal disposable income grew 1.1% in the fourth quarter following an increase of 1.5% in the third. In 2003, real personal disposable income grew 1.1%, following 2.7% growth in 2002.

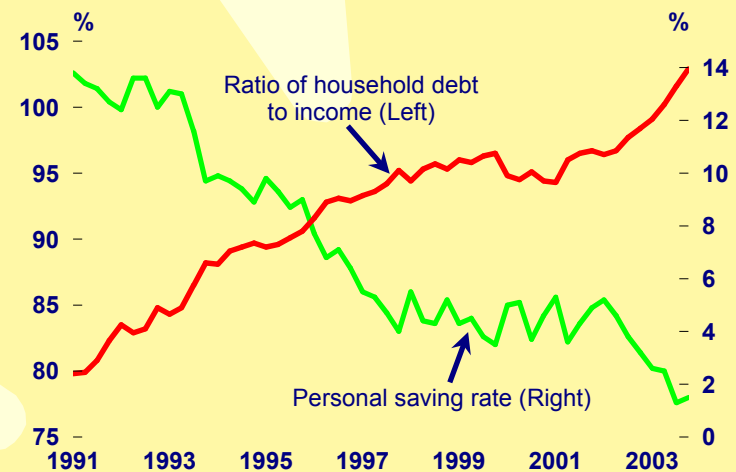
**...but the savings rate increased slightly as consumer spending stalled**

**Growth in personal income (2.6%) exceeded that of consumer spending (0.1%) in the fourth quarter. This led the savings rate to increase to 1.5% from its record low of 1.3% in the third quarter.**

**The household debt-to-income ratio increased 5.2% in the fourth quarter, the seventh consecutive quarterly increase.**

- **Consumer credit increased 7.8% in the fourth quarter while mortgages, which represented over 70% of household debt, rose 6.1%.**

### **Personal Debt and Savings Rate**



Source: Statistics Canada

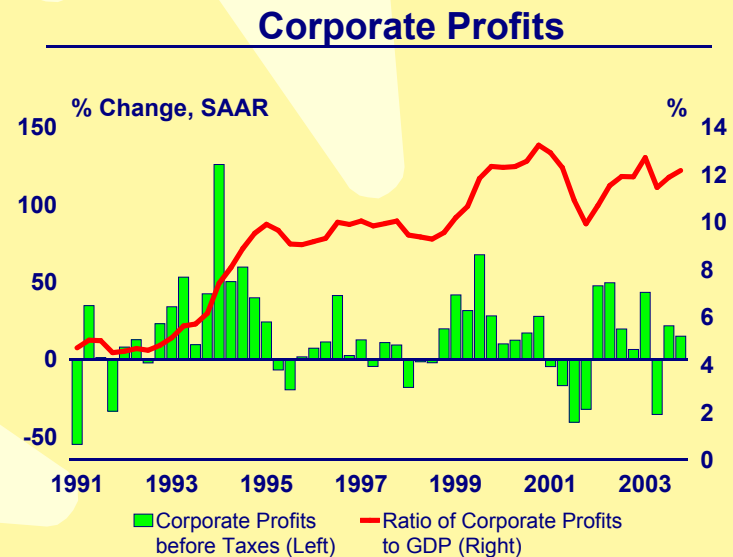


## Both quarterly and yearly corporate profits post back-to-back gains

Corporate operating profits grew 14.7% in the fourth quarter. They have now posted double-digit growth for two consecutive quarters and have nearly recovered from their second quarter drop.

In 2003, corporate profits rose 10.1% despite the adverse economic effects of SARS, the Ontario power outage and the rapid appreciation of the Canadian dollar.

In the fourth quarter, the profit share of GDP increased slightly to 12.2%, well above the ten-year average of 10.6%. For 2003 as a whole, the ratio stood at 12.1%.



Source: Statistics Canada



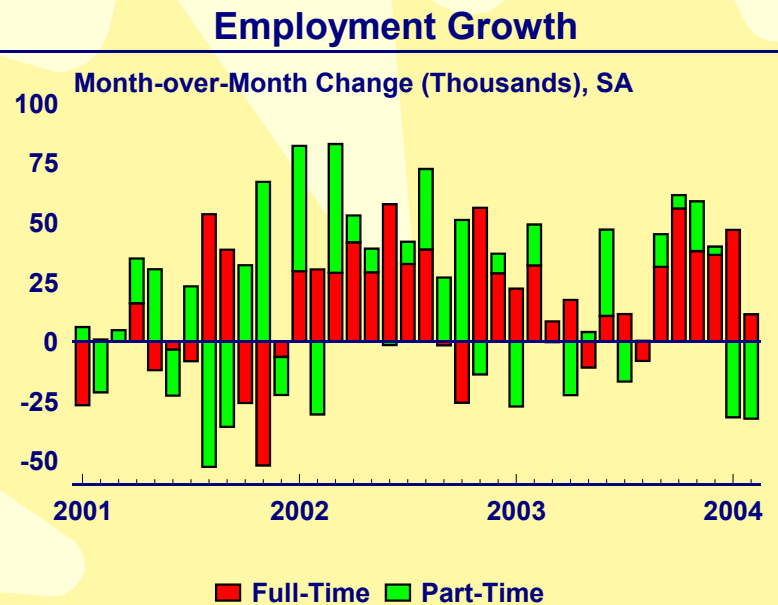
**Domestic Scene**

*Labour Situation*

## ***Labour market conditions weakened in February...***

**In February, employment fell by 21,000, after rising 15,000 in January. Despite the decline, employment has grown by almost 200,000 since August 2003.**

- All job losses were in part-time (33,000) as full-time employment continued to increase (11,000). Since August 2003, full-time employment has increased by 220,000, while part-time jobs have declined by 21,000.**



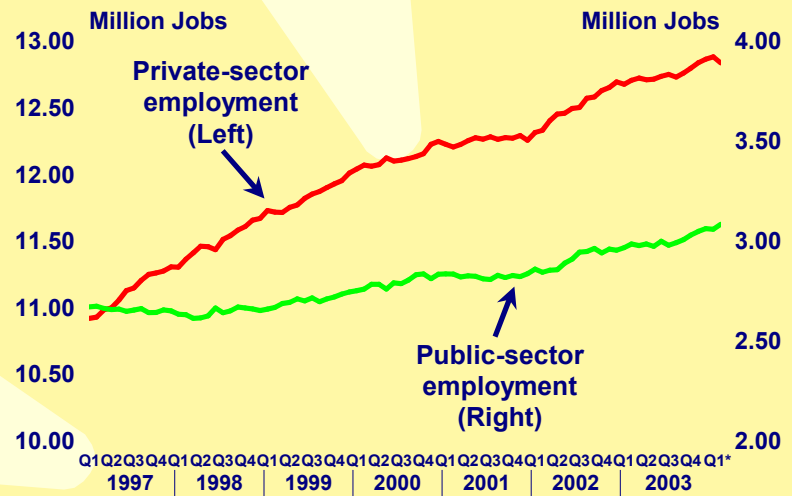
Source: Statistics Canada

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

In February, a decline of 21,000 self-employed workers and 25,000 private sector employees, more than offset a gain of 24,000 jobs in the public sector.

- Since August 2003, the number of public sector employees has grown 3.1% (92,000), while private sector employment increased 1.1% (118,000). Meanwhile, the number of self-employed workers is about the same as it was in August 2003.

**Employment: Private vs. Public**



\*Data for 2004Q1 includes January and February only.

Source: Statistics Canada

## ***The labour force declined, but the participation rate remained near record levels...***

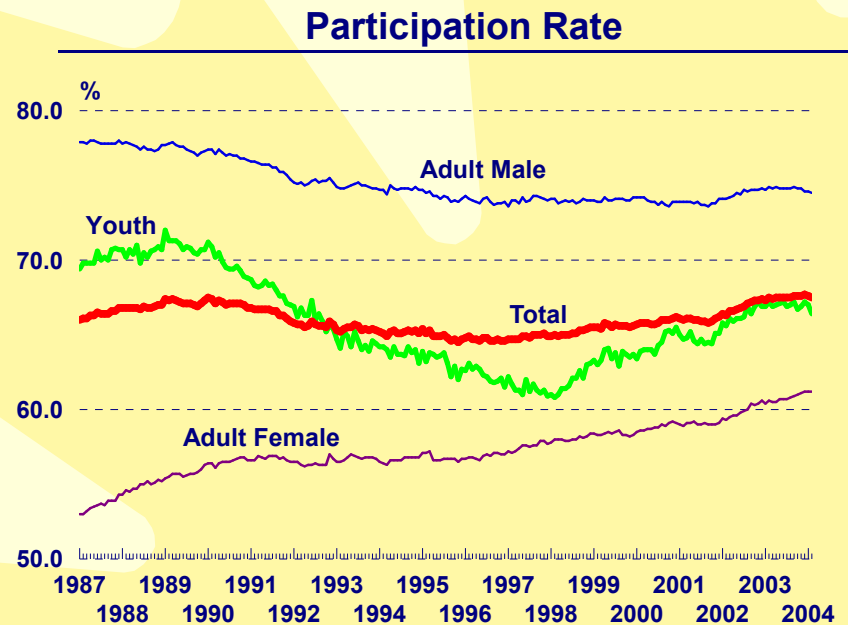
Following ten consecutive monthly gains, the labour force fell 22,000 in February. The participation rate stood at 67.5%, just 0.2 percentage point lower than December's record level of 67.7%.

The rate for adult men edged down slightly to 74.5, below a recent high of 74.9% in September 2003.

In February, the participation rate for adult women remained at a record high of 61.2%.

The participation rate of adults aged 55 and over has increased steadily since mid-2001, reaching above 30%, the highest since 1980.

After reaching a record level of 67.2% in December, the youth participation rate dropped for the second straight month to 66.4% in February.



Source: Statistics Canada

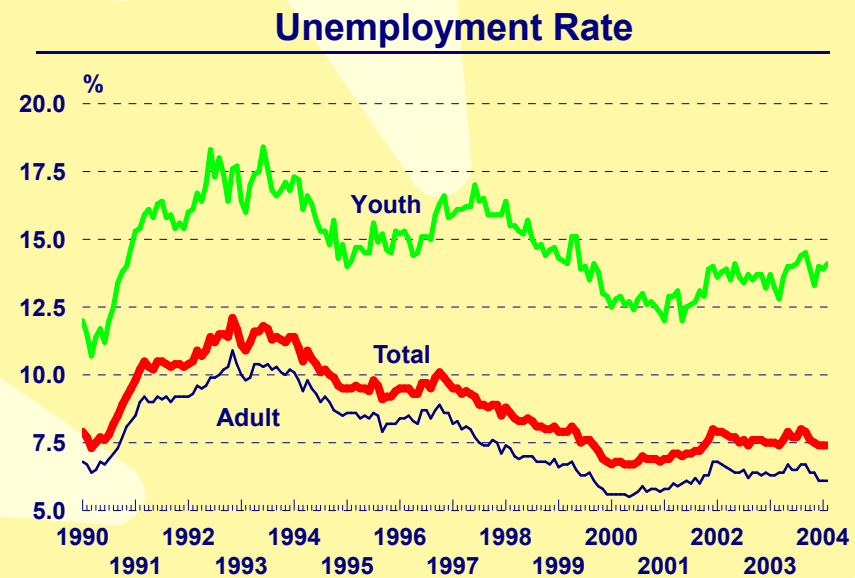
**...and the unemployment rate held steady at 7.4%**

For the third consecutive month, the unemployment rate remained at 7.4% in February.

