The Economy in Brief

DEPARTMENT OF FINANCE JUNE 2001

Overview

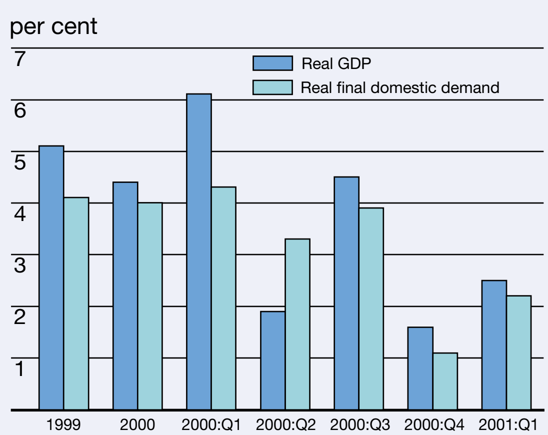
- In the first quarter of 2001 real gross domestic product (GDP) grew 2.5%. The increase was above that in the fourth quarter (1.6%) but below the 4.4% annual growth in 2000.
- Growth was supported by stronger real final domestic demand, primarily in the areas of consumer spending and residential construction. Also boosting real GDP was a shift in demand to Canadian-made products, as imports dropped 11.0%.
- While the volume of exports fell 5.7%, reflecting weakening demand from the United States, nominal exports rose, led by higher energy prices. That pushed the current account surplus to a record $50.9 billion, or 4.6% of nominal GDP.
- Employment growth resumed, with a gain of 55,000 net new jobs in March and April after a loss in February and no gain in January. More than 355,000 net new jobs have been created since the end of 1999. The unemployment rate in April 2001 was 7.0%.

Modest real GDP growth continues

In the first quarter of 2001 the Canadian economy continued its more modest expansion after strong growth in the previous two years. This was the 36th consecutive quarterly gain. Real final domestic demand increased 2.2% after a gain of 1.1% in the fourth quarter, and shifted somewhat toward Canadian-produced goods and services. These factors boosted Canadian output (Chart 1). However, increased demand was partly satisfied from inventories, resulting in reduced inventory accumulation. That plus lower foreign demand moderated the pace of growth.

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is noon, May 31, 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:Q3	2000:Q4	2001:Q1	Most recent	
Real gross domestic product	5.1	4.4	4.5	1.6	2.5		–
Final domestic demand	4.1	4.0	3.9	1.1	2.2		–
Government expenditure							
Goods and services	2.6	2.2	1.2	3.5	4.8		–
Gross fixed capital	12.3	7.6	7.0	2.2	-3.6		–
Consumer expenditure	3.4	3.6	5.2	1.2	3.6		–
Residential investment	5.3	2.7	9.7	3.9	6.4		–
Business fixed investment	7.2	8.1	-0.3	-3.5	-7.5		–
Non-residential construction	1.8	5.3	-0.5	2.7	0.5		–
Machinery and equipment	10.5	9.7	-0.1	-7.0	-12.0		–
Business inventory investment ($ billion)	4.6	9.2	10.4	4.5	1.9		–
Exports	9.9	7.6	1.2	-0.1	-5.7		–
Imports	7.3	8.1	-0.3	-9.1	-11.0		–
Current account balance							
(nominal $ billion)	1.7	26.9	27.6	34.2	50.9		–
(percentage of GDP)	0.2	2.5	2.6	3.2	4.6		–
Real personal disposable income	3.3	3.5	-0.4	6.7	5.4		–
Profits before taxes	21.9	21.8	12.9	7.5	16.2		–
Costs and prices (%, y/y)							
GDP price deflator	1.4	3.7	3.5	3.4	3.6		–
Consumer price index	1.7	2.7	2.7	3.1	2.8	3.6	Apr-2001
CPI – excluding food and energy	1.5	1.5	1.5	1.7	1.9	2.1	Apr-2001
Unit labour costs	0.8	2.3	2.0	2.7	2.8		
Wage settlements (total)	2.2	2.5	2.3	2.9	3.6	3.8	Mar-2001
Labour market							
Unemployment rate (%)	7.6	6.8	6.9	6.9	7.0	7.0	Apr-2001
Employment growth	2.8	2.6	1.0	3.0	0.9	2.0	Apr-2001
Financial markets (average)							
Exchange rate (cents U.S.)	67.32	67.34	67.47	65.55	65.47	64.70	30-May-2001
Prime interest rate (%)	6.44	7.27	7.50	7.50	7.08	6.25	30-May-2001

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

Consumer spending strengthens

Real consumer expenditure advanced a healthy 3.6% in the first quarter, three times its pace in the previous quarter, and dominated the gain in final domestic demand. Spending growth on durables surged 11.6%, with strong gains in automotive products, furniture and appliances, while that on services eased somewhat.

Personal income increased robustly, rising more than in the fourth quarter, with solid increases in all major categories except investment income. Labour income rose more robustly than in the previous quarter even though employment growth slowed, as average hours worked per week jumped. Real personal disposable income was up over 5% and in per capita terms increased to its highest level ever.

With personal disposable income growth outpacing that of nominal consumer spending, the personal savings rate rose to 4.4% from 4.0%.

Business fixed investment continues to fall

Business spending on plant and equipment was 7.5% less in the first quarter than in the fourth, the third consecutive decline. Investment in import-intensive machinery and equipment fell 12.0% after dropping 7.0% in the previous quarter. While they were widespread, the declines were especially evident in transportation and telecommunications equipment. However, non-residential construction, which is largely satisfied by domestic production, increased a modest 0.5%, with growth in engineering projects more than offsetting a decline in building projects.

