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Recent Economic Development in Canada: March to May 1963 — 12 pages

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Recent Economic Developments in Canada: March to May 1963

The marked improvement in economic conditions in Canada, reported in the preceding review of developments prepared in March,[1] has continued during the past three months. Canada's foreign trade results for the first quarter revealed the most favorable merchandise balance for that three-month period in a decade. Favorable external developments and encouraging signs of a resumption of domestic economic expansion in the early months of the year reflect the effects of the devaluation of the Canadian dollar and the emergency restrictive measures taken in June 1962. They provide a favorable background against which the newly-elected Liberal Government has decided to proceed immediately with a package of expansionary measures designed to reduce unemployment and to spur domestic growth.

On the external side, the Canadian dollar has remained strong throughout the period under review. The trade returns do not extend beyond March but the spot exchange rate has been well maintained in April and May and reserve gains of $71 million were reported for April and $41 million for May.

Dramatic improvement in Canada's external position during the second half of 1962, which is summarized in Table 1, was to be found in all main categories of the balance of payments. A payments deficit of $957 million between January and June (1962) was replaced by a surplus of $1,164 million between July and December. The trade deficit declined sharply and very substantial amounts of both long and short-term capital flowed into Canadian

1/ See "Recent Economic Developments in Canada: November 1962 to March 1963," dated March 20, 1963.

Table 1. Canada: Summary of the Balance of Payments, Half-Yearly, 1961 to 1963
(in millions of Canadian dollars)

	1961		1962		1963
	Jan.-June	July-Dec.	Jan.-June	July-Dec.	Jan.-May
Balance on goods and services	-648	-334	-695	-153	
Long-term capital movements	+456	+334	+ 11	+707	
Short-term capital flows	+348	+ 73	-273	+610	
Total payments balance	+156	+ 73	-957	+1,164	
Financing:					
Special international assistance	--	--	+707	-377	
Changes in official reserves, increase(-)	-156	- 73	+250	-787	-173.0
Total financing	-156	- 73	+957	-1,164	-173.0

Source: Dominion Bureau of Statistics, Quarterly Estimates of the Canadian Balance of International Payments, "Fourth Quarter 1962 and Preliminary Estimates for the year 1962."

markets. Estimates for the first quarter of 1963, which should be released during June, are expected to show a continuation of these trends in the trade and long-term capital categories because of the favorable trade returns and record Canadian local government long-term borrowing in United States markets in January and February.

On the domestic side, there have been encouraging signs of a resumption of domestic economic expansion in the early months of this year. After remaining virtually stationary since last August, the index of industrial production turned up in February and advanced further in March. Despite some improvement in April, however, the level of unemployment remains high.

The Canadian authorities have taken fiscal and monetary actions to reduce unemployment. The 1963-64 budget will not be introduced until mid-June but the Treasury's spending estimates, announced to Parliament on May 29, indicate an expansion in the neighborhood of 5 per cent over the rate of spending during the fiscal year ending on March 31, 1963.

In addition, the authorities have moved to create easier credit conditions. On May 6, the Bank of Canada's discount rate was reduced from 4 to 3-1/2 per cent, the fourth reduction since a 6 per cent rate was imposed as one of the emergency measures in June 1962. A general downward adjustment in the interest-rate structure occurred in May after this action.

The declining trend in Canadian interest rates has brought them much closer to yields in U. S. markets. (See Table 2). By May 29, the yield spread on Treasury bills was only 0.20 per cent compared with 0.70 per cent on May 2. Because the discount on the forward Canadian dollar disappeared in late May, however, there remained a slight net interest differential in favor of Canadian money-market paper despite lower Canadian rates. As a result, a modest flow of funds from the United States continued, largely as purchases of Canadian finance paper and as U. S. dollar deposits with Canadian banks. Bond yields also moved closer together, the spread on 8-year maturities falling from 0.75 per cent on May 2 to 0.44 per cent on May 29. (See Table 2.)