The youth unemployment rate rose to 14.1%, reflecting a sharp drop in employment (28,000) and a fall in the youth labour force.

The adult unemployment rate remained at 6.1% for the third straight month. The unemployment rate for men was 6.3% compared to 5.8% for women.

- Full-time employment among adult women rose further (20,000), while employment among adult men fell 13,000.



Source: Statistics Canada

## Job losses in British Columbia offset gains in other provinces...

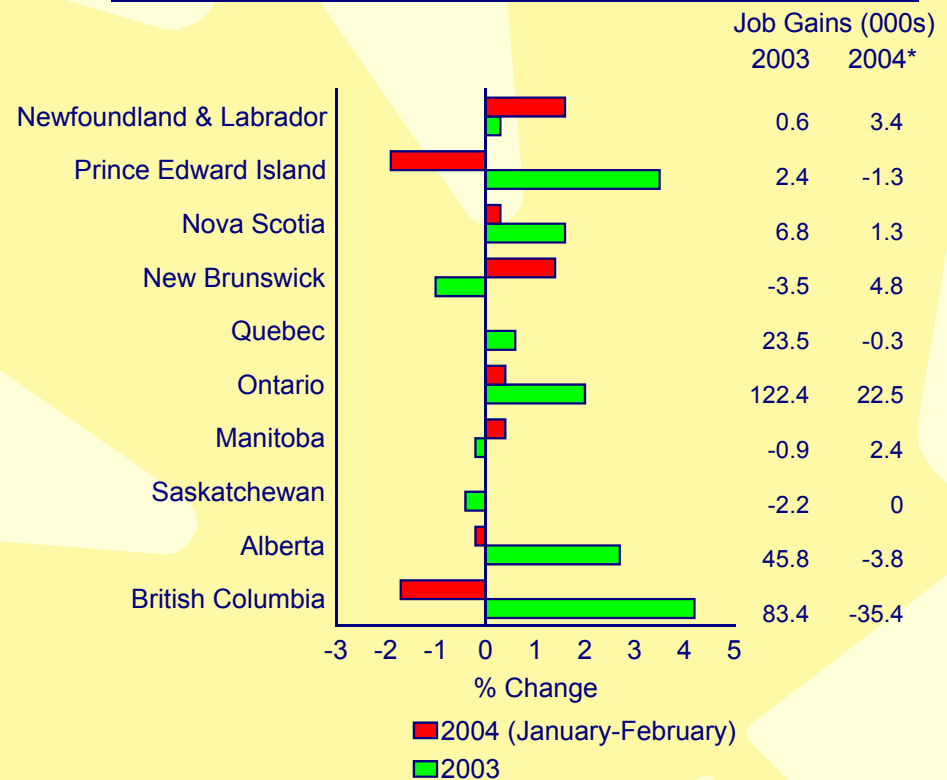
Following strong job gains in British Columbia in the fourth quarter of 2003, employment fell 36,000 in February, mostly among adult men and youth, and specifically in the retail trade and construction sectors. Employment increased in the other three Western provinces, with Alberta recording the highest gains (4,000).

In February, employment in Ontario rose for a third consecutive month (5,000) as gains in transportation, warehousing, retail, and wholesale trade more than offset losses in health care and social assistance.

In Quebec, employment was little changed in February, with gains in retail and wholesale trade offsetting a decline in construction.

Employment edged up 2,000 in the Atlantic provinces, with Nova Scotia reporting the largest gain (4,200). Employment also increased in New Brunswick, but fell in Newfoundland and Labrador and in Prince Edward Island.

### Employment Growth by Province



\* Figures for 2004 are year-to-date (January-February)  
Source: Statistics Canada

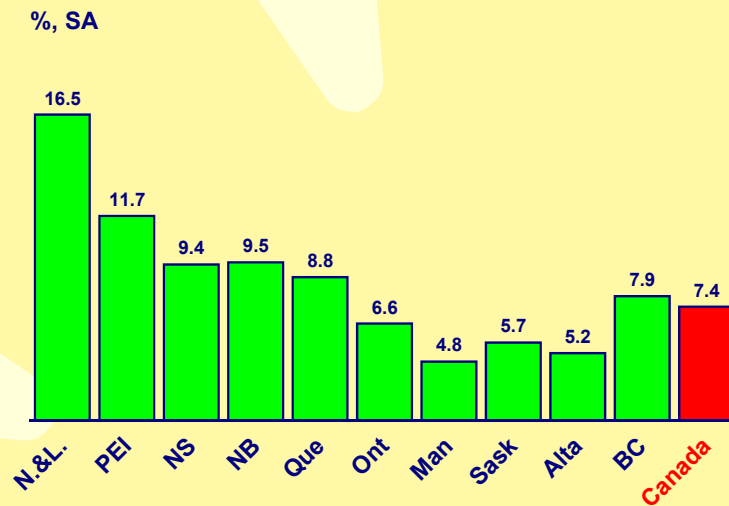
**...with mixed changes in provincial unemployment rates**

In February, sharp job losses pushed up the unemployment rate in British Columbia (0.6 percentage point) and in Prince Edward Island (0.9), while an increased labour force led to slightly higher rates in Saskatchewan (0.1) and Alberta (0.2).

Employment gains led to a fall in the unemployment rate in Nova Scotia (0.3), while a reduced labour force led to lower unemployment rates in New Brunswick (0.9), Quebec (0.3) and Manitoba (0.4).

Unemployment rates in Ontario and Newfoundland and Labrador remained unchanged.

**Unemployment Rates: February 2004**



Source: Statistics Canada



## Goods sector employment fell in February

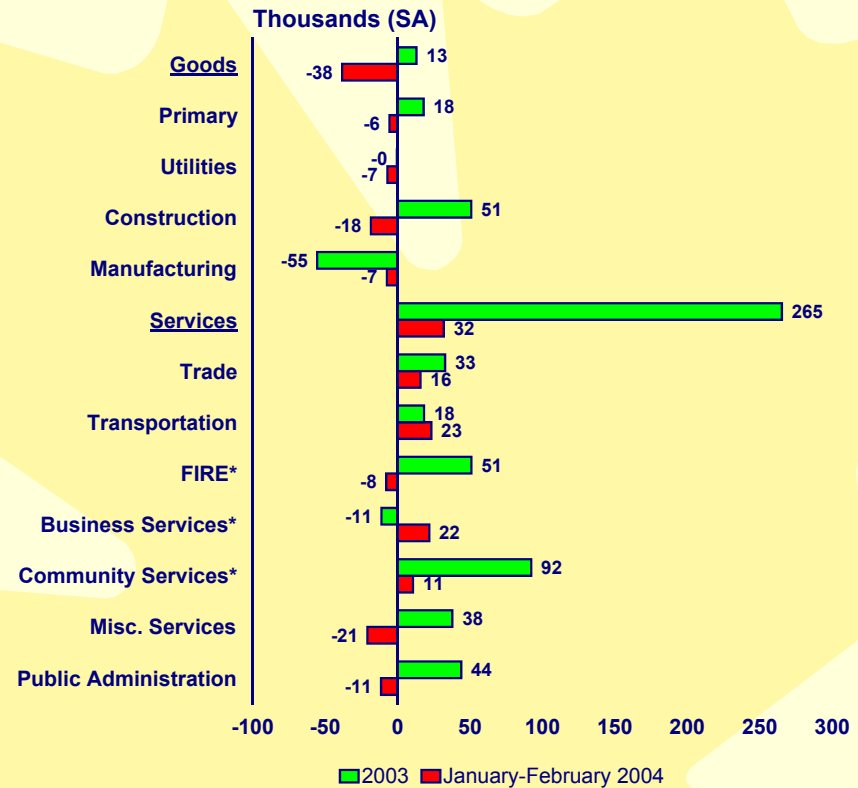
Employment in the Goods sector decreased 21,000 in February, bringing year-to-date job losses to 38,000.

- The decrease was led by a downturn in manufacturing employment (12,000) and a second straight monthly decline in construction (7,000).

Employment in the Services sector was virtually unchanged in February, following a sharp increase in January (31,000).

- The largest gains were in transportation and trade, while the highest losses were in health & social services and in finance, insurance, real estate & leasing.

### Job Growth by Industry



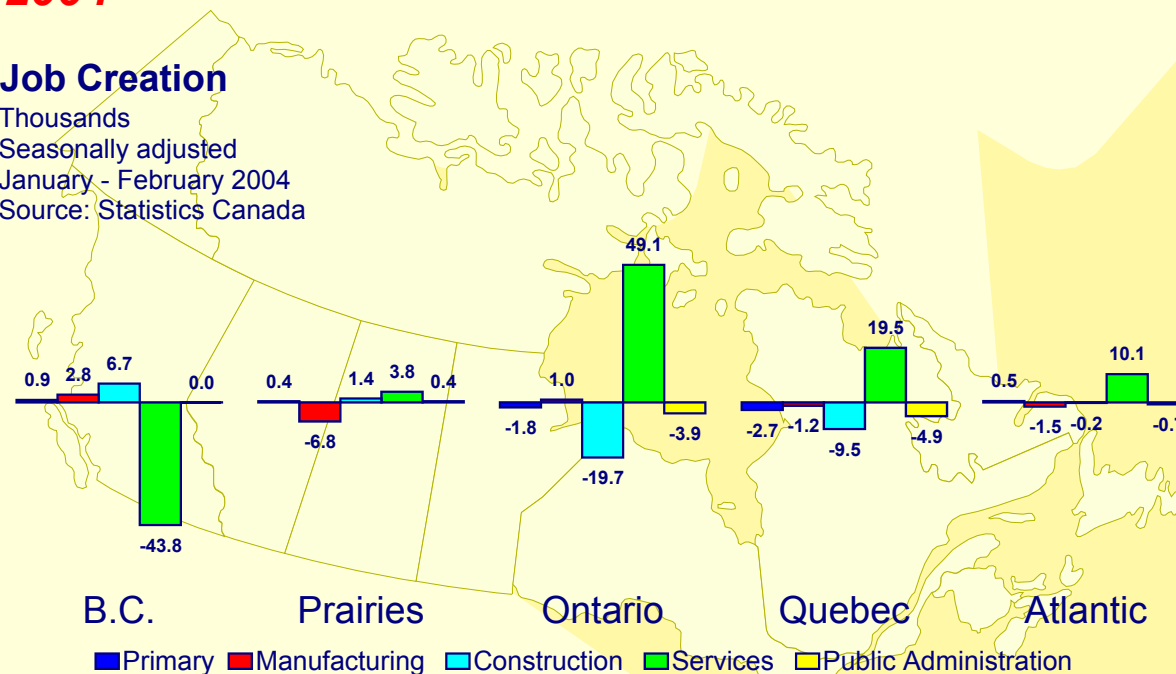
\* FIRE: Finance, Insurance, Real Estate and Leasing  
 Business Services: Management, Administrative, Professional, Scientific & Technical Services  
 Community Services: Educational Services, Health & Social Assistance.

