# CANADA'S ECONOMIC PERFORMANCE

The Canadian economy continued to expand at a robust pace in 1988 as real gross domestic product (GDP) advanced 4.5 per cent, a rate that is among the highest of the Summit countries. For the fourth consecutive year, growth in final domestic demand exceeded that of real GDP in 1988, registering its largest annual increase since 1973. All categories of final domestic demand posted strong gains. Growth in consumption and housing, which slowed following the October 1987 stock market downturn, rebounded strongly in the second half of 1988. Business non-residential investment continued to serve as the primary engine of growth in 1988. Buoyed by high and rising rates of capacity utilization and healthy corporate financial positions, real business investment in plant and equipment has increased by more than 30 per cent over the past two years, with machinery and equipment spending being particularly strong.

The robust growth in domestic demand, particularly in the import sensitive categories of machinery and equipment investment and consumer durables spending, contributed to a deterioration in the merchandise trade surplus in 1988. The current account deficit also increased in 1988, but this was due in large part to several special dividend payments by Canadian corporations to foreign shareholders at the end of last year.

The continued, above-potential growth in the Canadian economy in 1988 contributed to a further tightening in labour and product markets. Capacity utilization rates approached 100 per cent in several industries. Employment grew by 3.2 per cent in the year, the fastest annual rate of growth during the recovery. After a marked slowing in the May to October period, employment again increased strongly late in the year. The unemployment rate dropped to 7.7 per cent in the fourth quarter, a level comparable to the average rate that prevailed prior to the recession. In the first quarter of 1989, the unemployment rate remained largely unchanged.

The tightening in labour and product markets has heightened inflationary pressures. After fluctuating between 3.8 and 4.2 per cent in 1988, the all-items Consumer Price Index (CPI) rate of inflation rose to 4.6 per cent in February 1989 and remained at that level through April. The underlying rate of inflation, as measured by the CPI (excluding food and energy components), rose to 5.4 per cent in February, from 4.2 per cent at the end of 1987, and remains above 5 per cent. The increase in inflation occurred in spite of the moderating influence of the sharp appreciation in the Canadian dollar and declining world oil prices in 1988.

As in other Summit countries, short-term interest rates have risen significantly in Canada in 1988 and early 1989 as monetary policy has responded to the emergence of inflationary pressures. Long-term interest rates, on the other hand, have declined from 1987 and 1988 levels, reflecting investor confidence that inflation will remain in check. Since early 1988, the Canadian dollar has appreciated sharply against all major currencies including the U.S. dollar, moving from US$0.77 in early 1988 to above US$0.83.

In its June 1989 economic forecasts, the OECD anticipates that Canada's economic growthg rate (for real GDP) will slow to 3.25 per cent in 1989 and further, to 2.25 per cent in 1990. It foresees consumer prices rising by 4.25 per cent this year and next, with unemployment stable at 7.75 per cent over the coming 18 months. These figures are somewhat more optimistic on unemployment and inflation than the Canadian government forecasts used as the basis for the April 1989 budget. The OECD has in its recent forecasts been moving closer to the Canadian government's assessment of the economic outlook.