The main outline of the new Cabinet's economic program, as revealed in general terms in the Speech from the Throne which opened the new Parliament in May, indicates that a package of measures will be introduced to accelerate growth, reduce unemployment and cut back borrowings in the United States.

a. To promote growth, a new agency, The Canadian Economic Council, is to be established. The Council, which is to be a meeting place for government, industry and labor to make recommendations affecting long-term growth, seems to be more closely related to Britain's National Economic Development Council than to the Council of Economic Advisers in the United States. A Department of Industry is also to be established. Within this body, an Area Development Agency will seek to promote development in areas of chronic unemployment.

b. To reduce Canada's dependence on outside financing, two new agencies are to be established:

(i) a National Development Corporation to marshall savings within Canada and to make them available for new industries or for increasing Canadian ownership in existing industries; and

(ii) a Municipal Development and Loan Board to use a $400 million low-cost Treasury loan fund to "buy municipal debentures on favorable and generous terms" as one alternative to borrowing abroad.

c. To contribute to general economic expansion throughout the world, the government will encourage attempts to reduce trade barriers and promote world trade.

<u>Expansionary policies reflected in budget spending estimates</u>

The intention of the authorities to promote domestic economic expansion is indicated by 1963-1964 budget spending estimates presented to the Canadian Parliament at the end of May. For the fiscal year which began on April 1, the Government's spending estimates (inclusive of supplementary estimates) total (C)$6.5 billion, an increase of about 5 per cent over a preliminary

Table 2. Canada: Selected Yields on Government Securities, 1962 to 1963
(in per cent per annum)

	1962			1963		
	July 19	Nov. 8	Nov. 15	May 2	May 9	May 29
Bank of Canada discount rate	6.00	5.00	4.00	4.00	3.50	3.50
Selected Canadian market yields:						
Treasury bills (3-month)	5.51	4.09	3.62	3.60	3.33	3.19
Bonds:						
1964	5.76	4.33	3.80	3.97	3.81	3.77
1965	5.58	4.40	3.98	4.47	4.26	4.15
1967-68	5.11	4.53	4.27	4.32	4.14	4.12
1975-78	5.42	5.11	4.94	5.00	4.92	4.85
1996-98	5.15	5.12	5.03	4.97	4.94	4.90
Differentials of Canadian yields over U.S. yields						
Treasury bills:						
3-month	2.58	1.29	0.78	0.70	0.42	0.20
6-month	2.59	1.33	0.89	0.75	0.41	0.23
Bonds:						
8 years	1.16	1.00	0.73	0.75	0.58	0.44
20 years	1.44	1.19	1.02	0.98	0.94	0.89
35 years	1.03	1.25	1.15	0.94	0.93	0.82

Treasury bill yield is the average yield at Thursday tender. Bond yields are based on preceding day's closing rate.

total of (C)$6.2 billion for the current fiscal year (1962-1963). In the main spending categories, defense expenditures are almost unchanged, so that increased Government spending is almost entirely concentrated in budgets for civil departments. The largest single increase is accounted for by higher health and social welfare outlays, but spending will also go up for civil servants' salaries and for public debt charges.

On the basis of present expectations with regard to tax proposals which will be submitted in the middle of June, it is now estimated that Canadian budget accounts may show a deficit of about (C)$570 million, or roughly the same as in the current fiscal year.

Monetary authorities "nudge" interest rates downward

On May 6, the Bank of Canada's discount rate was cut from 4 to 3-1/2 per cent marking the fourth reduction from the 6 per cent level at which the rate was set at the time of the June 1962 emergency program. Between the previous reduction on November 13 and the May 6 cut, Canadian short-term money rates had declined by about 1/2 per cent, with the average tender on 3-month Treasury bills dropping from 4.09 per cent on November 8 to 3.60 per cent on May 2. (See Table 2.)

The May 6 action (as was also true of the preceding reduction in November) put the discount rate fractionally below the preceding week's Treasury bill tender rather than, as historical practice would have it, at a fractionally higher level. That Canadian monetary policy was moving toward easier credit conditions was suggested by Governor Rasminsky's statement that "...it is appropriate in present circumstances for the central bank to continue to encourage credit conditions that facilitate sound domestic expansion."