Source: Statistics Canada

## Ontario and Quebec led the Services sector in job gains for the first two months of 2004

### Job Creation

Thousands  
Seasonally adjusted  
January - February 2004  
Source: Statistics Canada



On a year-to-date basis, employment gains in Services have been concentrated largely in Ontario and Quebec, offsetting a sharp drop in British Columbia. Meanwhile, Ontario and Quebec have led overall job losses in Public Administration.

Job losses in Construction were largely centered in Ontario and Quebec, more than offsetting gains in British Columbia and the Prairies. Lower Manufacturing employment in the Prairie, Atlantic, and Quebec regions offset small gains in British Columbia and Ontario. Primary sector job losses in Quebec and Ontario were more than small gains in British Columbia, and the Prairie and Atlantic regions.

**Domestic Scene**

***Sectoral Overview***

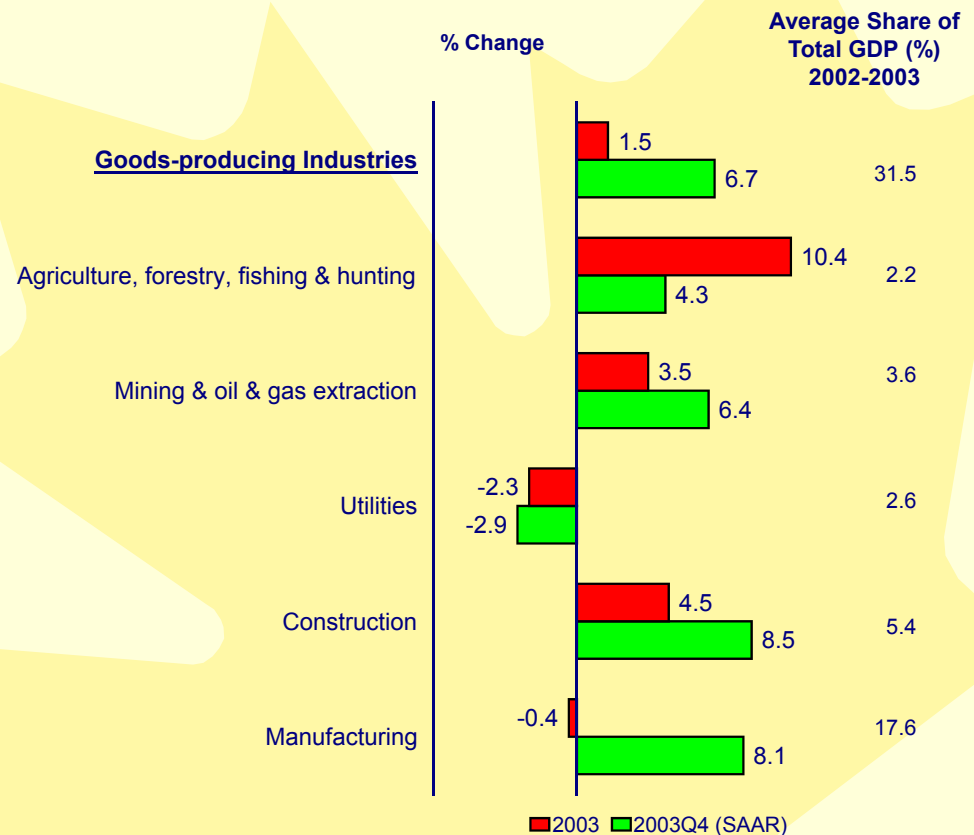
## Output in goods-producing industries ends 2003 on a solid note...

Real GDP in the goods-producing industries rose 6.7% (annualized) in the fourth quarter, after a 1.5% gain in the third. All major groups posted gains except Utilities.

- Construction gained 8.5% due to low interest rates. Manufacturing staged a sharp recovery (8.1%) from the adverse effects of the power outage in Ontario in the third quarter. Mining, Oil & Gas extraction output rose 6.4%, as higher prices provided the impetus for Oil & Gas. Metal ore mining, affected by labour disputes in previous quarters, rebounded.

Despite strong performance at the end of the year, output in the goods-producing sector rose only 1.5% in 2003, after 1.9% growth in 2002. This slowdown reflected declines in the Manufacturing and Utilities sectors, which were adversely affected by SARS, the power outage in Ontario and the rapid appreciation of the Canadian dollar.

### Real GDP Growth by Industry: 2003Q4



Source: Statistics Canada

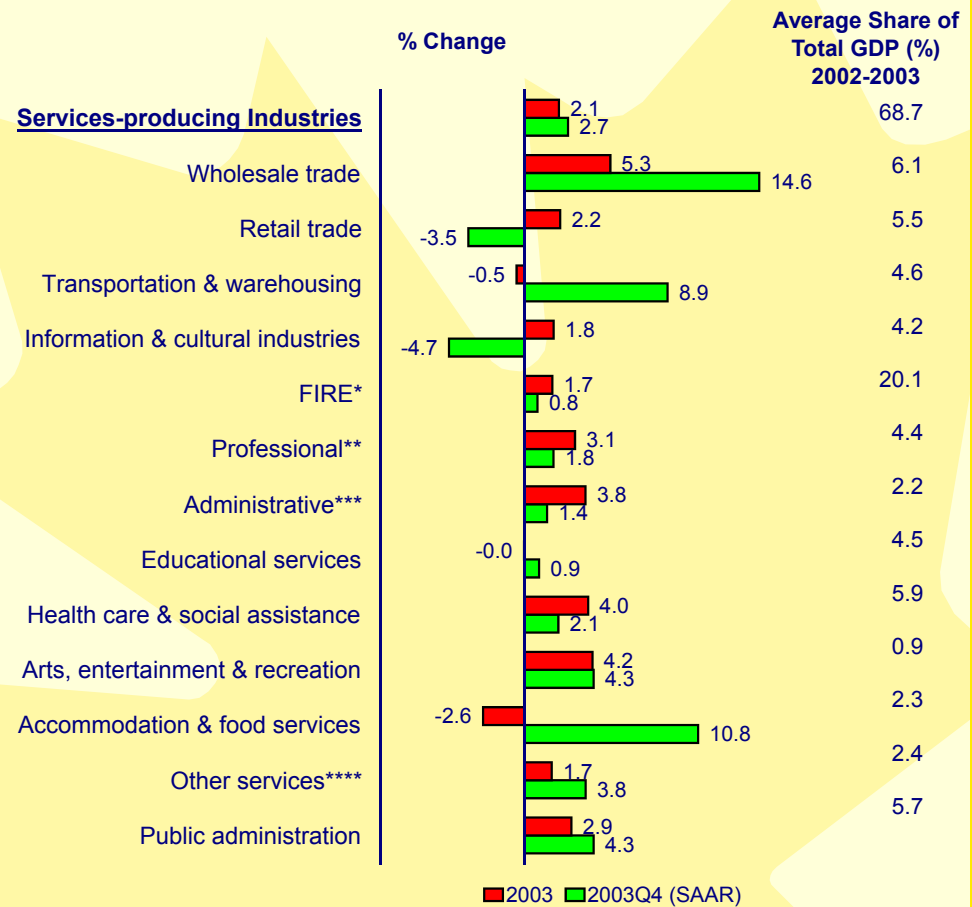
## ...and the services sector continued to grow

Service sector output grew 2.7% (annualized) in the fourth quarter, up from 2.1% in the third. Eleven of thirteen major groups posted increases.

- Higher Manufacturing production increased activity for wholesalers and transportation and storage. The air travel industry, helped by the appreciation of the Canadian dollar, recovered after being battered by SARS and the war in Iraq.

In 2003, Services sector output grew 2.1%, half the increase of 2002, with ten of thirteen groups posting gains. Accommodations and Food Services (-2.6%) posted the largest decline in output due to SARS and the war in Iraq earlier in the year, despite a sharp recovery in the fourth quarter.

### Real GDP Growth by Industry: 2003Q4



\* 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 rose to record levels in 2003

Corporate profits rose 3.3% in the fourth quarter, after a similar advance in the third. Corporate profits have risen in seven out of the last eight quarters.

- Profits of non-financial enterprises increased \$0.7 billion (or 2.5%), led by mining, transportation & warehousing, other services, utilities and real estate, rental & leasing. Manufacturing profits were 2.0% higher than in the third quarter, but 16.9% lower than a year earlier. Oil & gas profits fell as oil prices retreated from their first quarter spike.
- Profits of financial enterprises rose 5.5%, as profits of deposit credit intermediaries went up 10.6% to \$5.4 billion and insurers profits increased 6.3%.

In 2003, Canadian companies posted record profits of \$168.3 billion (up 15.1%), as sixteen of twenty-four industries posted higher profits led by oil & gas producers (61.2%) and chartered banks (58.1%). Manufacturers lost the gains of 2002.

### Corporate Operating Profits, 2003Q4

	2003Q4 Level (\$M)	Difference	
		03Q3-03Q4 (\$M)	02Q4-03Q4 (%)
<b>Total - All Industries</b>	<b>42,854</b>	<b>1,352</b>	<b>3.3</b>
<b>Total Non-Financial</b>	<b>31,770</b>	<b>772</b>	<b>2.5</b>
Agriculture, forestry, fishing & hunting	399	-27	-6.3
Mineral fuels	4,141	-447	-9.7
Mining except mineral fuels	569	174	44.1
Utilities	1,003	99	11.0
Construction	711	-64	-8.3
Manufacturing industries	8,283	163	2.0
Wholesale trade industries	3,571	166	4.9
Retail trade industries	2,771	111	4.2
Transportation and warehousing	1,250	261	26.4
Information and cultural industries	2,113	-173	-7.6
Real estate, rental and leasing	3,966	328	9.0
Professional/Scientific	784	65	9.0
Management of companies	2,423	-46	-1.9
Other services to business	568	28	5.2
Education services	-25	-1	4.2
Health care and social assistance	609	-13	-2.1
Arts, entertainment and recreation	157	7	4.7
Accommodation and food services	410	1	0.2
Other services	491	95	24.0
<b>Total Financial</b>	<b>11,084</b>	<b>580</b>	<b>5.5</b>
Depository credit intermediation	5,404	518	10.6
Non-depository credit intermediation	1,330	-18	-1.3
Insurers	1,876	111	6.3
Funds and other financial vehicles	6,473	2,661	n/a
Other financial intermediaries	2,475	-29	-1.2

