L.5.2 RFD 412

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Recent Economic Developments in Canada: November 1962-March 1963 — 18 pages

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Summary

During the year 1962 as a whole, Canadian GNP grew about 8 per cent, making it the best year since the mid-1950's. Most economic sectors advanced strongly, particularly during the first three quarters of the year; while unemployment remained at just under 6 per cent of the labor force (seasonally adjusted), it was nonetheless at about its lowest level in three years.

Available year-end data, however, suggest a perceptible and possible temporary levelling in the expansion of Canadian output in the fourth quarter as inventories were liquidated. No downturn in business activity has taken place, and general economic indicators are sufficiently strong to suggest that the inventory readjustment may well be a mild one.

A dramatic fourth-quarter improvement in the trade accounts--to a quarterly surplus at an annual rate of $560 million--helped Canada earn its second trade surplus since 1952. This fourth-quarter trade improvement is a substantial sign that an underlying adjustment in the external deficit which led to the mid-1962 exchange crisis and to the devaluation of the Canadian dollar is, in fact, underway.

The Canadian economy reacted with considerable outward calm to the political shakeup in February. Despite its caretaker status the Diefenbaker Government has continued gradually to unwind the austerity measures imposed during the exchange crisis in the summer of 1962. By the end of 1962, much of the emergency foreign assistance had been repaid; and in February the third and most

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1/ Canadian economic developments prior to this period were reviewed in "Recent Economic Developments in Canada" (December 13, 1962).

sweeping reduction was made in the import surcharges imposed at the time of the crisis. Interest rates--particularly on short-term--have been permitted to decline somewhat further from the high rates of summer and fall of 1962. The yield on three-month Canadian Treasury bills was fairly steady during January and February at a level about 1-1/4 per cent below the rates of early fall, and about 1/2 per cent under the early-December rate.

Despite some decline in Canadian interest rates, an interest incentive favoring long-term financing in the U. S. capital market remains. Canadians borrowed heavily in the U. S. market during the second half of 1962, bringing the year's total to some $700 million. This heavy rate of U. S. financing continued through the first two months of 1963.

Nevertheless, the record growth in Canadian exchange reserves slowed substantially after October. Following moderate exchange losses incurred around the time of the February political shakeup, and after allowing for the $300 million of IMF emergency assistance still to be repaid, Canada's reserves of gold and U. S. dollars at the end of February were almost $200 million above the pre-crisis high of October, 1961.

At the moment, the chief element of uncertainty in the Canadian picture stems from the uncertain political balance. Under the circumstances, the present administration has not been in a position to formulate a long-term program designed to reduce unemployment or further to strengthen Canada's external position. Further policy actions to solve these basic problems can scarcely be looked for until after the general elections which are scheduled for April 8.

<u>Balance of payments reflects significant improvement</u>

The Canadian balance of payments for the third quarter of 1962 recorded a surplus of $750 million, as compared with a second-quarter deficit of $668 million (see Table 1). The bulk of the improvement--$1.1 billion--was in the capital accounts, and reflected the second-quarter flight and third-quarter return-flow of capital; the remainder was brought about by improvement in trade ($102 million) and other current ($214 million) accounts. After seasonal factors are discounted, however, the trade balance worsened somewhat during the third quarter (see Table 2).

In the fourth-quarter, the current deficit was reduced to less than half that of the corresponding period of 1961 (see Table 1) by considerable improvements in both the trade ($78 million) and the non-merchandise ($75 million) accounts. Trade reached all-time-record levels. Exports increased by 5.7 per cent while imports declined by 1.5 per cent, as compared with the fourth quarter of 1961. The result was a fourth-quarter trade surplus running at an annual rate of $560 million. During the year 1962, Canadian exports increased 7.7 per cent to $6,347.8 million, while imports, totaling $6,268.3 million, were 8.6 per cent above 1961. The resulting 79.5 million surplus was the second surplus registered on trade account since 1952.

