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Recent Economic Conditions in Canada,
March 1964 - May 1964

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Summary

The expansion in Canadian economic activity that was renewed last fall following a mid-summer lull has continued during the period under review.1/ Production, sales, and exports continue their advance; the rate of unemployment continues downward, though at a somewhat slower pace; while prices and interest rates show surprisingly little upward pressure for so prolonged a period of economic growth.

The external payments position remains favorable. The Canadian dollar, which had fluctuated within an extremely narrow range since the end of 1963, dropped below par briefly in late April for the first time since early September. Nonetheless, Canadian official reserves of gold and foreign exchange at the end of April registered a small gain following four successive months of minor decline.

By contrast with the experience of the previous year, the Budget Message for 1964-65 was extremely moderate in tone and had little impact on financial markets. Elsewhere on the fiscal front, a renewal of the continuing dialogue between federal and provincial authorities concerning their respective fields of financial responsibility and sources of revenues culminated in a compromise agreement, announced on April 20, that provided the basis for a new Canada-wide contributory Pension Plan. While the yields on Treasury bills and most bonds were fluctuating over an exceedingly narrow range, a strong upsurge in stock market activity was fanned by the announcement of a major mineral discovery near Timmins, Ont. On April 24 the Report of the Royal Commission on Banking and Finance, calling for a major transformation of the Canadian banking system, was presented to the House of Commons.

1/ Canadian economic developments during the preceding three months are reviewed in "Recent Economic Developments in Canada, November 1963 - February 1964", dated February 27, 1964.

Most domestic indicators continue to show improvement

Most broad indicators of domestic economic activity continued on the strongly upward path they had been following since last summer. The index of industrial production, which has hit successive record highs each month since September 1963, had by February attained a level more than 10 per cent above the year-ago figure. In rising 1.3 per cent from January to February, all three major divisions of the index moved higher, with the increase for manufacturing alone amounting to 1.6 per cent. The unemployment rate, seasonally adjusted, declined further in March and, at 4.6 per cent of the labor force, was lower than at any time since the first half of 1957. As compared with March 1963, an increase of 217,000 in the labor force was more than offset by a 310,000 increase in the numbers employed. For the period January - February, chain store sales were 15.3 per cent higher than during the corresponding period of 1963; new motor vehicle sales, 21.2 per cent (by volume); producer shipments of iron ore, 30.8 per cent; generation of electric power, 10.7 per cent; while new housing starts (in centers of 5,000 population and over) totalled 14,328 units in 1964, as compared with 8,299 units in 1963.

Similar strength was demonstrated in the performance of indicators that become available only after some time lags. Gross national product, which has advanced in each quarter since early 1961, increased a further 2.8 per cent in the fourth quarter of 1963 to a seasonally adjusted annual rate of $44.3 billion. The ratio of manufacturing inventories to shipments, which had climbed to 2.05 as recently as August, declined abruptly from 1.90 in November to the extraordinarily low figure of 1.77 in December.

However, it should be noted that two significant indicators registered small declines between January and February on a seasonally adjusted basis: total retail trade fell off 1.6 per cent, and total starts of new dwelling units decreased 2.6 per cent. The latter figure takes on special significance in view of the widespread feeling that the federal government's special subsidy for winter-time housing construction may be borrowing against construction activity that would otherwise have occurred this spring.

International trade continues as strong stimulant.

By contrast with earlier periods of postwar expansion, the current upswing in economic activity continues to be fed by thriving export sales. While imports in February were valued at a record $514 million (19.2 per cent higher than during the preceding year), the rise in exports exceeded 25 per cent. Accordingly, the export surplus on commodity trade for January - February amounted to $97.5 million, double that of the previous year. In trade with the USA alone, however, the import deficit widened from just under $100 million to almost $170 million.

Table 1. Canadian Imports and Exports, January-February 1963 and 1964

	Total Exports		Imports	
	1963	1964	1963	1964
	Millions of dollars			
Month of February				
United Kingdom	57.6	73.1	30.1	37.4
Other C'wealth & Pref.	23.9	30.1	22.3	16.7
United States	266.3	320.8	313.5	380.0
Others	89.9	124.9	65.4	80.1
Total C'wealth & Pref.	81.5	103.2	52.3	54.1
Total others	356.2	445.8	378.9	460.1
Grand total	437.7	549.0	431.2	514.2
January - February				
United Kingdom	136.3	185.0	67.1	76.[illegible]
Other C'wealth & Pref.	57.7	67.6	43.7	43.9
United States	582.7	631.1	681.3	798.9
Others	207.8	299.4	143.9	166.2
Total C'wealth & Pref.	194.0	252.7	110.7	120.5
Total others	790.5	930.5	825.2	965.1
Grand total	984.5	1,183.1	936.0	1,085.6

Notes: 1. Export values are final, import values for 1964 are estimates.
2. Figures may not add due to rounding.