Source: Statistics Canada

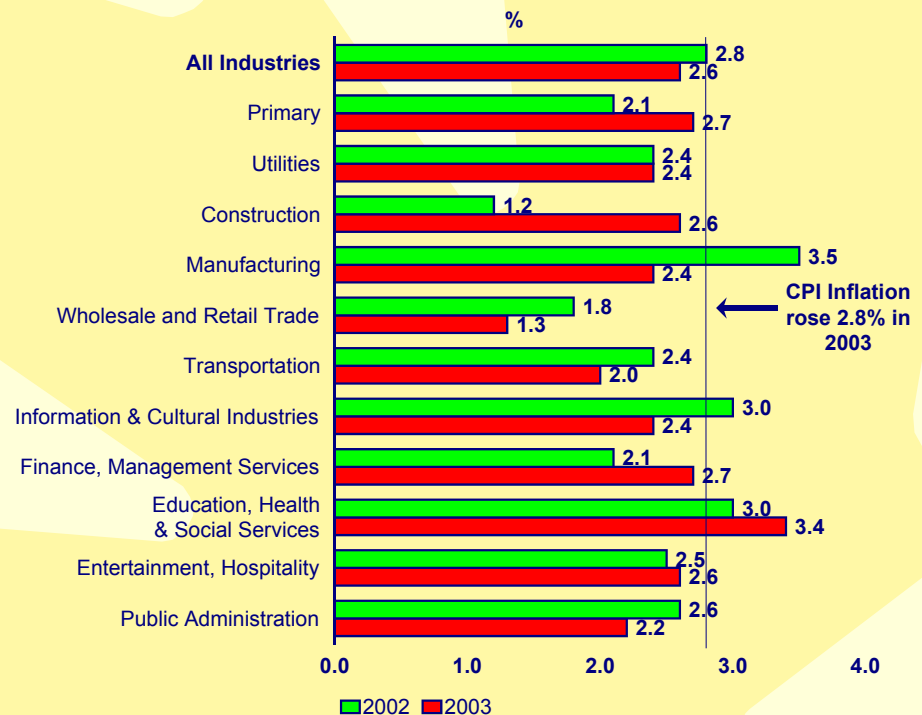
## Wage settlements down in 2003

Wage settlements averaged 2.6% in 2003, lower than the 2.8% reported for 2002.

- Private sector wage gains slowed to 1.5% in 2003 from 2.5% in 2002. The public sector averaged 2.9% in both years. The lower private sector wage increases in 2003 were, in part, due to small settlements in retail trade and the wage freeze or cuts in three high profile Air Canada agreements. Excluding these three settlements, average private sector wage gains for 2003 were 2.0%.
- The largest increases were in education, health & social services (3.4%) and the smallest in trade at 1.3%.

Ontario and Nova Scotia posted the highest wage increases (3.3%), while British Columbia had the smallest increase (1.3%).

### Wage Settlements by Industry



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

Source: Human Resources Development Canada

## Capacity utilization posted its biggest jump in almost a decade

Capacity utilization rose by a sharp 1.6 percentage points to 82.9% in the fourth quarter. The advance was driven by increases in the output of a number of export-oriented industries.

The capacity utilization rate in Manufacturing jumped 2.1 points to 84.0%, following four consecutive declines.

- Sixteen of twenty-one industries posted increases, led by Primary Metals, Computer & Electronic Products, Clothing and Plastic & Rubber Products.

In the non-manufacturing sectors, utilization rates were higher in Logging & Forestry, Mining & Oil & Gas Extraction and Construction. Only Electric Power Generation, Transmission & Distribution posted a decline.

In 2003, capacity utilization was down 0.3 point to 82.0%. Only Forestry & Logging and Mining & Oil & Gas Extraction posted higher rates.

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

	Level (%) 2003Q4	Change (% points)		10-year Average
		Q/Q	Y/Y	
<b>Total Industrial</b>	<b>82.9</b>	<b>1.6</b>	<b>0.3</b>	<b>82.7</b>
Forestry & logging	91.2	3.4	3.3	82.6
Mining & oil & gas extraction	72.2	1.6	3.4	76.1
Electric power *	83.9	-0.9	-4.8	84.5
Construction	86.7	0.7	0.5	83.7
<b>Total Manufacturing</b>	<b>84.0</b>	<b>2.1</b>	<b>0.1</b>	<b>83.8</b>
Food	80.0	1.8	-0.5	80.6
Beverage & tobacco products	74.2	-0.3	-3.4	80.5
Textile mills	71.0	-2.2	-5.4	80.9**
Textile product mills	74.9	-2.1	-9.2	79.7**
Clothing	76.2	3.0	-10.9	82.7
Leather & allied products	65.1	-1.6	-5.2	74.8
Wood products	96.9	2.3	-0.1	87.5
Paper	90.4	-0.3	-1.9	90.6
Printing & related support activities	74.9	2.3	3.8	77.9
Petroleum and coal products	97.2	1.1	1.3	93.3
Chemical	84.7	2.3	-1.5	82.6
Plastic & rubber products	92.5	2.8	4.2	84.8
Non-metallic mineral products	92.5	1.7	6.4	80.4
Primary metal	97.2	4.7	4.3	90.8
Fabricated metal products	83.0	2.7	1.2	81.1
Machinery	78.1	1.2	-3.2	81.1
Computer & electronic products	71.5	3.3	5.7	79.9
Electrical equipment	71.0	1.7	-2.5	82.9
Transportation equipment	86.5	1.9	-0.2	86.4
Furniture & related products	75.9	0.5	-5.1	81.5
Miscellaneous manufacturing	81.0	4.5	-3.2	81.7

\* Electric power generation, transmission & distribution

\*\* Represents available data between 1997Q1-2003Q4

<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***

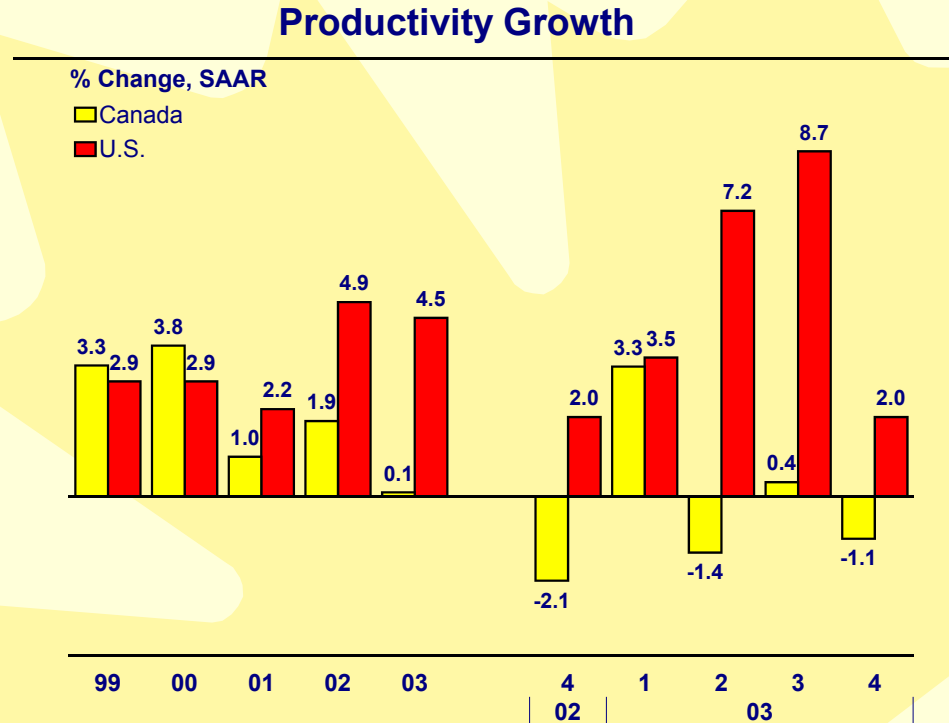
## Labour productivity fell in the fourth quarter...

Canada's labour productivity in the business sector declined 1.1% (annual rate) in the fourth quarter, reflecting stronger growth in hours worked (4.3%) than output (3.5%).

In 2003, productivity was essentially unchanged, as both production and hours worked increased by about 1.5%. This is the worst productivity performance since the 0.2% drop recorded in 1996.

Labour productivity in the U.S. business sector increased 2.0% in the fourth quarter, as output (3.9%) grew faster than hours worked (1.9%).

For 2003 as a whole, U.S. productivity rose 4.5%, coming from an increase in output (3.7%) and a decrease in hours worked (-0.8%).



Source: Industry Canada calculations

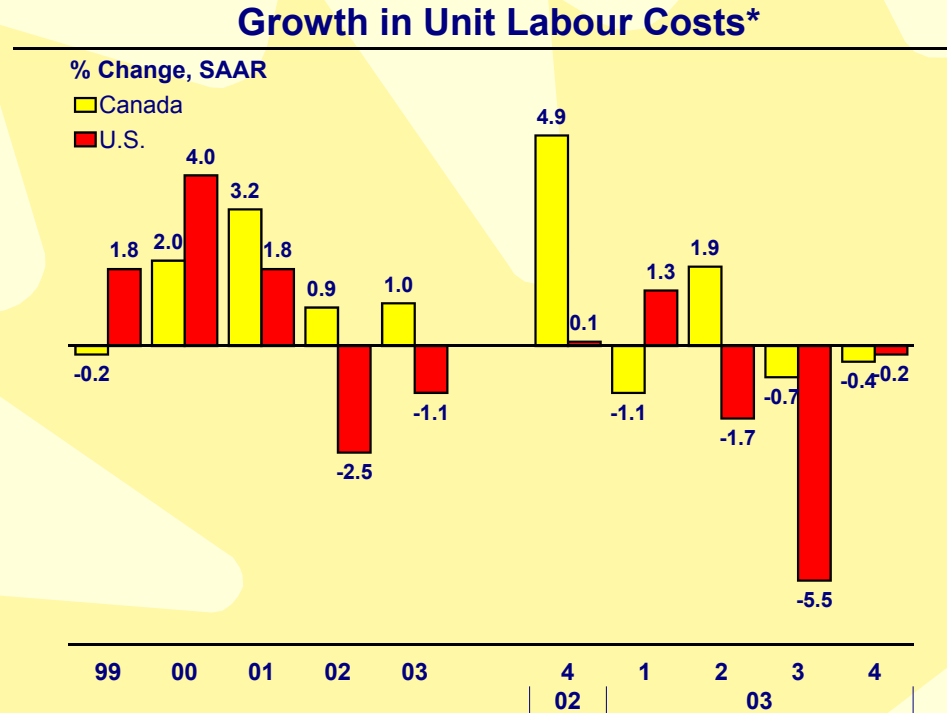
**...and unit labour costs declined**

Unit labour costs declined 0.4% (annual rate) in the fourth quarter, as decreases in hourly wages (-1.3%) was slightly higher than the reduction in productivity.

However, for 2003 as a whole, unit labour costs rose 1.1%, as small productivity growth did not compensate for wage increases (1.2%).

In the U.S., unit labour costs continued to fall (-0.2%) in the fourth quarter, but at a slower pace than the two previous quarters. Labour productivity growth was slightly higher than hourly compensation (1.8%).

In 2003, U.S. unit labour costs fell 1.1%, the second consecutive yearly decline.