Trade with the U. S. reached record levels during 1962. Canadian exports to the United States showed an increase of 16.5 per cent over 1961, with a somewhat sharper rate of increase during the first half of the year. Canadian imports from the United States grew somewhat less, or by 11.5 per cent; most of this increase occurred during the first six months, with a levelling in the third quarter and some decline during the last three months. Canada's 1962 trade deficit with the United States was $565 million, a decrease of about $85 million from 1961.

Favorable developments in Canada's trade accounts furnish some evidence of the impact of the June 1962 emergency surcharges and of Canadian dollar devaluation.

Table 1. Canada: Balance of International Payments, 1961-62
(Millions of $ Canadian)

	1961 II	1961 III	1961 IV	1962 I	1962 II	1962 III	1962 IV
Current Account:							
Trade balance	- 31	+138	+ 60	- 5	- 44	+ 58	+138
Other current	-280	-200	-332	-348	-333	-119	-257
Total	-311	- 62	-272	-353	-377	- 61	-119
Capital Account:							
Direct Investment (net)	+137	+105	+ 82	+ 80	+ 55	+115	+165
Securities Transactions (net)	+148	+ 82	+ 4	- 53	+ 55	+ 38	+247
Other long-term Capital Transactions	- 22	+ 12	+ 22	+ 5	-130	+ 33	- [illegible]
Bank balances and other short-term funds abroad (excluding official reserves)	+ 54	-140	+ 72	+ 49	-245	+257	+ 17
Other capital movements (excluding reserves, international agencies, and special assistance)	+126	- 6	+184	- 72	- 26	+368	+158
Total	+443	+ 53	+364	+ 9	-291	+811	572
Surplus or Deficit (-)	+132	- 9	+ 92	-344	-668	+750	+453
Financing:							
Change in Canadian dollar holdings by foreigners	- 72	- 1	+ 44	- 31	+ 34	- 58	+ 24
Special international financial assistance	--	--	--	--	+707	--	-377
Liabilities to international agencies (excluding special assistance)	- 9	- 52	- 1	+ 11	+ 41	- 6	+ 1
Change in official holdings of gold and foreign exchange (increase -)	- 51	+ 62	-135	+364	-114	-686	-101
Total financing	-132	+ 9	- 92	+344	+668	-750	-453

Source: Dominion Bureau of Statistics, Quarterly Estimates of the Canadian Balance of International Payments, Cat. No. 67-001, Vol. 10, No. 3 (Third Quarter, December 1962). And Vol. 10, No. 4 (Fourth Quarter, March 1963). Data have been rearranged to aid analysis.

Table 2. Canada: Merchandise Imports and Exports
(Seasonally adjusted)

		Monthly Average ($ million)		
		Exports (Including Re-exports)	Imports	Trade Balance
1961:	II	476.3	452.5	+23.8
	III	504.6	497.3	+ 7.3
	IV	517.3	518.9	- 1.6
1962:	I	506.5	516.2	- 9.7
	II	543.9	524.3	+19.6
	III	525.0	551.1	-26.1
	IV	546.2	505.2	+41.1

Source: Computed from data in Dominion Bureau of Statistics, "Canadian Statistical Review," January, 1963, p. 62; and Dominion Bureau of Statistics, Daily Bulletin, Vol. 32, No. 29 (February 11, 1962) and Vol. 32, No. 48 (March 8, 1963).

Motor vehicle sales, for example, were one of the strongest aspects of the Canadian domestic business picture during 1962. As automobile sales soared and Canadian motor vehicle production increased by some 30 per cent during the year, the share of imports in the Canadian market dropped from 21 to 13 per cent. Similarly, appliance imports dropped sharply while domestic Canadian appliance production jumped.

Continued unwinding of emergency restrictive measures

Canadian short-term interest rates dropped abruptly by nearly one-half per cent following the announcement of a Bank rate cut from 5 to 4 per cent on November 13 (see Table 3). The Treasury bill yield partially recovered from 3.62 to about 3.8 per cent by the following week, increased slightly further and held steady at around 3.9 per cent through December. The rate declined gradually and steadily throughout January to a level of about 3.65 per cent early in February, where it held through the first week in March.

By mid-November 1962, for the first time since early June, the spread between U. S. and Canadian 91-day Treasury bill rates had narrowed to less than 1 per cent. The uncovered spread gradually declined further and has remained between 0.7 and 0.8 per cent since the end of January.

