THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE JUNE 2006

OVERVIEW

- In the first quarter of 2006 real gross domestic product (GDP) grew 3.8%, following a 2.6% gain in the fourth quarter of 2005.
- Real final domestic demand, reflecting healthy employment and income growth, climbed 5.0% and boosted the need for increased domestic production. Residential investment and household spending on durables led the way. Net international trade made almost no contribution to output growth. Real exports dipped 0.9% while real imports fell 1.6%.
- The current account surplus dropped $9.5 billion from a record $52.1 billion in the fourth quarter of 2005. At 3.0% of nominal GDP, this was the 27th consecutive quarterly surplus.
- Since the end of 2005 the economy has created 220,200 net new jobs, almost all of them full-time. At 6.1% in May, the unemployment rate hit its lowest level in over 30 years.

Real GDP grows 3.8%

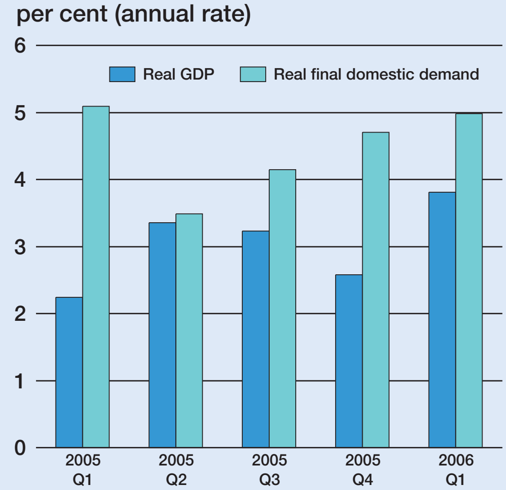
Real GDP rose 3.8% in the first quarter of 2006, as final domestic demand growth remained solid (Chart 1).

Consumer spending growth picks up

Real consumer expenditure grew 4.6% in the first quarter, a stronger pace than in the fourth quarter (Chart 2). Spending on durables, semi-durables and services rose while that on non-durables dipped. Sales of motor vehicles rebounded 6.7% following a sharp drop in the previous quarter. Spending on furniture and appliances rose sharply with a healthy housing market.

The 7.9% gain in personal income in the first quarter followed a 4.8% rise in the fourth. Wages and salaries increased 5.0%. While employment climbed more slowly than in the previous quarter, average hours worked per employee grew along

Chart 1
Growth in real GDP and real final domestic demand
per cent (annual rate)



Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, June 9, 2006.

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

	2004	2005	2005:Q3	2005:Q4	2006:Q1	Most recent	
Real gross domestic product	3.3	2.9	3.2	2.6	3.8		–
Final domestic demand	4.2	4.3	4.1	4.7	5.0		–
Government expenditure							–
Goods and services	3.0	2.7	3.0	4.4	2.3		–
Gross fixed capital	3.3	6.8	8.1	13.4	3.1		–
Consumer expenditure	3.3	3.9	2.6	3.6	4.6		–
Residential investment	7.8	3.2	5.5	0.0	14.2		–
Business fixed investment	9.1	9.4	12.3	11.4	6.5		–
Non-residential construction	7.4	7.9	10.9	12.0	7.5		–
Machinery and equipment	10.3	10.5	13.4	10.8	5.7		–
Business inventory investment ($ billion)	9.7	15.5	15.0	14.9	10.1		–
Exports	5.2	2.1	8.5	6.4	-0.9		–
Imports	8.2	7.1	11.2	12.7	-1.6		–
Current account balance							
(nominal $ billion)	27.6	31.8	32.4	52.1	42.6		–
(percentage of GDP)	2.1	2.3	2.3	3.7	3.0		–
Nominal personal income	5.0	5.0	6.6	4.8	7.9		–
Nominal personal disposable income	4.7	4.2	6.4	4.3	8.7		–
Real personal disposable income	3.2	2.5	3.7	3.7	7.2		–
Profits before taxes	18.3	10.6	20.2	23.6	-15.3		–
Costs and prices (%, y/y)							
GDP price deflator	3.0	3.2	3.4	4.1	3.0		–
Consumer Price Index	1.9	2.2	2.6	2.3	2.4	2.4	Apr-2006
CPI excluding eight most volatile items	1.5	1.6	1.6	1.6	1.7	1.6	Apr-2006
Unit labour costs	1.4	2.3	2.8	3.2	2.5		
Wage settlements (total)	1.8	2.3	2.8	1.7	2.2	2.2	Mar-2006
Labour market							
Unemployment rate (%)	7.2	6.8	6.8	6.5	6.4	6.1	May-2006
Employment growth	1.8	1.4	1.5	2.4	1.6	7.3	May-2006
Financial markets (average)							
Exchange rate (U.S. cents)	77.0	82.6	83.3	85.2	86.6	89.12	08-Jun-06
Prime interest rate (%)	4.0	4.4	4.3	4.8	5.3	6.00	08-Jun-06