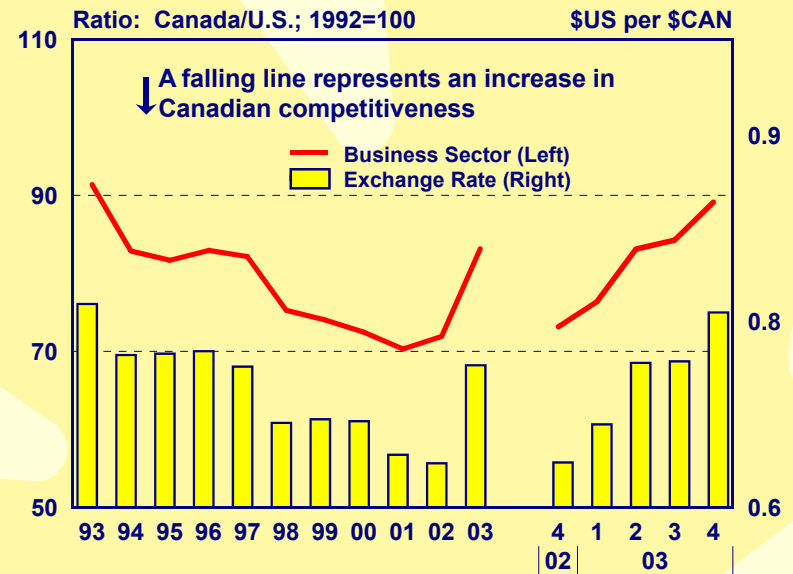
\* For the business sector  
Source: Statistics Canada, U.S. Bureau of Labour Statistics and Industry Canada calculations.

## Canadian competitiveness further deteriorated

In the fourth quarter, Canada's business sector competitiveness relative to the U.S. deteriorated further, due to a large increase of the value of the Canadian dollar (5.8%) and stronger labour productivity performance south of the border.

Canada's competitiveness eroded sharply in 2003, following a small deterioration in 2002. While the deterioration in 2002 solely reflected U.S. superior productivity performance, in 2003, it was due to the sharp appreciation of the Canadian dollar and stronger U.S. productivity growth.

### 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*

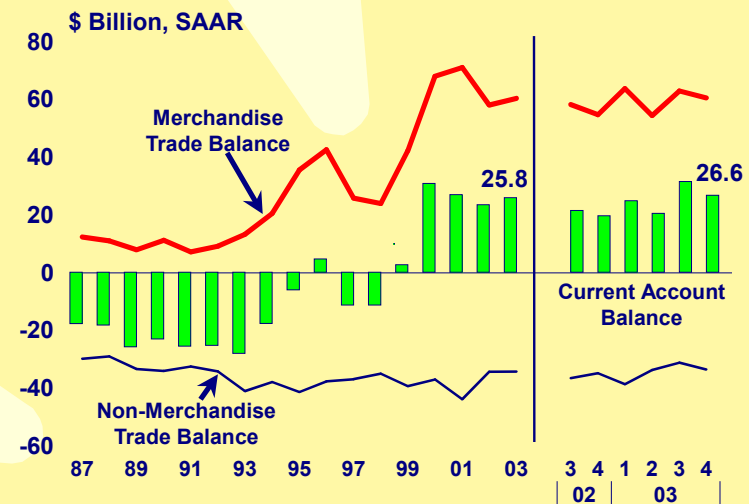
## Current account surplus fell in the fourth quarter...

Canada's current account surplus declined \$1.2 billion to \$6.7 billion (\$26.6 billion annualized) in the fourth quarter.

- Lower surplus on the merchandise trade and higher deficit in investment income were responsible for the lower current account surplus.

In 2003, the current account surplus rose to \$25.8 billion. The goods surplus increased, as imports fell more than exports, while the investment deficit decreased.

### 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

**...as the merchandise trade surplus fell and the deficit on investment income rose**

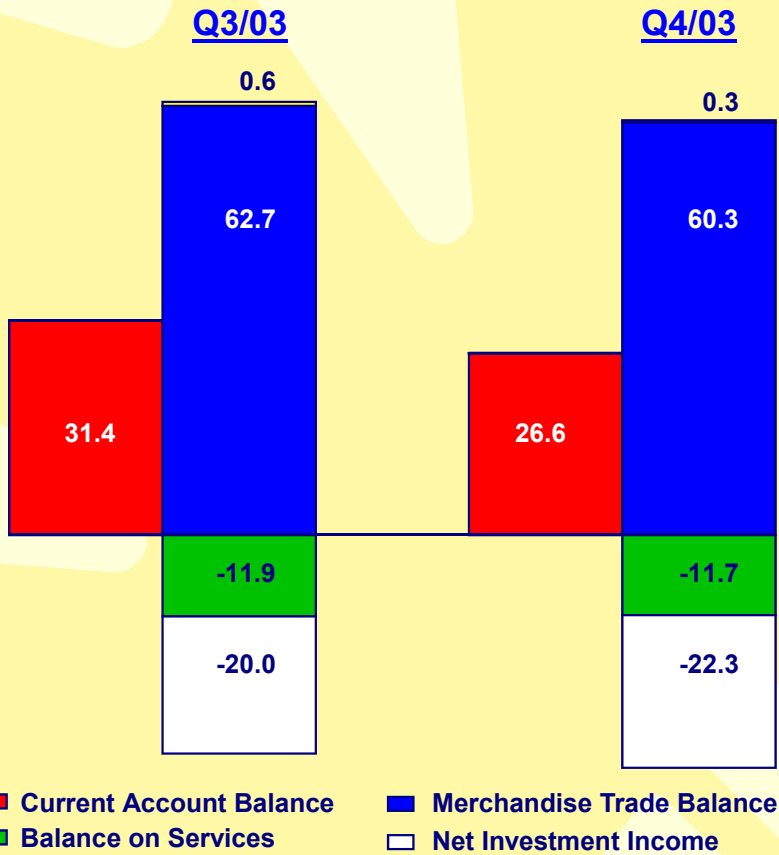
**Main Components of the Current Account**

\$ Billion, SAAR

The merchandise trade surplus reached \$15.1 billion (\$60.3 billion annualized) in the fourth quarter, \$0.6 billion lower than the previous quarter. Exports decreased while imports rose.

Meanwhile, the deficit in services decreased by less than \$0.1 billion to \$2.9 billion. The largest change came from the travel sector. Expenditures on travel abroad led to a \$0.2 billion increase in the deficit.

Furthermore, the deficit on investment income increased \$0.6 billion to \$5.6 billion, as profits earned by Canadian investors abroad diminished, mainly in the energy and finance and insurance sectors.



Source: Statistics Canada

## Merchandise exports continued to decrease, but at a slower pace...

In December, exports rose 3.6%, led by automotive products (+8.0%) and industrial goods & materials (+6.8%). Automotive products posted their second highest percentage gain of 2003 as production resumed on several assembly lines. Forestry products posted the only decrease.

Merchandise exports declined 0.3% in the fourth quarter, after posting a decrease of 0.6% in the third. Losses were concentrated in energy and machinery & equipment.

Exports in 2003 were down 3.2% from the previous year. The decline was led by automotive products and machinery & equipment. Energy products was the only category that posted a gain, as strong demand and high prices were behind the increase. On a regional basis, exports to the U.S. fell 4.6%, the third consecutive annual decline.

### Merchandise Exports, 2003

	\$ Billion	% Change Jan.-Dec./02 - Jan.-Dec./03
<b>Total</b>	<b>401.2</b>	<b>-3.2</b>
<u>By Trade Partner</u>		
U.S.	331.1	-4.6
Japan	9.9	-3.8
E.U.	24.2	6.2
All Others	36.1	5.2
<u>By Principal Commodity</u>		
Agricultural & Fishing Products	29.3	-5.2
Energy Products	61.3	23.7
Forestry Products	34.5	-7.2
Industrial Goods & Materials	66.6	-5.2
Machinery & Equipment	89.2	-8.3
Automotive Products	87.9	-9.4
Other Consumer Goods	17.1	-3.1

Source: Statistics Canada



## **...while merchandise imports increased**

In December, imports rose 0.7% as energy (+7.0%) and industrial goods & materials (+1.9%) imports posted strong gains. Imports increased for all major sectors except other consumer goods and forestry products.

Merchandise imports edged up 0.3% in the fourth quarter, after declining 2.9% in the third. Increases were led by automotive products and industrial goods & materials.

In 2003, imports fell 4.2% compared to the previous year. Losses were concentrated in machinery & equipment and automotive products. Regionally, lower imports from the U.S., Japan and the E.U. offset gains with all other regions.

### **Merchandise Imports, 2003**

	\$ Billion	% Change Jan.-Dec./02 - Jan.-Dec./03
Total	341.4	-4.2
<u>By Trade Partner</u>		
U.S.	239.2	-6.2
Japan	10.7	-9.1
E.U.	34.9	-3.5
All Others	56.6	5.6
<u>By Principal Commodity</u>		
Agricultural & Fishing Products	21.5	-1.2
Energy Products	19.6	18.3
Forestry Products	3.0	-3.7
Industrial Goods & Materials	65.1	-5.5
Machinery & Equipment	98.2	-7.2
Automotive Products	76.4	-6.3
Other Consumer Goods	46.2	-0.5

Source: Statistics Canada

## Canadians invested more in foreign enterprises

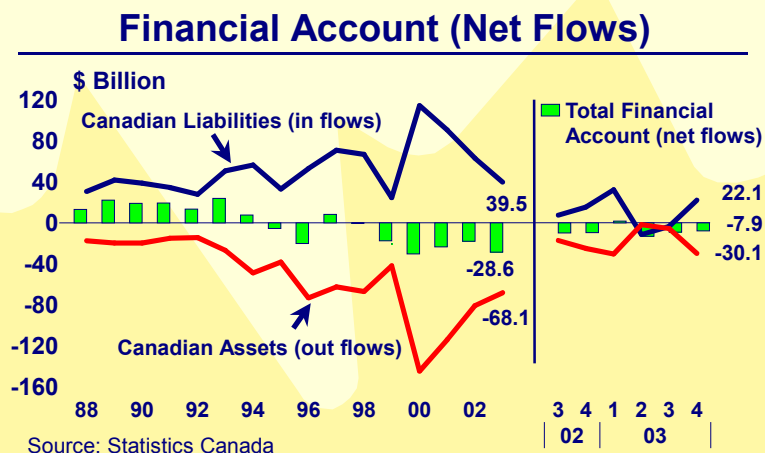
Canadians invested \$30.1 billion abroad while foreigners invested \$22.1 billion in Canada in the fourth quarter. For 2003 as a whole, Canadians invested \$68.1 billion abroad and foreigners invested \$39.5 billion in Canada.