The fully-covered arbitrage incentive favoring the Canadian Treasury bill has also generally narrowed as Canadian short-money rates declined through the winter. Declining Canadian rates and an increased cost of forward cover combined to eliminate the covered incentive in favor of the Canadian Treasury bill since mid-February, but modest amounts of short-term funds have continued to move into Canadian finance paper.

Further repayments of emergency assistance. On December 26, the Bank of Canada terminated the final $25 million of the $100 million swap with the Bank of

Table 3. Canada: Selected Market Yields on Government Securities

	3-month Treasury bills (Thursdays)	Bonds (Wednesdays) 1964	1965	1967-68	1975-78	1996-98
Week of:						
1962:						
April 12	3.04	3.58	3.93	4.13	4.80	4.88
July 19	5.51	5.76	5.58	5.11	5.42	5.15
September 13	4.98	5.38	5.31	5.04	5.35	5.17
October 18	4.22	4.19	4.35	4.50	5.13	5.10
November 8	4.09	4.33	4.40	4.53	5.11	5.12
15	3.62	3.80	3.98	4.27	4.94	5.03
December 20	3.94	4.09	4.31	4.39	5.07	5.07
1963:						
January 10	3.85	4.06	4.32	4.36	5.08	5.02
24	3.78	4.12	4.44	4.37	5.09	5.01
February 7	3.72	4.02	4.47	4.35	5.08	5.01
14	3.66	4.02	4.46	4.37	5.09	5.02
March 7	3.63	4.00	4.52	4.36	5.07	5.04

England during the June crisis. At the same time, the $75 million still outstanding of the currency swap with the Federal Reserve Bank of New York was reversed, and the total of the original $250 million swap with the Federal Reserve System was placed on a standby basis.

The reversal of the currency swaps with the Bank of England and the Federal Reserve Bank of New York involved the repayment of $350 million of the $650 million in emergency foreign assistance received by Canada in late June. The $400 million standby from the Export-Import Bank was never drawn upon, and has been cancelled. Still outstanding is the $300 million drawing from the International Monetary Fund.

Despite a rather uncertain political atmosphere, Finance Minister Nowlan on February 19 announced the third, and by far the most comprehensive, reduction in the import surcharges imposed last June as a part of the emergency austerity program. This reduction eliminated the surcharges on $950 million in imports, primarily machinery. In addition, surcharges were reduced on other imports, amounting to $235 million. This leaves temporary emergency surcharges on about one-fifth of Canada's total imports--just over one-third of the trade originally affected.

Slowdown in reserve accruals after October

The extremely rapid July-October (1962) rate of reserve accruals by the Bank of Canada slowed in early November. The market for Canadian dollars displayed some weakness immediately following the announcement by the Bank of Canada on November 13 of a cut in the discount rate from 5 to 4 per cent. This weakness was short-lived, however, and the market rate on the Canadian dollar edged back upward and held firm, but with the Bank of Canada generally acquiring fewer dollars from the market.

January reserve accruals of $123.1 million brought official Canadian holdings of gold and foreign exchange to an all-time high of $2,662.5 million. Losses of $68.6 million--primarily around the time of the early-February political crisis--reduced this total to $2,593.9 million at the end of February (see Table 4). Net of the $300 million in emergency assistance still to be repaid to the International Monetary Fund, the end-of-February official holdings of gold and foreign exchange represented an increase of $183 million over the pre-crisis high in reserve holdings of $2,111 million in October 1961.

Reaction to political shakeup. The fall of the Diefenbaker Government early in February was accompanied by only a mild and short-lived reaction in Canadian foreign exchange and money markets. Political uncertainties in Ottawa led to some uneven selling pressures on the Canadian dollar, while periodic market strength came from the movement of the proceeds of Canadian security sales in the U. S. bond market.

Fluctuations in the Canadian dollar market rate were moderated by periodic Bank of Canada intervention on both sides of the market. The rate weakened slightly during the first week in February, but strengthened thereafter and remained generally stable at 92.8 U. S. cents during the rest of the month. The net reserve losses of $68.6 million in February occurred primarily during the first week of the month.