Residential investment remains strong

Residential investment, which is also largely satisfied by domestic sources, jumped 6.4% in the first quarter following a gain of 3.9% in the fourth. Growth in new construction activity rose sharply with housing starts, gaining about 16%. Ownership transfer costs registered a healthy gain while spending on renovations declined.

Businesses are correcting inventories

Inventory accumulation in the first quarter was lower than in the fourth and subtracted from GDP growth. Business inventories increased $1.9 billion after rising $4.5 billion in the previous quarter. This largely reflected a need to reduce stocks in the automotive sector.

Imports fall more than exports

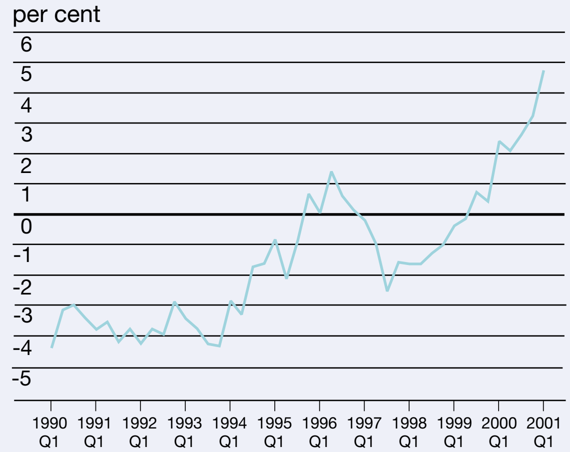
With domestic demand shifting toward Canadian-produced goods and services, real imports dropped 11.0% in the first quarter. This decline was largely in automotive products, consistent with the inventory correction in that sector, and machinery and equipment, reflecting reduced business investment.

Foreign demand for Canadian goods decreased in the first quarter. Exports of machinery and equipment and automotive products took the brunt of the 5.7% fall. This is consistent with the slowing of U.S. economic growth and the significant inventory correction in that country.

Another record current account surplus

With real exports falling less than real imports and the terms of trade improving (export prices rose more than import prices due largely to higher energy prices), the nominal trade surplus improved by more than $15 billion from its fourth-quarter level, achieving another new record. This boosted the current account surplus by over $16 billion to a record $50.9 billion, or 4.6% of nominal GDP (Chart 2), a sharp improvement from the $12-billion current account deficit in 1998.

Chart 2
Current account as a percentage of nominal GDP



Inflation remains subdued while labour costs rise

Underlying price and cost pressures remain subdued even though the chain price index for GDP advanced 5.0% in the first quarter to a level 3.6% higher than a year earlier. The size of the increase reflects the impact of higher export prices, in particular energy prices. Domestic inflation remains more subdued. While consumer price inflation was 3.6% in April on a year-over-year basis, up sharply from that in March, the increased pace in recent quarters is again largely due to higher energy prices. Underlying CPI inflation, which excludes food and energy, was 2.1% in April on a year-over-year basis.

Labour productivity registered a mixed result in the first quarter: output per employed person rose 1.6% while output per hour worked dropped 0.8%. As a result of that and strong wage growth, labour costs per unit of output rose 3.0% to a level 2.8% higher than a year earlier.

Energy boosts corporate profits

Pre-tax corporate profits increased for the 11th consecutive quarter and at double the pace in the fourth quarter, gaining 16.2% to a level 11.2% above that of a year earlier. Gains were notable in the energy sector, reflecting increased energy prices and energy rebate programs for businesses in Western Canada.

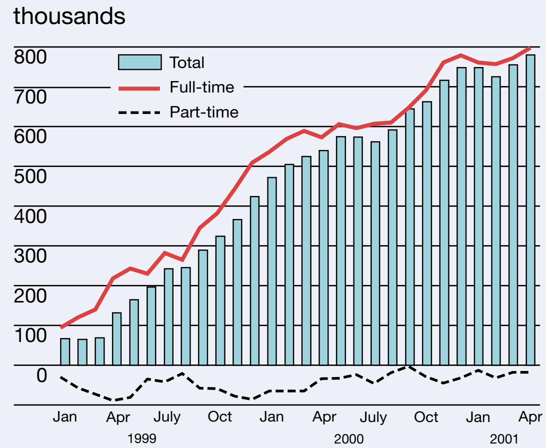
Unemployment remains low

First-quarter employment growth slowed, rising 0.9% after gaining 3.0% in the fourth quarter. Nonetheless, employment growth has been strong in recent years. With nearly 325,000 net new jobs created in 2000 plus another 55,000 added in March and April, the increase since the end of 1998 stands at over 780,000 (Chart 3). Full-time jobs have accounted for the total gain. The unemployment rate in April 2001 was 7.0%.

Short-term interest rates fall

In response to weakening economic growth, the U.S. Federal Reserve has lowered its target for the Federal Funds rate five times for a total of 250 basis points during 2001. The most recent change was a 50-basis-point decline on May 15. The Bank of Canada lowered its Bank Rate four times over the same period by a total of 125 basis points, with the most recent change a 25-basis-point decline on May 29.

Chart 3
Cumulative employment growth since December 1998



Long-term interest rates in the U.S. have risen over the last two months despite the cuts to the Federal Reserve's target rate. They are similar to those in late November. Short rates have dropped more than 200 basis points since the beginning of the year and about 250 basis points since late November. Long rates have risen as much or more in Canada than in the U.S. while short rates have fallen significantly less than in that country. As a result, interest rates in Canada are generally above those in the U.S.

The widening gap with U.S. interest rates has helped the Canadian dollar to recover from recent weakness. After trading at about 65 cents U.S. in early March, the value of the Canadian dollar dropped in early April to near its record low close of 63.31 cents U.S. However, it has since rebounded and closed at 64.70 cents U.S. on May 30.

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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