### Direct Investment

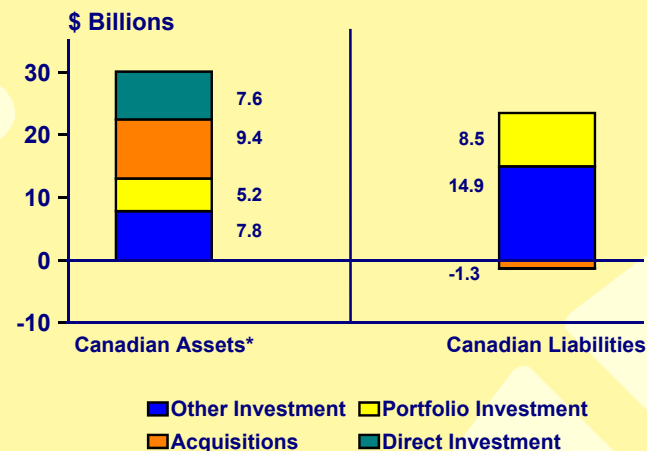
Canadian direct investment abroad rose sharply in the fourth quarter (\$17.1 billion), with most coming from the acquisitions of foreign enterprises in finance and insurance and energy and metallic minerals related businesses. However, it fell to \$30 billion in 2003 from \$45 billion in 2002. Foreign direct investors withdrew funds from Canada (\$1.3 billion) for a second straight quarter, resulting in foreign direct investment to average only \$8.2 billion in 2003, down from \$32 billion in 2002 and the lowest in ten years.

### Portfolio Investment

Canadians bought \$3.2 billion of foreign stocks, the highest investment in shares during the year 2003. Foreign investors increased their holdings of Canadian bonds by \$3.7 billion. They also purchased \$5.2 billion of Canadian shares, an amount similar to the previous quarter.



### Financial Account Components Q4/2003



Source: Statistics Canada

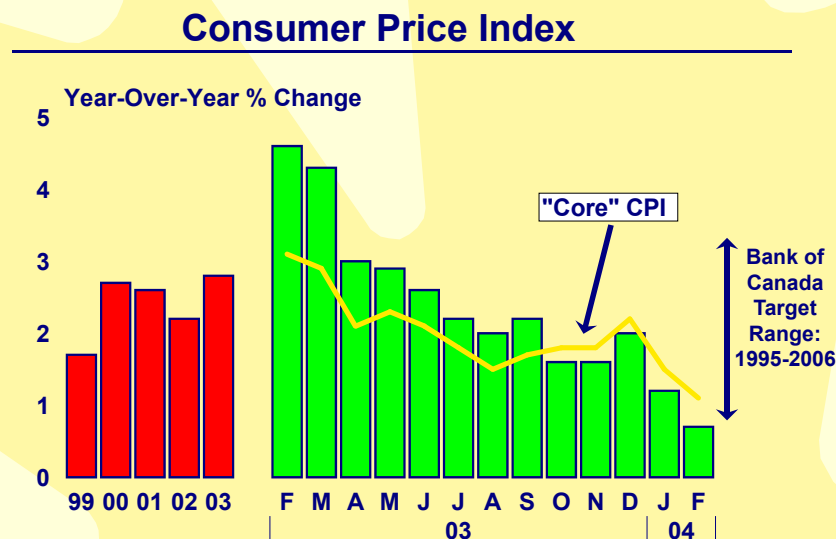
**Domestic Scene**

***Price Movements***

## ***Inflation plunged in February...***

The year-over-year change in the Consumer Price Index (CPI) was 0.7% in February. CPI inflation has trended downward since last February when energy prices were considerably higher.

"Core" inflation – which excludes the most volatile components of the overall CPI and indirect taxes, and is the target for monetary policy – fell to 1.1% from 1.5% in January, near the bottom of the official 1-3% target range.



In May 2001, the 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

## **...with all components registering a decrease compared to January**

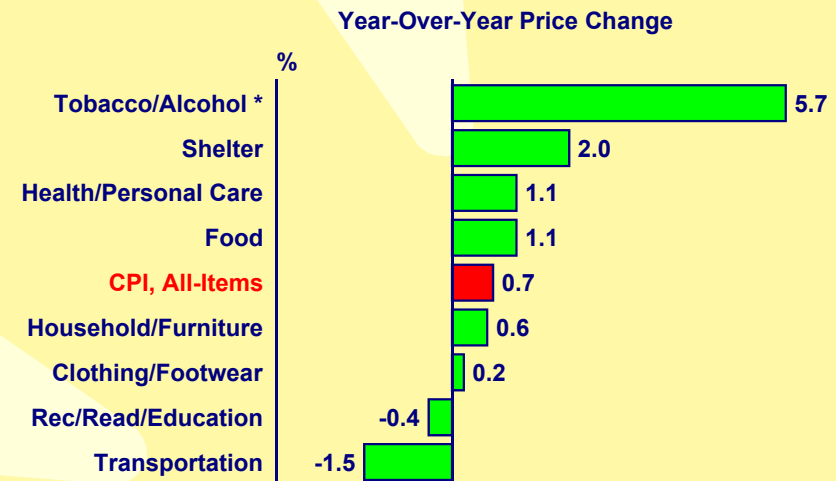
**CPI inflation moderated to 0.7% in February, from 1.2% in January and the lowest since December 2001.**

- Declines in transportation costs, mostly due to falling gasoline prices and lower purchase and leasing costs for automobiles exerted downward pressure on inflation.
- Increases in alcohol & tobacco product prices eased, following tax increases last year.

**Energy prices fell 3.6%, following a 1.1% decline in January.**

- A small increase in natural gas prices was offset by marked declines in gasoline and fuel oil prices.
- Excluding energy, CPI inflation was 1.1% in February, down from 1.5% in January.

### **Components of CPI: February 2004**



\* 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

## Industrial prices fell again in January

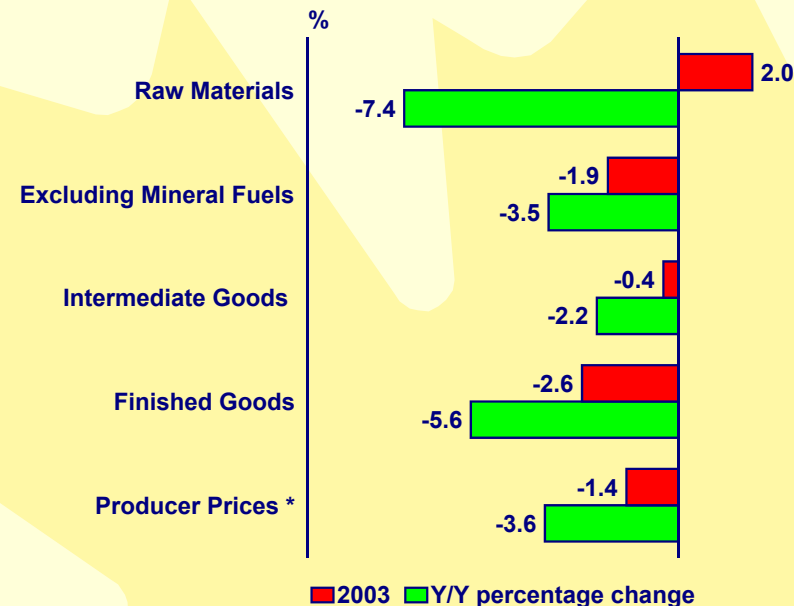
Prices fell 3.6% year-over-year in January, the tenth consecutive month that industrial product prices – those received by producers at the factory gate – declined. The appreciation of the Canadian dollar in January continued to depress prices.\*

- Automobiles, wood products, and electrical and communication products remained the main contributors to the price decline.
- On a monthly basis, prices were up 0.4% in January, reflecting higher prices for petroleum and coal, primary metals, and lumber.

Raw material prices fell 7.4% in January, following a 5.1% drop in December.

- Crude oil, and vegetable and animal products had the largest influence on the year-over-year decline in raw material prices.
- On a monthly basis, crude oil and non-ferrous metals prices led the 2.4% rise in the raw material price index.

### Price Chain - January 2004



\* 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 0.8% year-over-year and on a monthly basis, instead of rising 0.4% from December to January.

Source: Statistics Canada

**Domestic Scene**

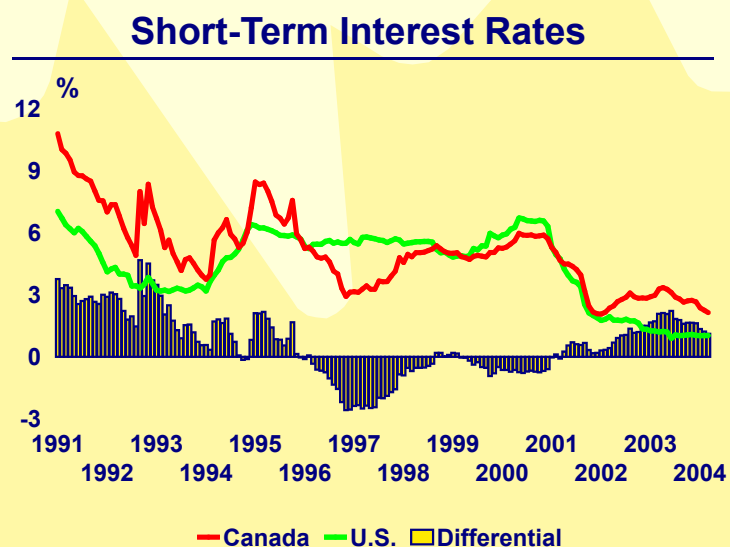
*Financial Variables*

## ***The Bank of Canada continued to reduce interest rates to support economic activity***

On March 2, the Bank of Canada reduced its overnight target rate by 25 basis points (bps) to 2.25% to support aggregate demand and return inflation to the target range. Since last July, the Bank has cut its overnight rate by a total of 100 bps. It is widely expected that the Bank of Canada will cut interest rates further at its next interest rate announcement on April 13.

In the U.S., the Federal Reserve left its federal funds rate unchanged at 1.0% on March 16. In light of low inflation and still slack labour markets, the Federal Reserve is expected to keep interest rates steady in the near term.

Consistent with these developments, the spread between the Canadian 90-day corporate paper rate and its U.S. counterpart has narrowed by about 110 bps since June to about 111 bps on March 17.



Last data point plotted: March 17, 2004

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

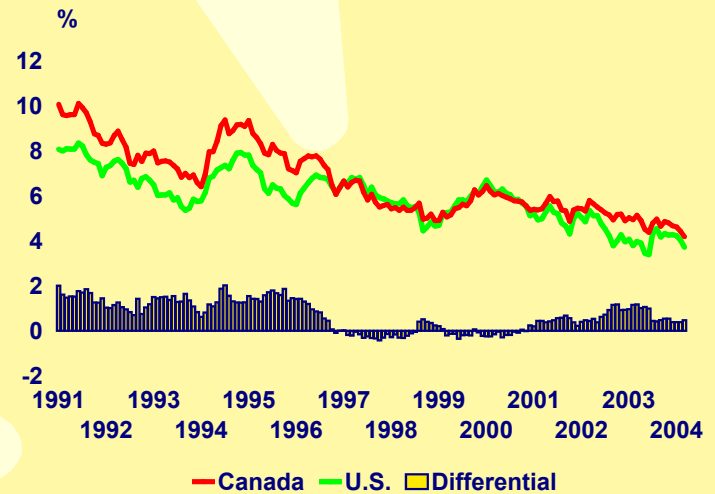


## ***Bond yields trended downward in line with low interest rates***

North American long-term bond yields have trended down since reaching recent highs in the fall of 2003. The downward trend reflects weaker than expected economic conditions, particularly in Canada.