Domestic levelling off may be short-lived

The year 1962 was one of considerable economic gains for Canada. Although final figures are not yet available, estimates place the 1962 increase in GNP at about 8 per cent, and an increase in real income of about 6.5-7.0 per cent after allowing for price changes. This increase moved the real per-capital GNP above

Table 4. Canada: Changes in Official Reserves March 1962-February 1963

End of Period	Official Holdings of Gold & U.S. dollars (millions of $ U.S.)	Unadjusted change during period	Special Non-Market Receipts (-) (net)	Adjusted change
1962:				
March	1,709.4	- 37.3	--	- 37.3
April	1,594.8	-114.6	--	-114.6
May	1,492.8	-102.0	--	-102.0
June 24	1,100.0	-392.8	--	-392.8
June (from 24th)	1,808.7	+708.7	a/ -650.0	+ 58.7
July	2,114.4	+305.7	b/ - 61.0	+244[illegible]
August	2,330.6	+216.2	--	+216.2
September	2,444.6	+114.0	--	+114.0
October	2,613.9	+169.3	c/ + 20.0	+189.3
November	2,607.5	-6.4	d/ + 75.0	+ 68.6
December	2,539.4	- 68.1	e/ +100.0	+ 31.9
1963:				
January	2,662.5	+123.1	f/ -125.0	- 1.9
February	2,593.9	- 68.6	--	- 68[illegible]

a/ External assistance received, as follows: $300 million from I.M.F.; $250 million from Federal Reserve; $100 million from Bank of England.

b/ Advance debt repayment by France.

c/ Special receipts included a $30 million debt prepayment by the Netherlands and receipt of $125 million proceeds of Government of Canada loan in the U.S.; payments included termination on October 31 of half the Swaps with the Federal Reserve Bank of New York and the Bank of England ($175 million).

d/ On November 30, Canada terminated an additional $75 million of the Swaps with the Federal Reserve Bank of New York and the Bank of England.

e/ On December 26, Canada reversed the remainder of the swaps with the Federal Reserve System and the Bank of England in the amounts of $75 million and $25 million. The reciprocal currency swap in the amount of $250 million with the Federal Reserve Bank of New York was placed on a standby basis.

f/ Receipt of the remaining $125 in proceeds of the Government of Canada loan in the U.S.

the 1956 level for the first time. While remaining quite high at just under 6 per cent of the labor force, unemployment (after correcting for seasonal variation) both in absolute terms and as a percentage of the labor force declined to the lowest levels in nearly three years.

Strong indications are accumulating, however, that much or all of the forward momentum of the Canadian expansion had been lost by the fourth quarter of 1962. Growth rates began to decline by about mid-year, and the third-quarter GNP rise was attributable largely to inventory accumulations which, according to Canadian analysts, were of an "involuntary" sort. On the basis of the estimated overall increase of 8 per cent during 1962, it appears that the increase in GNP (seasonal factors discounted) had virtually stopped by the fourth quarter (see Table 5).

Table 5. Canada: Gross National Product, 1960-62
(Quarterly changes, at annual rates, in per cent)

	I	II	III	IV
1960	+1.6	-1.0	+0.3	+1.9
1961	-2.3	+2.6	+2.5	+1.4
1962	+2.8	+1.5	+1.7	a/+0-1.0

a/ A preliminary estimate, based upon an 8 per cent total GNP growth for 1962, and upon estimated seasonal factors.

Source: Based upon data in Canadian Statistical Review, January 1963, and an assumed 8 per cent GNP increase in 1962.

This suggestion that growth slowed during the final months of 1962 is reinforced by the behaviour of other aggregates which tend to move with the trend of total output. The seasonally-adjusted index of industrial production increased

14.3 per cent during the period of expansion from January 1961 to August 1962, and over 5 per cent during the first 8 months of 1962, but remained almost at a standstill from August to December, the latest period for which data are available (see Table 6). Similarly, total employment and employment in industry have remained very nearly static during approximately the same period.

