THE ECONOMY IN BRIEF

DEPARTMENT OF FINANCE | JANUARY 2008

OVERVIEW

- In the third quarter of 2007 real gross domestic product (GDP) grew 2.9%, down from a 3.8% pace in the second quarter.
- Domestic demand growth remained solid. Real final domestic demand rose 4.6% compared to 4.9% in the second quarter. Business inventory accumulation was $15.4 billion after a smaller buildup of $4.5 billion in the second quarter.
- Real imports grew more than real exports, moderating real GDP growth and narrowing the nominal trade surplus and the current account surplus (the amount that receipts from non-residents exceed payments to them). The current account surplus decreased by $21.2 billion to $4.2 billion, falling to 0.3% of nominal GDP from 1.7% in the previous quarter.
- A healthy labour market has underpinned domestic demand growth. Employment rose 1.7% in the third quarter, up from 1.3% in the second quarter. In November, the unemployment rate was 5.9%, up slightly from 5.8% in October when it was at its lowest level in nearly 33 years.

Real GDP increases 2.9%

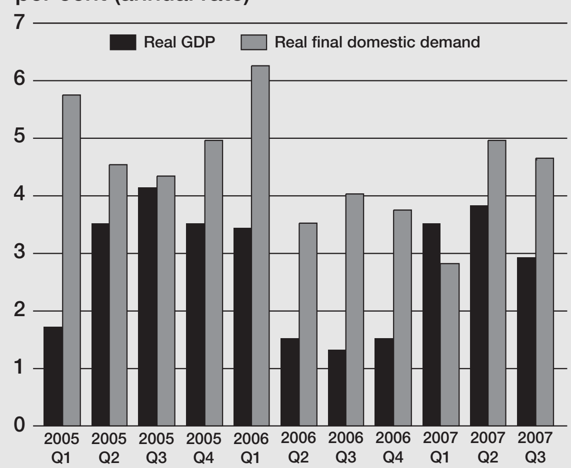
Real GDP rose 2.9% in the third quarter of 2007 (Chart 1). Domestic demand growth remained solid, with real final domestic demand and inventory investment both contributing to the gain. The increase in real final domestic demand outpaced that of real GDP for the 11th time in the last 12 quarters as real imports rose more than real exports.

Consumer spending stays healthy

Real consumer expenditure grew 3.0% in the third quarter of 2007, following a gain of 5.9% in the previous quarter. Spending on semi-durable goods and services (notably net spending abroad) increased, while that on durable goods (especially automotive products) and non-durable goods fell.

Note: Unless otherwise noted, data and per cent changes are quoted at annual rates. The cut-off date for data is end of day, December 18, 2007.

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



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

	2005	2006	2007:Q1	2007:Q2	2007:Q3		Most recent
Real gross domestic product	3.1	2.8	3.5	3.8	2.9		–
Final domestic demand	4.5	4.7	2.8	4.9	4.6		–
Government expenditure							–
Goods and services	2.2	3.3	2.3	3.2	5.8		–
Gross fixed capital	10.9	8.1	-2.0	0.8	6.5		–
Consumer expenditure	3.8	4.2	3.4	5.9	3.0		–
Residential investment	3.5	2.1	8.2	5.8	5.2		–
Business fixed investment	10.8	9.9	-0.8	3.6	8.9		–
Non-residential construction	10.8	12.9	1.6	1.4	2.9		–
Machinery and equipment	10.8	7.4	-3.2	5.8	15.4		–
Business inventory investment ($ billion)	13.5	10.2	2.5	4.5	15.4		–
Exports	2.2	0.7	0.8	3.1	2.3		–
Imports	7.5	5.0	0.1	7.7	18.6		–
Current account balance							
(nominal $ billion)	27.9	23.6	25.6	25.4	4.2		–
(percentage of GDP)	2.0	1.6	1.7	1.7	0.3		–
Nominal personal income	5.1	6.1	9.8	6.7	1.1		–
Nominal personal disposable income	4.3	6.4	9.3	3.1	2.5		–
Real personal disposable income	2.6	5.0	5.8	0.8	2.4		–
Profits before taxes	11.9	5.0	9.0	5.1	10.6		–
Costs and prices (%, y/y)							
GDP price deflator	3.4	2.4	2.6	3.5	2.8		–
Consumer Price Index (CPI)	2.2	2.0	1.8	2.2	2.1	2.5	Nov-2007
Core CPI[1]	1.6	1.9	2.3	2.4	2.2	1.6	Nov-2007
Unit labour costs	2.6	3.1	3.5	4.3	3.0		
Wage settlements (total)	2.3	2.5	3.1	3.0	3.9	4.7	Sep-2007
Labour market							
Unemployment rate (%)	6.8	6.3	6.1	6.1	6.0	5.9	Nov-2007
Employment growth	1.4	1.9	3.9	1.3	1.7	3.1	Nov-2007
Financial markets (average)							
Exchange rate (U.S. cents)	82.6	88.2	85.4	91.1	95.7	99.45	18-Dec-07
Prime interest rate (%)	4.4	5.8	6.0	6.0	6.3	6.00	18-Dec-07