Short-term money rates reacted sharply to the discount rate reduction, with the Treasury bill yield moving from 3.60 per cent on May 2 to 3.33 per cent on the 9th. The Treasury bill rate continued to move downward in subsequent weekly auctions, reaching 3.19 per cent on May 30. At this point, the yield was roughly 1/2 per cent below the end of April level (3.66 per cent).

The decline during May in the Treasury bill rate was accompanied by a narrower yield spread which normally favors the Canadian over the U. S. Treasury bill, and the differential declined from 0.70 per cent on May 2 to 0.20 per cent on May 30. At the same time, however, the cost of forward cover for moving funds into Canada also declined, leaving the fully covered incentive in favor of the Canadian bill--at about 1/4 per cent--almost unchanged from early May. By the end of the month the earlier discount of nearly 1/2 per cent on the forward Canadian dollar disappeared completely.

Moderate easing in long-term yields

During April, Canadian bond yields slipped perceptibly downward for the first time since late fall. After the May 6 discount rate reduction, they moved to the lowest levels recorded in about a year. Yield spreads over comparable U. S. Government securities were also at the lowest levels since before the mid-1962 emergency program. After drifting downward through the third week in May, Government bond yields rose in the last week in May.

Yield trends in Canadian local government and corporate securities paralleled those in the government sector during April and May. At the end of May, the 40 bond yield average prepared by the McLeod, Young, Weir & Company was 5.32 per cent, as compared with 5.45 per cent at the end of March.

Canadian dollar remains strong, reserves mount

In the period under review, the Canadian dollar strengthened and remained in considerable demand. The market rate on the dollar rose following the election, and remained fractionally above 92.9 U. S. cents throughout April. Upward pressure on the spot rate eased somewhat following the May 6 cut in the discount rate, but hovered around the 92.8 cents level for the resc of the month. In early June the rate fell fractionally, and on June 6 the spot rate was 92.7 U. S. cents.

The Bank of Canada sustained some reserve losses before the election, but took in U. S. dollars during the remainder of April. The rate of reserve gains apparently accelerated in the latter part of the month, and the Bank of Canada reportedly engaged in spot sales against forward purchases of U. S. dollars in order to shift some part of April accruals into later months. With these forward operations, official Canadian reserves rose in April and May by a total of U. S. $112 million, bringing Canada's holdings of gold and U. S. dollars to a record level of $2,712 million. (See Table 3.)

The only obligation against the reserves remaining from the emergency assistance received during the mid-1962 crisis is the $300 million IMF drawing.

Record inflow of long-term capital

International security transactions resulted in a record net inflow of $359 million into Canada in the first quarter of this year, according to official data just released; this compares with an outflow of $64 million during the corresponding quarter last year. The gross total of $435 million recorded from the sale of new security issues in January-March 1963 includes $140 million proceeds of the Government of Canada issue placed in this market last fall and

Table 3. Canada: Official Holdings of Gold and U.S. Dollars

End of period	Gold	U.S. Dollars	Total
	(millions of U.S. dollars)		
1961 December	946.2	1,109.6	2,055.8
1962 May	913.0	579.8	1,492.8
June	669.0	1,139.7	1,808.7
December	708.5	1,830.9	2,539.4
1963 January	714.4	1,948.1	2,662.5
February	725.4	1,868.5	2,593.9
March	732.1	1,868.0	2,600.1
April	738.7	1,932.7	2,671.4
May	n.a.	n.a.	p/ 2,712.0

p/ Preliminary.

Table 4. 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 - 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
March - May:						
1963--						
Feb. 25 to May 20	106.1	--	--	33.0	4.7	68.5
1962--						
Feb. 26 to May 22	104.5	--	--	--	1.5	103.0
1961--						
Feb. 27 to May 29	112.4	--	--	--	26.4	86.0

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

$197 million of provincial bond issues. Of the total inflow, $245 million reportedly came from securities sales in the United States. In addition, it was reported that some $400 million would be entering Canada from proceeds of issues already sold but not yet delivered to foreign buyers.