Some indicators suggest the possibility of an impending downturn in the level of general Canadian business activity. New construction starts in all categories (on a seasonally adjusted basis) have been dropping for several months; and the value of building permits secured has been generally declining since late summer. For the second consecutive month, new orders for capital goods (seasonally adjusted) declined, from $175 million in September to $134 million in November, the lowest level in 14 months. Although total shipments by manufacturers are holding up well, total manufacturers' unfilled orders have been moving generally downward since last July.

Consumer demand factors present a rather mixed picture. Most of the growth in retail sales during the present expansion took place between September 1961 and April 1962; since April, total retail sales have fluctuated irregularly. The most dramatic increase has been in motor vehicle sales, which climbed 10 per cent in November to a record high (seasonally adjusted) of $250 million. According to the most recent MacLean-Hunter consumer survey, automobile sales should continue to lend strength to the picture through the early part of 1963.

Exports became a source of considerable strength in 1962, particularly during the fourth quarter (see Table 2). Preliminary data indicate that in January, exports (seasonally adjusted) increased from the December level and remained at about the monthly average level (adjusted) for the fourth quarter of 1962--$546 million.

Table 6. Canada: Index of Industrial Production (1949=100)

Period		Monthly Average or Month (seasonally adjusted) Total	Manufacturing		
			Total	Durables	Non-durables
1957		155.4	142.9	146.7	139.7
1958		154.4	140.7	139.9	141.3
1959		166.1	149.8	149.5	150.1
1960		167.4	149.3	146.4	151.8
1961		172.9	153.0	148.4	157.0
1961:	January	165.6	146.7	134.4	152.7
	July	173.4	154.0	145.0	158.8
	December	180.5	160.8	148.6	163.5
1962:	May	186.0	164.5	170.9	165.5
	August	189.2	166.6	156.8	165.0
	November	189.5	168.2	174.6	165.4
1963:	January	189.7	n.a.	n.a.	n.a.

Source: Dominion Bureau of Statistics, "Canadian Statistical Review."

Canadian analysts characterize the present levelling of business activity as a period of necessary--but probably brief--inventory readjustment following the considerable inventory accumulations of the third quarter of 1962. Following a 16-month period of uninterrupted inventory accumulation totalling $438 million (seasonally adjusted), total manufacturing inventories declined by $5 million in October and $11 million in November, the latest periods for which data are available.

However, substantial elements of strength are present in the Canadian business picture. There has apparently been no actual decline in Canadian business activity; and recent data do not seem to indicate one in the immediate offing. For example, although sales and industrial production are not moving up steadily, present high levels are being maintained. Retail sales figures recently released for January show an increase of 1.9 per cent over December. The inventory readjustment may not continue for long; an apparent substantial slowdown in the rate of decline in chartered bank general loans in February may indicate that the bulk of that adjustment has already been completed. Recent consumer surveys indicate that consumer spending will probably show considerable strength during 1963. In addition, a survey of investment intentions by the Department of Trade and Commerce and the Dominion Bureau of Statistics revealed planned capital outlays during 1963 by all sectors of the Canadian economy totaling a record $9.1 billion, an increase of about 4 per cent over total outlays during 1962. 1/ Within this total, business plans call for capital outlays during 1963 of $5.2 billion, an increase of 5.2 per cent over the 1962 level. Investment plans also indicate a further increase of 2.4 per cent in outlays on housing and social capital following the large (11 per cent) increases of 1962.

1/ Private and Public Investment in Canada: Outlook 1963 and Regional Estimates, Cat. No. C51-1/1963 (Ottawa: Queens Printer, 1963).

On balance, many Canadian business analysts see enough strength to bring about an upturn in activity during the second half of 1963.

Canadian prices show no advance in fourth quarter

The upward drift in Canadian prices came to a halt, at least temporarily, during the fourth quarter. General wholesale prices, the cost of living, and export prices were no higher at the end of December than they were at the end of September. (See Table 7). Fourth-quarter import price data are not yet available.

Thus far, Canadian prices have shown only a moderate response to the continuing decline in the value of the Canadian dollar. Since the beginning of 1961, the exchange value of the currency has declined by nearly 10 per cent but wholesale prices have risen by only 4 per cent and the cost of living by only 2 per cent. (See Table 7). The import price index has closely followed the exchange rate: this index rose by 7 per cent to the end of September 1962 (latest data available).