Note: Real values are in chained 2002 dollars.
[1] Core inflation excludes eight of the components of the CPI basket that display the greatest volatility, as well as the effect of changes in indirect taxes on the remaining components.
Sources: Statistics Canada, the Bank of Canada and Human Resources and Social Development Canada.

Gains in income growth have supported household spending. Personal income increased 1.1% in the quarter. Supported by higher employment, labour income rose 1.9%, albeit a slowdown from 7.2% in the second quarter. This slowing reflected the end of Quebec government pay equity payments and special contributions from the Newfoundland and Labrador government to its Public Service Pension Plan. These factors had boosted labour income in the first half of 2007.

In the third quarter, real personal disposable income rose 2.4% and per capita real personal disposable income increased 1.1%. The personal savings rate was 1.3%, down from 1.6% in the second quarter.

Residential and business investment grow

Residential investment rose 5.2% in the third quarter after a gain of 5.8% in the second. Increased housing starts raised new construction activity by 10.2%. Spending on renovations increased 4.8%. The home resale market, however, softened from record levels, reducing transfer costs by 6.1%.

Business investment in plant and equipment grew 8.9% in the third quarter following a gain of 3.6% in the second. Spending on machinery and equipment rose 15.4%. With the airline industry raising capital outlays, investment in other transportation equipment jumped. Businesses also sharply boosted spending on computers, software and telecommunications equipment. Non-residential construction rose 2.9%, double the pace in the previous quarter and the 19th consecutive quarterly increase.

Increased business inventory accumulation

Businesses added $15.4 billion to inventories in the third quarter, up from $4.5 billion in the second. The increase in inventory investment contributed 2.9 percentage points to real GDP growth. Inventories of retailers and wholesalers rose sharply, with a large part of that build-up being motor vehicles. Manufacturers also added to inventories. With the inventory accumulation in the quarter, the overall inventory-to-sales ratio rose, but remained well below its recent average.

Real imports rise more than real exports, shrinking the current account surplus

In the third quarter, real exports rose 2.3% while real imports climbed 18.6%, continuing a trend of imports growing more than exports that began as the Canadian dollar started to appreciate at the end of 2002. Greater real exports of industrial goods and materials and automotive and energy products more than offset reduced exports of machinery and equipment and forest products. Weakness in the U.S. housing market dampened Canada's exports of forest products.

Real imports, except for energy products, were up across all major categories, with sharp gains in machinery and equipment, automotive products and other consumer goods, a reflection of increased domestic spending by businesses and households for final products and inventories and of the reduction in the prices of imports given the appreciation of the Canadian dollar.

As a result of strong real import growth and weaker real export growth in the quarter, the nominal trade balance worsened by $20.5 billion and the current account deteriorated by $21.2 billion to $4.2 billion, or 0.3% of nominal GDP (Chart 2). Nonetheless, this was the 33rd consecutive current account surplus.

Corporate profits show a healthy gain

Corporate profits rose 10.6% in the third quarter after a gain of 5.1% in the second quarter. Profits as a share of nominal GDP increased modestly to 13.9% (Chart 3). While somewhat below the peak at the end of 2005, their share remained near record highs. Stronger consumer spending boosted the profits of retailers and wholesalers. World demand and higher prices supported the oil and gas extraction industry along with petroleum and coal refineries. Profits at financial institutions also increased. Wood and paper producers, however, saw profits decline as the weak housing market in the United States hindered exports.