- The Canada-U.S. 10-year bond yield differential has remained near 39 bps, down 15 bps since last November.

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



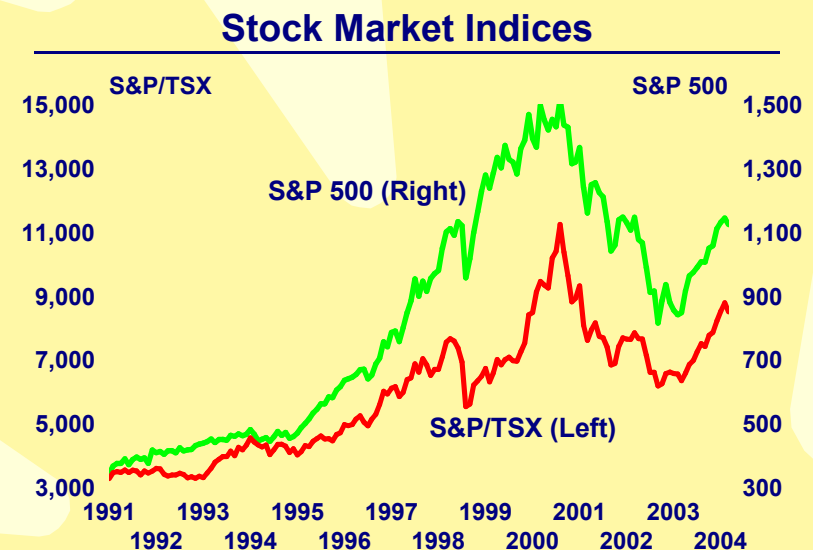
Last data point plotted: March 17, 2004

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

## Equity markets continued to rise

Optimism about a sustained recovery in corporate profits and some good news in the technology sector in the latter part of 2003 and the early part of 2004 pushed stock market indices higher. However, a recent pullback in technology stocks has put some downward pressure on stock markets in March.

- On March 17, the S&P/TSX index closed at 8503, up 4% since the start of this year and up 49% from the low of October 9, 2002. In the U.S., the S&P 500 was at 1124, up 1% since the start of the year.



Last data point plotted: March 17, 2004

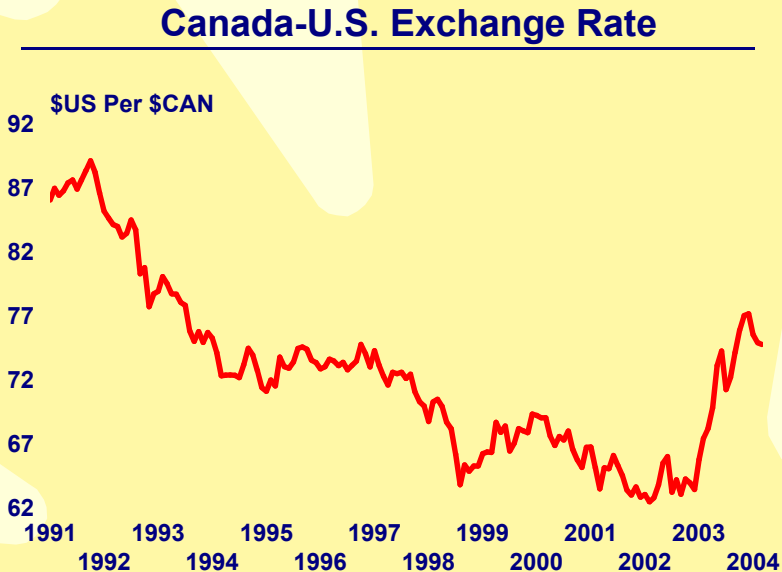
On May 1st, Canada's main equity index was renamed the Standard & Poor/Toronto Stock Exchange index (S&P/TSX).

Source: Statistics Canada

**The Canadian dollar is averaging US75¢**

The Canadian dollar has averaged around US75¢ in recent months since hitting a ten-year high of US78.8¢ in early January. This reflected, at least in part, the lowering of interest rates in Canada which resulted in a significant narrowing of the spread between Canada-U.S. short-term interest rates.

The U.S. dollar has also recently appreciated relative to other currencies, including the Euro and the Australian dollar, while depreciating vis à vis the Yen.



Last data point plotted: March 17, 2004

Source: Bank of Canada

**Domestic Scene**

***Fiscal Track***

## The federal government presented a balanced budget for 2004-05

On March 23, 2004, the Federal Government presented a balanced budget for 2003-04 and the next two fiscal years. Further details can be found in the attached Annex.

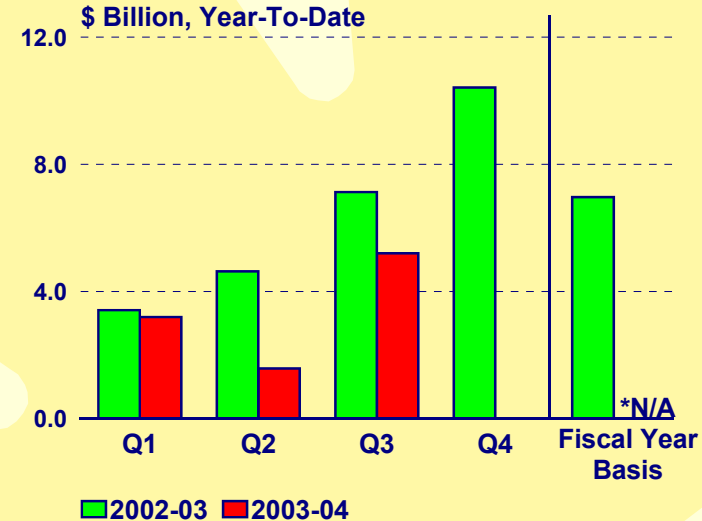
- The budgetary surplus is estimated at \$5.5 billion for the April 2003 to January 2004 period, down from the surplus of \$7.2 billion reported for the same period of 2002-03.
- The 2004 Budget expects the surplus for 2003-04 to be \$5.5 billion, with \$3.6 billion allocated to health and agriculture, and the remaining \$1.9 billion to the Contingency Reserve.

The combined provincial-territorial sector is expected to post a deficit for the second consecutive year. The estimated \$5 billion deficit largely reflects sizeable deficits in Ontario and British Columbia. Although five provinces are projecting balanced budgets or better, only Alberta is forecasting a significant surplus.

On March 24, 2004, Alberta presented the eleventh-consecutive balanced budget. Alberta expects to pay off another \$1 billion over the next two years, cutting the debt to \$2.7 billion by the end of 2005-06.

The provinces of Newfoundland and Labrador, New Brunswick, Quebec and Saskatchewan were scheduled to present a budget in the last week of March.

### Federal Budgetary Balance



Source: Department of Finance Canada

\* Fiscal year data for 2003-2004 is not yet available.

# **U.S. Developments**

*Real Economic Activity*

## ***U.S. economic activity remained strong in the fourth quarter***

Real GDP was halved to 4.1% (annual rate) in the fourth quarter (preliminary) after a twenty-year record pace of 8.2% in the third quarter.

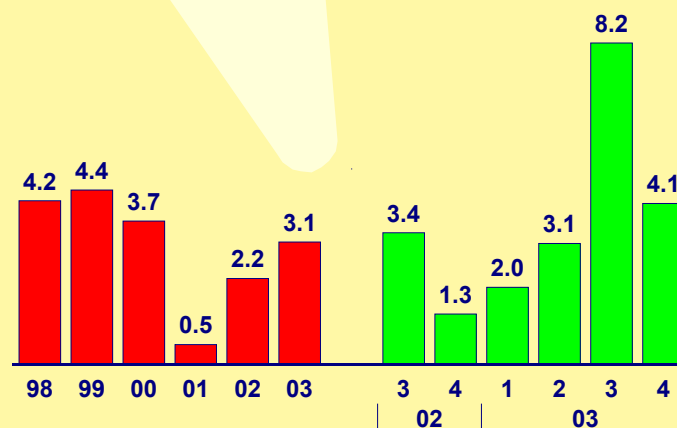
- Real personal consumption spending slowed by more than half to 2.7%, while business spending on structures fell further (-7.1%). Equipment spending remained strong, up 15.1%.

- Export growth more than doubled to 21%, but stronger import growth widened the trade deficit.

Nonfarm business sector productivity fell from 9.5% in the third quarter to 2.6% in the fourth quarter, as hours worked posted their largest rise since the first quarter of 2000, up 1.5%.

### **Real GDP Growth**

% Change, SAAR



Source: U.S. Department of Commerce

Data released in early 2004 point to softer consumer spending and moderating optimism. However, car sales, housing markets and business activity have remained strong. Moreover, the manufacturing and non-manufacturing indices from the Institute for Supply Management (ISM) have shown broad-based growth and a positive outlook going forward while industrial production has continued to rise.

Year-over-year total CPI inflation was only 1.7% in February, the lowest since September 2002. Excluding food & energy, inflation was 1.2%.

The March consensus outlook calls for real GDP growth of 4.6% in 2004 and 3.7% in 2005.

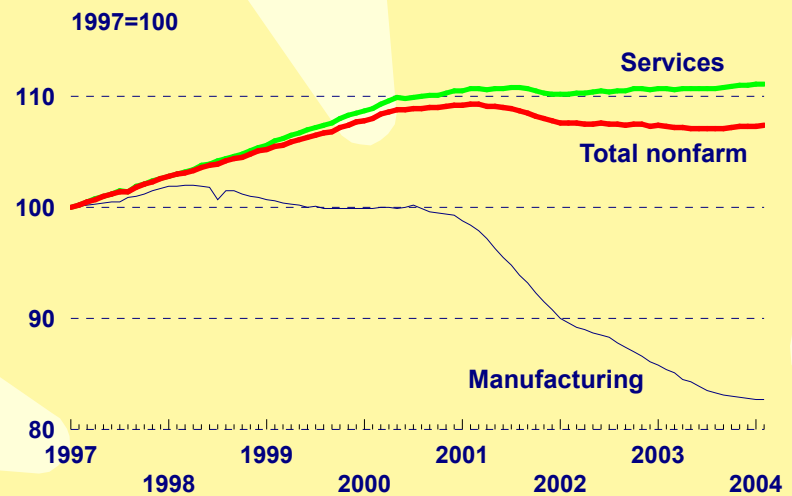
## **Employment was weak in February**

**Nonfarm payroll job employment rose by 21,000 in February on gains of 46,000 in service-producing industries. The cumulative gains since August 2003 have been 364,000.**

- **Manufacturing employment fell by 3,000 compared to monthly average losses of 16,000 since August.**

**The unemployment rate was 5.6% in February, unchanged from January and down from a recent high of 6.4% in June 2003. The participation rate fell further to 65.9%, pursuing a downward trend that started out at 67.4% in early 2000.**

### **Employment Trend**



Source: U.S. Bureau of Labour Statistics



## ***For Further Information***

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

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**(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 March 24, 2004.