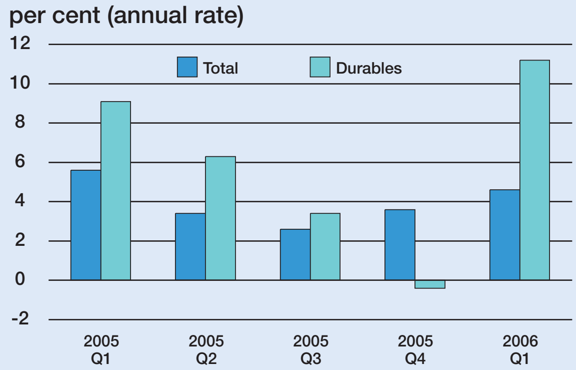
Note: Real values are in chained 1997 dollars.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development.

with average hourly compensation. Adding to personal income in the quarter were government transfers from three unique programs: the Alberta Resource Rebate program, Ontario's credit on electricity bills and the federal Energy Cost Benefit. Real personal disposable income jumped 7.2%, a 15th consecutive increase. Per capita real disposable income rose 6.6% and stood 21.1% above its recent trough in the second quarter of 1996. The personal savings rate was 1.9%, up from 1.3% in the previous two quarters.

Residential investment increases

Solid employment and income growth plus still low interest rates supported a vibrant housing market in the first quarter. Residential investment increased 14.2%, the strongest quarterly advance in more than two years. With warmer than usual weather, housing starts climbed to their highest level since 1987, boosting new construction activity 19.7%. House resales grew, boosting agents' commissions and ownership transfer costs. Renovations increased 9.4%.

Chart 2
Growth in consumer spending: total and durables



Business fixed investment climbs

Supported by still healthy profitability, above average capacity utilization, and lower import prices due to the appreciating dollar, business spending on plant and equipment registered a 13th consecutive increase in the first quarter, growing 6.5%. Non-residential construction grew a solid 7.5% after increasing 12.0% in the fourth quarter of 2005. For the fifth consecutive quarter, both building construction, such as office towers and shopping malls, and engineering projects contributed to growth. Although growth in engineering projects slowed from a double-digit pace in the previous two quarters, it remained solid, as higher energy prices have boosted investment in oil and gas extraction.

Investment in machinery and equipment increased 5.7%. Higher investment in cars, trucks, industrial machinery and computers more than offset reduced spending on other transportation equipment and software.

Business slows inventory buildup

Businesses added $10.1 billion to inventories, down from a $14.9-billion accumulation in the fourth quarter. Energy sector inventories fell during the quarter following an accumulation in the previous quarter. Additions to stocks occurred mostly in the retail sector. The inventory-to-sales ratio remained low.

Exports dip

Real exports declined 0.9% in the first quarter. Exports of automotive and forest products declined sharply. Trucks in particular saw a large drop as high gasoline prices weakened U.S. sales of vans and SUVs, especially in the fourth quarter of 2005. Exports of machinery and equipment climbed, reflecting the strength of investment in the United States, while energy exports rose sharply, lowering inventories. Exports of services increased 4.0%.