Recently, the pace at which new Canadian issues have been placed in the U. S. market has declined from the extremely high levels witnessed late last fall and winter. (See Table 4.) The record Canadian capital inflow in the first quarter may therefore reflect the lag in delivery of issues sold during the earlier period of very heavy placements in this market. Recent A. E. Ames & Company reports indicate that sales of Canadian issues in the U. S. in the past few months have not been noticeably higher than in comparable periods in recent years; these, in turn, were moderate as compared with the heavy outflow of U. S. capital to Canada during the late 1950's.

However, the reduced spread between U. S. and Canadian yields (see Table 2), combined with the Canadian government's current efforts to improve the supply of domestic funds for capital investment, could be expected to reduce the pressure on the U. S. balance of payments which has reflected the outflow of long-term funds to Canada during the past nine months.

Foreign trade continues favorable adjustment

In January-March, Canadian foreign trade resulted in the most favorable first-quarter merchandise balance in a decade. Exports rose by 7.1 per cent, and totalled (C)$1.63 billion; during the same period, imports declined by 2.5 per cent to a total of (C)$1.51 billion, reversing the 1962 first quarter deficit of (C)$29.1 million. (See Table 5.) Canada's import deficit with the United States was reduced by almost one-fourth during January-March of this year. Exports to the U. S. amounted to (C)$955.0 million, rising by 3.7 per cent, while imports totalled (C)$1.05 billion, a decline of 0.9 per cent.

Table 5. Canada: Foreign Trade, 1962-63
(millions of Canadian dollars; seasonally-adjusted)

Period	Exports	Imports	Trade Surplus (+) or Deficit (-)
1962 I	1,519.5	1,548.6	- 29.1
II	1,631.8	1,572.8	+ 59.0
III	1,575.1	1,645.9	- 70.8
IV	1,649.1	1,495.0	+ 54.1
1963 I	1,627.3	1,510.6	+116.7

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

Period		Monthly Average or Month (seasonally adjusted)	Manufacturing		
		Total	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
1962:	May	186.0	164.5	163.2	165.5
	August	189.2	166.6	168.5	165.0
	December	189.3	169.7	173.2	166.8
1963:	January	189.3	168.7	172.0	165.8
	February	191.2	169.5	172.0	167.5
	March	194.3	172.3	171.8	172.7

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

Foreign trade developments suggest that the expected readjustment to the new exchange value of the Canadian dollar has been taking place. However, foreign trade gains registered in the first quarter of this year still reflect the fact that the Canadian market continued to be partially sheltered because of the surcharges imposed as part of the June 1962 emergency program. After a succession of reductions in scope as the emergency program was dismantled, the final portion of the import surcharges was canceled at the end of March.

Domestic output resumes expansion

Encouraging signs of a resumption of domestic economic expansion have become apparent in economic indicators for the early months of this year. After remaining virtually stationary since last August, the index of industrial production turned up in February and continued its recovery in March as well. On a seasonally adjusted basis, industrial production increased by 2.6 per cent in the first quarter, as compared with an increase of 2.1 per cent in the corresponding three-month period in 1962 (See Table 6.) The gain in the first quarter was registered chiefly in non-durables manufacturing. Nonrecurrent factors (such as settlement of a major labor dispute in the chemicals field--which led to the resumption in March of operations in much of the industry--and reaction to the expected settlement of the U. S. newspapers strikes, which helped to boost output of paper products) contributed to the improvement. Most components in the durables manufacturing index registered slight declines, but production of primary metals increased, with steel production in March registering the fourth consecutive monthly output gain.

Despite some improvement in April, the level of Canadian unemployment remains high. Allowing for seasonal factors, unemployment in April was 5.4 per cent of the labor force--down slightly from the 5.7 level registered in March. Reduction of this margin of persistent unemployment is one of the central objectives which the new Canadian Government is trying to pursue in its new program.