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

**ISSN 1206-260X**



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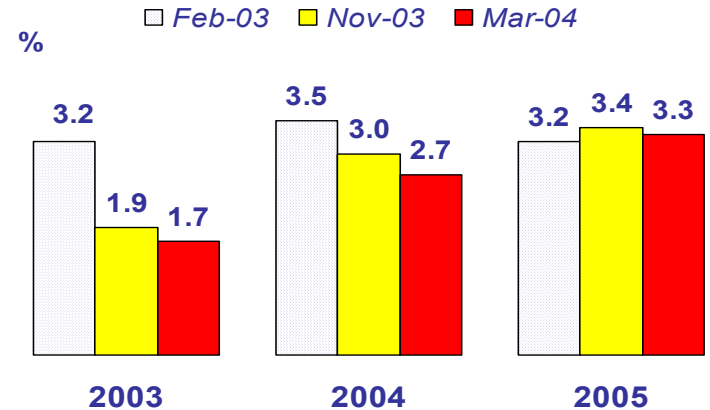
# *Annex*

## *Budget 2004 Highlights*

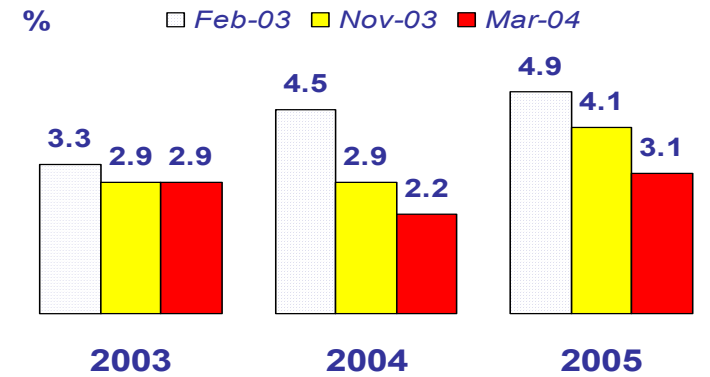
# The Economic Outlook

- The economic outlook for Canada has been downgraded somewhat since the February 2003 budget. Meanwhile, the U.S. outlook was upgraded.
  - The Canadian economy grew by 1.7% in 2003, well below 3.2% growth expected in the February 2003 budget. Supported by strong domestic fundamentals, low interest rates, and a pick-up in the global economy, growth is expected to rise to 2.7% in 2004 and to 3.3% in 2005.
  - The U.S. economy picked up in the second half of 2003 and is expected to grow by 4.7% in 2004 and 3.8% in 2005.
- Risks to the outlook are the appreciation of the Canadian dollar and the sustainability of the U.S. recovery.

## Real GDP Growth



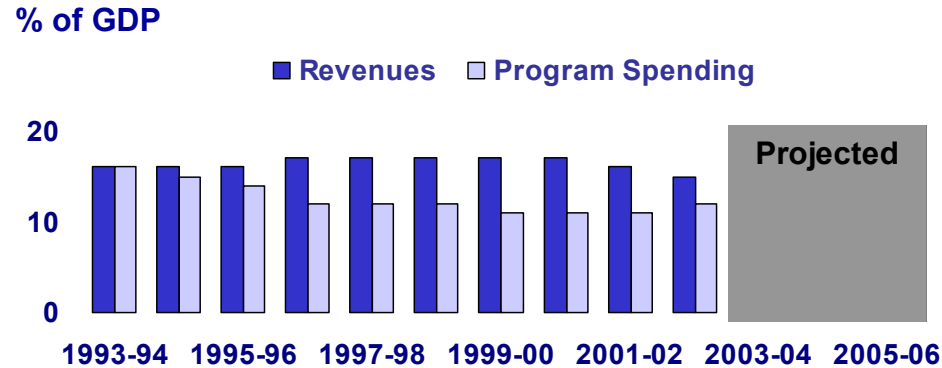
## 3-month Treasury Bill Rate



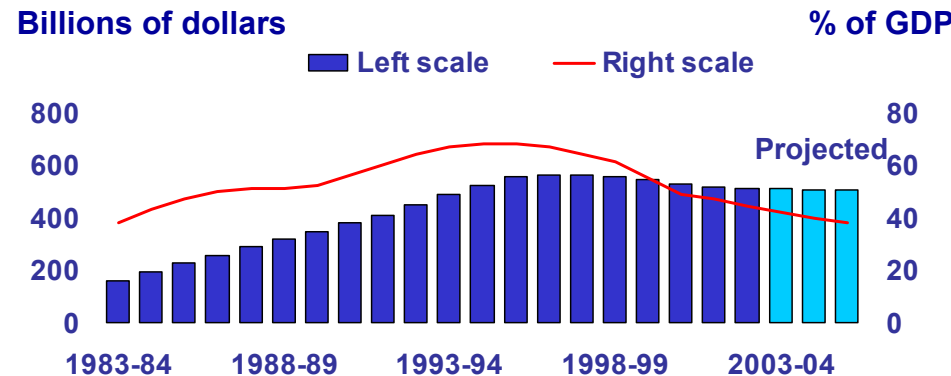
# The Fiscal Situation

- A balanced budget or better is foreseen for 2003-04 and the following two years.
- Revised figures for the planning budgetary surpluses are now \$5.5 billion in 2003-04, \$4.2 billion in 2004-05 and \$6.6 billion in 2005-06, up from the *Economic and Fiscal Update* of last November.
- Revenues are projected to rise to \$181.1 billion (or 14.9% of GDP) in 2003-04 and to \$187.2 billion (or 14.8% of GDP) in 2004-05.
- Program spending is expected to rise by 7.6% to \$143.4 billion in 2003-04 (or 11.8% of GDP) and to \$147.9 billion (or 11.7% of GDP) in 2004-05.
- The debt-to-GDP ratio is projected to fall to 42.0% in 2003-04, down from a peak of 68.4% in 1995-96. The Government has set a new objective of reducing the debt-to-GDP ratio to 25% within 10 years.

## Federal Revenues and Program Spending Public Accounts Basis



## Net Federal Debt Public Accounts Basis



# *Sound Financial Management*

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- The Budget sets the Contingency Reserve at \$1.9 billion for 2003-04. Moreover, the normal annual \$3-billion Contingency Reserve is maintained and the \$1 billion in economic prudence restored in 2004-05 and 2005-2006.
- The Government set a new objective of reducing the debt-to-GDP ratio to 25% within 10 years.
- The Budget confirms the ongoing nature of the \$1 billion reallocation. In addition, the Cabinet Committee on Expenditure Review is mandated to conduct a review of all programs with the objective of finding at least \$3 billion in ongoing annual savings.
- To strengthen financial management, the Budget re-establishes the Office of the Comptroller General of Canada, strengthens the mandate of departmental comptrollers and announces stronger internal audit functions.

# Canadian Priorities: Health

---

Recognizing the importance of health, Budget 2004:

- Re-confirms the \$2 billion for the provinces and territories for health, bringing to \$36.8 billion funding provided under the 2003 Health Accord;
- Establishes a new Canada Public Health Agency and provides funding of \$665 million in 2003-04 and over the next two years to improve readiness to deal with public health emergencies; and
- Includes improvements to tax fairness for Canadians with disabilities and those who care for them, and provides increased funding of \$30 million annually to support employment assistance programs dedicated to Canadians with disabilities.

# Learning

---

Investments to promote learning in Canada and meet the ever increasing demand for skilled workers:

- New initiatives aimed at improving access to post-secondary education for low- and middle-income families:
  - A new Canada Learning Bond to help low-income families accumulate savings for their children's post-secondary education;
  - Enhancement of the Canada Education Savings Grants; and
  - Improvement to the Canada Student Loans program.
- \$125 million over 5 years for the Aboriginal Human Resources Development Strategy and doubling to \$50 million support for the Urban Aboriginal Strategy;
- \$15 million per year for language training for new immigrants and \$5 million per year to raise awareness about integration of skilled immigrants and recognizing credentials of internationally trained workers;
- Development of a Workplace Skills Strategy. \$15 million over 2 years for pilot Training Centre Infrastructure Fund.

# ***Knowledge and Commercialization***

---

Recognizing the critical importance of generating new knowledge and improving the commercialization of world-first innovations, Budget 2004 provides:

- New funding of \$270 million to enhance access to venture capital financing for companies turning promising research into new products and services;
- An additional \$20 million per year to universities and research hospitals to address their indirect costs.
- \$75 million over 5 years to Industry Canada for two new pilot competitive commercialization funds;
- A permanent increase of \$90 million per year for the three federal granting councils, with direction to triple current \$10 million support for commercialization efforts;
- A one-time contribution of \$60 million to Genome Canada in continued support of its research funding.





# Communities

The Federal Government recognizes the importance of supporting communities:

- \$7 billion in GST/HST relief for municipalities of all sizes over the next 10 years, and acceleration of the \$1-billion Municipal Rural Infrastructure Fund, with spending over the next 5 years instead of 10;
- New funding of \$4 billion over 10 years to clean up federal contaminated sites and sites for which the Government has partial responsibility;
- \$200 million to finance the development and commercialization of new environmental technologies over the next two years and a further \$800 million to be invested, as new opportunities and priorities are identified; and
- \$120 million in increased support for the social economy, including:
  - \$17 million over the next 2 years for Industry Canada-led pilot program in support of strategic planning and capacity building of community economic development organizations;
  - \$100 million over 5 years for Industry Canada-led program to increase lending to social economy enterprises and to develop up to four regional funds for social enterprises
- \$6 million over next 2 years to advance Voluntary Sector Initiative.

# Canada's Relationship to the World

The Government will restore Canada's place of influence and pride on the global stage:

- An additional \$250 million over two years will cover costs of Canada's participation in peacekeeping missions in Afghanistan and the fight against terrorism and an additional \$50 million for Canada's participation in the peacekeeping force in Haiti;
- An additional \$605 million over five years for the security contingency reserve;
- Exemption from tax of the income earned by Canadian Forces personnel and police while serving on high-risk international missions; and
- By building on the 8-percent increase in international assistance to \$3.2 billion for 2004–05 (already provided in the Budget 2003), an additional \$248 million for 2005–06.

# *Improving the Business Environment*

Ensuring that Canada has a strong and competitive business environment that encourages innovation and attracts investment and talent:

- Accelerated CCA rates for ICT assets (45% for computer equipment; 30% for data network infrastructure equipment);
- Increase of carry-forward period for non-capital losses from 7 to 10 years;
- Increase in small business deduction limit to \$300K accelerated to 2005;
- Small business working group on paper burden, with a mandate to identify short-term actions, strengthen regulatory processes and measure progress; and
- Actions to strengthen corporate governance standards in the Canada Business Corporations Act and reinforced commitment to new Not-For-Profit Act.