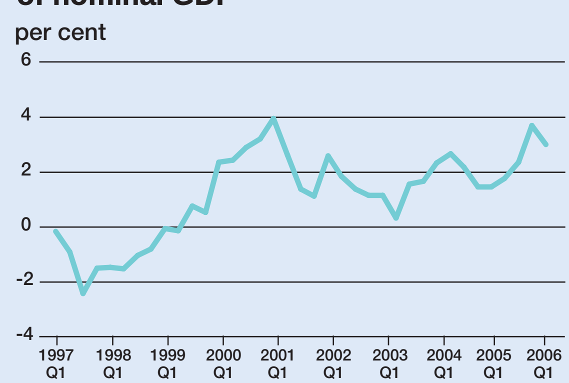
Imports decrease more than exports

Real imports decreased 1.6%, following two consecutive double-digit increases. A 47.3% drop in energy imports was largely responsible for the overall decline. Machinery and equipment imports slipped as well. A 9.1% gain in non-automotive consumer goods imports followed two consecutive double-digit increases. Imports of automotive products edged higher. Imports of services increased 5.6%.

Current account surplus shrinks

In the first quarter, the terms of trade fell as export prices declined more than import prices. The export price decline largely resulted from lower natural gas prices. The nominal trade surplus fell by $13.5 billion; however, lower dividend and interest payments to non-residents led to a $5.2-billion improvement in the investment income deficit. The current account surplus decreased to $42.6 billion or 3.0% of GDP from a record level of $52.1 billion in the fourth quarter of 2005 (Chart 3).

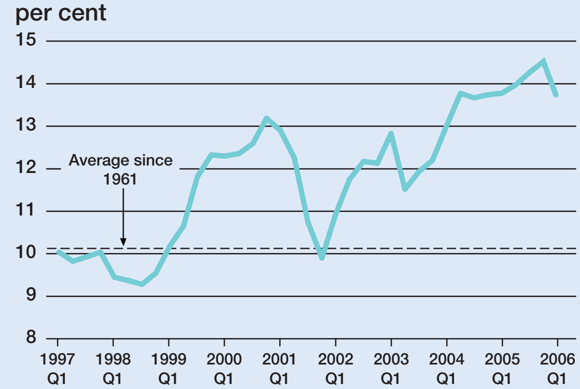
Chart 3
Current account as a percentage of nominal GDP



Corporate profits slip but remain healthy

In the first quarter, corporate profits declined 15.3%. However, at 13.7%, profits as a share of GDP remained well above the 10.2% historical average (Chart 4). Lower commodity prices reduced profits in primary industries such as oil and gas extraction and metal mining. Petroleum and coal manufacturers' profits dropped, as unusually warm weather weakened demand. Strong consumer spending, however, pushed up retailers' profits.

Chart 4
Profits before taxes as a share of nominal GDP



Consumer price inflation remains subdued

Reflecting lower energy prices, the GDP deflator, a comprehensive measure of prices, decreased 2.8% in the first quarter to stand 3.0% higher than a year earlier.

Thanks in part to higher gasoline prices, year-over-year consumer price inflation rose to 2.4% in April from 2.2% in March. At 1.6% in April, core CPI inflation, which excludes the eight most volatile items, remained below the mid-point of the 1% to 3% target band.

Unemployment rate declines in May

Employment grew 1.6% in the first quarter, and another 118,700 jobs were added in April and May. Since the end of 2005 the Canadian economy has created 220,200 net new jobs, almost all of them full-time. The participation rate stood at 67.3% in May, up from 67.1% last December, but below its record high of 67.7% set in the second quarter of 2004. The employment rate rose to an all-time high of 63.2% in May.

The unemployment rate dropped 0.3 percentage points in May and sat at 6.1%, its lowest level in over 30 years.

Hourly labour productivity increased 2.1% in the first quarter and was 1.8% higher than a year earlier. Labour costs per unit of output rose 0.7% in the first quarter to stand 2.5% higher than a year earlier.

Bank of Canada raises policy rate

On May 24, the Bank of Canada raised its key policy rate—the target for the overnight rate—by one quarter of a percentage point to 4.25 per cent, the seventh increase in nine months. The Bank stated that the target rate was now at a level that is expected to keep the Canadian economy on its projected path and to return inflation to the 2-per-cent target. The U.S. Federal Reserve raised its target 25 basis points to 5.00 per cent on May 10, the 16th increase since June 2004. U.S. rates at all maturities are higher than those in Canada.

The Canadian dollar climbed to close at a 28-year high of 90.95 U.S. cents on May 10, as commodity prices remained high. It then eased to 89.12 U.S. cents on June 8.

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 Steven James at 613 992-4321. Also available on the Internet at www.fin.gc.ca

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