



# Weekly economic Briefing

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## Canada's economy slowing

The latest monthly reading of the Canadian economy shows that growth nearly stalled in March, coming in a fraction above zero after gains of 0.5% and 0.2% in January and February, respectively. Lower industry output was evident in wholesale and retail trade, utilities, the financial sector, and air transportation. Gains in housing construction, oil and gas exploration, and a temporary rebound in manufacturing offset those losses.

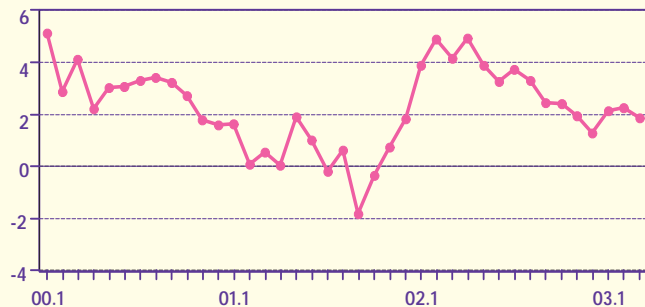
Statistics Canada also released the full national economic accounts for the first quarter, which showed an improved top-line figure over the fourth quarter 2002, at 2.4% versus 1.6% annualized growth, but with weakness lurking in the components. Inventory levels soared on lower car and truck sales and that means lower production ahead and a weaker second quarter. Without the build-up in non-farm inventories, overall GDP growth would have fallen to 1.2% in the first quarter.

Another area of weakness was exports, which dropped for the second straight quarter. As well as a drop in goods exports, service exports fell as the war in Iraq, the outbreak of SARS in March and increased American security measures at the border contributed to declines in travel spending and the number of foreign travellers to Canada. The rising Canadian dollar will further depress exports in the coming quarter.

On the brighter side, consumer spending continues to be the mainstay of economic growth, with a 3.5% annualized rate. Residential investment posted a 12.7% annualized growth rate thanks to low mortgage rates. Business investment in machinery and equipment saw a small 2.2% gain, while investment in non-residential structures shrank again.

### Canadian economy slowing

Canada GDP Industry Growth  
Per Cent, three month smoothed annual rate



Source: Statistics Canada. CUCBC.

Latest: March 2003

This economic report describes a slowing Canadian economy with weak manufacturing and export sectors and some inventory overhang that does not bode well for second quarter growth. A growth rate of less than 2% is very likely and it could possibly be nearer 1%. The implication for monetary policy is clear -- no rate increases anytime soon since the output gap has widened further and will be wider yet in the second quarter.

### **No rate change expected at Bank of Canada meeting**

The Bank of Canada meets on June 3 to decide whether to adjust monetary conditions by changing its key lending rate. Based on the latest economic indicators and the large gain in the Canadian dollar, the Bank will leave interest rates unchanged. A widening output gap and a falling inflation rate should be enough to warrant a stand-pat position on rates, and when the sharp appreciation of the Canadian dollar is taken into account, the rate decision becomes a no-brainer.

The Bank is expected to keep rates on hold until the end of the year, after stronger growth has emerged in Canada and the U.S. It's conceivable that the next rate increase might not come until early 2004, but the next move is more likely to be upward rather than downward. Rates are still too low relative to the economy's growth potential and underlying inflation rate, but higher rates will not materialize until economic growth picks up. Speculation of a rate cut by the Bank is just that -- there won't be a cut unless there is another negative demand shock dragging down the economy. A rate cut by the U.S. Federal Reserve Board would certainly put pressure on the Bank to follow suit, but that prospect is unlikely.