Chart 2
Current account as a percentage of nominal GDP

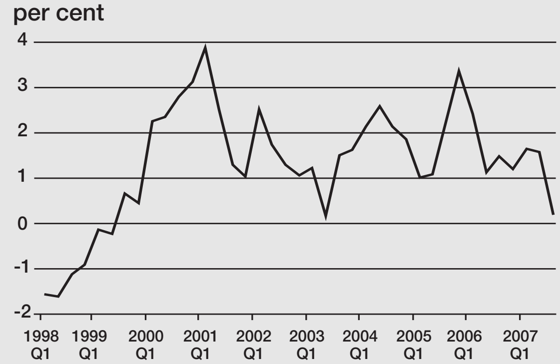


Chart 3
Profits before taxes as a share of nominal GDP

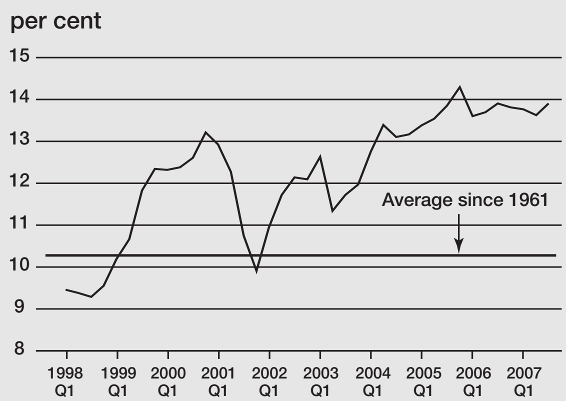
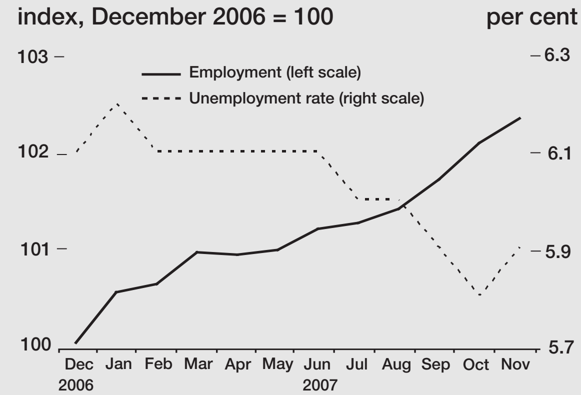


Chart 4
Employment and the unemployment rate



Consumer price inflation remains subdued

The GDP deflator, a comprehensive measure of prices, declined 1.0% in the third quarter following a 5.3% increase in the second. The decrease in the deflator was due to lower prices for energy exports and the end of special pension payments in Newfoundland and Labrador and pay equity payments in Quebec. The GDP deflator stood 2.8% higher than a year earlier.

Year-over-year consumer price inflation was 2.5% in November, up from 2.4% in October but the same as in September. Core CPI inflation, which excludes the eight most volatile items and the effect of changes in indirect taxes, fell to 1.6% year-over-year in November, down from 1.8% in October, when core inflation was below the official 2% target for the first time since June 2006.

Low unemployment rate

Employment grew 1.7% in the third quarter, a stronger pace than the 1.3% rate in the second quarter. With further gains in October and November, net job creation stood at a healthy 388,200 since the end of 2006 (Chart 4). In November, the unemployment rate was 5.9%, up slightly from 5.8% in October when it was at its lowest level in nearly 33 years. The participation rate stood at 67.8% in November, a record high.

Hourly labour productivity for the total economy was unchanged in the third quarter following growth of 1.2% in the previous quarter. Labour costs per unit of output on a total economy basis declined 1.4% in the third quarter, and are now 3.0% higher than a year earlier.

Bank of Canada lowers policy rate

On December 4, the Bank of Canada reduced its key policy rate—the target for the overnight rate—to 4.25%. In the announcement, the Bank judged that global financial market difficulties related to the valuation of structured products, anticipated losses on U.S. sub-prime mortgages and tightened credit conditions, plus risks to Canadian exports, had shifted the balance of risks for inflation to the downside. In response to credit market disruptions, on December 11 the U.S. Federal Reserve cut its discount rate and its target rate by 25 basis points. Since mid-August, the Fed has reduced its discount rate by 150 basis points and its target rate by 100 basis points.

High commodity prices, such as those for crude oil, have played a role in keeping the value of the Canadian dollar near parity with the U.S. dollar. After hitting a modern-day record high close of 108.52 U.S. cents on November 6, 2007, the value of the Canadian dollar has fallen to below parity. It closed at 99.45 U.S. cents on December 18.

The main source of data used in this publication is Statistics Canada. Subscription inquiries should be directed to the Department of Finance Distribution Centre at 613-995-2855. For other inquiries about this publication, contact Isabelle Amano at 613-992-4321.
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