Heavy borrowing in U. S. market continues

Canadian capital market conditions encouraged heavy U. S. borrowing by Canadian local governments and corporations during the second half of 1962, in contrast to moderate borrowing during the first half of the year. New Canadian issues payable in U. S. funds amounted to over $700 million during 1962--between four and five times the total for 1961, according to estimates by the A. E. Ames and Company (See Table 8).

So far in 1963, Canadian borrowing in the U. S. capital market has continued in extraordinarily heavy volume. During January, two large issues alone--Quebec Hydro ($300 million) and Trans-Canada Pipe Line ($93 million)--amounted to more than 2-1/2 times the total Canadian U. S. dollar securities

Table 7. Price and Exchange Rate Indexes, 1959-1962

End of period:		Exchange rate: Price of U.S. dollar	General Wholesale Prices	Cost of Living	Export Prices	Import Prices
		Indexes (Sept., 1959=100)				
1959:	III	100	100	100	100	100
	IV	101	99	101	100	100
1960:	I	101	99	100	100	100
	II	103	100	100	100	102
	III	103	99	101	100	102
	IV	105	99	102	100	101
1961:	I	104	100	102	100	103
	II	109	100	102	100	103
	III	109	101	102	101	106
	IV	110	101	102	102	10[illegible]
1962:	I	111	102	102	103	108
	II	114	103	103	105	110
	III	114	104	104	105	110
	IV	114	104	104	105	n.a.

Source: Computed from I.M.F., International Financial Statistics, Aug. 1960, and March, 1963, and D.B.S., Canadian Statistical Review, Dec. 1962.

Table 8. Canada: Sales of New Government, Municipal, and Corporation Bonds Payable in U.S. Funds

Time Period	Total	Gov't.	Provincial Direct	Provincial Guaranteed	Municipal	Corporation
Year to Dec. 31						
1962	700.7	250.0	17.5	92.0	44.7	296.5
1961	148.4	--	--	--	26.4	122.0
1960	283.2	--	25.0	67.0	110.9	80.3
January - June:						
1962 to July 9	103.5	--	--	--	1.5	103.0
1961 to July 10	117.4	--	--	--	26.4	91.0
1960 to July 13	238.0	--	25.0	52.0	110.7	50.3
January - February:						
1963 to February 25	467.0	--	25.0	320.0	25.0	97.0
1962 to February 26	--	--	--	--	--	--
1961 to February 27	5.0	--	--	--	--	5.0

Source: A. E. Ames & Co., "Weekly Bond Sales Summary."

sold during 1961. The $300 million Quebec Hydro loan was the largest loan negotiated by a foreign group in the U. S. since the end of World War I, and the largest loan ever received by Canadians from the United States. The funds will be used to finance the nationalization of 11 private electric firms in Quebec.

In addition to these two very large issues, Ames lists five other smaller issues sold in the U. S. market, ranging from $1.5 to $25 million, and bringing the total to $467 million for the first two months of the year (see Table 7).

It is difficult to determine how long Canadian financing in the U. S. market can be expected to continue at the record levels of late 1962 and early 1963. Press reports of preparations for U. S. bond issues by local Canadian government units have recently declined perceptibly, but this may in part only reflect the unprecedented volume of recent offerings.

A cost differential of the order of 1/4-1/2 per cent favoring U. S. financing continues to exist, however, and may continue to sway a large number of potential Canadian borrowers. Quebec Hydro, for example, was able to place $300 million of 25-year bonds in the U. S. market at a reported price of 99.00 U. S. to yield 5.07 per cent; at the same time (February 14), an issue of 19-year Quebec Hydro bonds was selling on the Canadian market at a price yielding 5.45 per cent. The $93 million (20-year) issue by Trans-Canada Pipe was reportedly placed in the U. S. at a price yielding 5.70 per cent; at about the same time, $45 million of that firm's bonds (in the same maturity) placed in Canada at a price yielded 6.20 per cent.