Later information indicates that March exports also attained a record level, although the margin over a year ago narrowed somewhat and the gain for the entire first quarter amounted to 20 per cent.

Price movements surprisingly moderate to date

Despite the vigor of the expansion, prices and wages have shown a high degree of stability. The general index of wholesale prices has been slipping slightly since the beginning of 1964 and, at 245.6 in both March and April, remained below the level attained last June.

Table 2. Canada: Wholesale Price Indexes

	April* 1964	March* 1964	April 1963	March 1963
		(1935 - 1939 = 100)		
General Wholesale Index	245.6	245.6	242.8	242.4
Vegetable products	226.0	227.7	224.9	223.0
Animal products	249.5	249.3	251.6	252.9
Textile products	249.9	249.6	248.9	247.7
Wood products	331.0	330.9	321.2	321.2
Iron products	255.4	255.0	253.0	253.0
Non-ferrous metals	204.1	201.5	196.5	196.1
Non-metallic minerals	190.5	191.5	189.1	189.4
Chemical products	190.2	190.1	189.5	189.3
Iron and non-ferrous metals (excluding gold)	266.3	264.1	259.4	259.0

* These indexes are preliminary.

The consumer price index continues its gentle rise. At the beginning of March 1964 it had registered an increase of only 0.1 per cent over February 1964 and 1.9 per cent over March 1963.

Table 3. Canada: Consumer Price Indexes

	Component Weights	1964 March	1964 February	1964 January	1963 March
			(1949 = 100)		
All-Items	100	134.6	134.5	134.2	132.1
Food	27	131.3	131.3	131.4	128.9
Housing 1/	32	137.5	137.3	137.3	136.0
Clothing	11	118.6	117.8	117.7	115.6
Transportation	12	143.0	142.6	141.1	139.6
Health & personal care	7	165.4	165.4	165.4	159.9
Recreation & reading	5	152.3	152.3	152.1	148.6
Tobacco and alcohol	6	119.4	119.4	118.5	118.0

1/ This index is composed of shelter and household operation.

Average weekly wages in manufacturing rose in January to \$81.91 from \$76.53 in December, but average hourly earnings actually declined slightly, from \$2.02 to \$1.99. Overtime and wage increases in iron and steel products were factors making for upward movement, but these were more than offset by a return to normal operations in the leather, textile and clothing industries, which are heavy employers of female labor.

The over-all stability in prices and wages has occurred despite an 8 per cent increase in the total money supply (as measured by chartered bank deposit liabilities and total currency outside banks) in the year ending April 30. A goodly portion of the increase continues to be immobilized in Government of Canada deposit balances, which were down from \$1,026 million on February 26, 1964 to \$720 million by April 29, but contrasted markedly with the level of \$97 as of the end of April 1963.

No change in general tax policy

On March 16, the Minister of Finance introduced a featureless budget, notable primarily for a one-third reduction in the projected deficit. With anticipated expenditures already some 6 per cent in excess of revenues, and high levels of unemployment largely confined to the Atlantic Provinces and Eastern Quebec, the Government decided against proposing any general reduction in income tax analogous to recent U. S. legislation. The punitive 20 per cent rate of withholding tax proposed for dividends paid nonresidents by foreign-owned companies has been withdrawn, but the favorable 10 per cent rate for companies meeting designated criteria of Canadian ownership continues in effect. There is no further mention of a Canadian Development Corporation to encourage the repatriation of Canadian equities; instead, increasing reliance is to be placed on private investment trusts, pension funds, and life insurance companies.

Over-all cash requirements in 1964-65 are estimated at $895 million, up considerably from the preliminary figure of $518.9 million for 1963-64 though much below the $1,463.9 million level of the preceding year, when advances to the exchange fund account absorbed $943 million. On a national-income accounts basis, the deficit is expected to be a nominal $40 million, after falling steadily from $536 million recorded in fiscal 1962.

Over one-third of the expected budget expenditures is in the defence ($1.6 billion) and public debt charges ($1.0 billion) categories. Personal and corporate income taxes together will continue to contribute about one-half of budgetary revenues.

Table 4. Canada: Budget Revenues, Expenditures, and Deficits 1960-65
(millions of dollars)

Fiscal year ended March 31	Budgetary Revenues	Budget Expends.	Deficit	Over-all Cash Reqrs. 1/	Deficit on nat. inc. accts. basis
1960	5289.8	5702.9	413.1	375.5	
1961	5617.7	5958.1	340.4	294.3	
1962	5729.6	6520.6	791.0	477.6	536
1963	5878.7	6570.3	691.6	1463.9	369
1964 (est'd)	6207.0	6892.0	685.0	518.9	221
1965 (projected)	6700.0	7155.0	455.0	895.0	40

1/ Including various nonbudgetary receipts and disbursements.

Source: Budget Papers (1964-65) and Bank of Canada Statistical Summary.

Dominion-provincial fiscal negotiations renewed

Particularly difficult problems of fiscal relationships between the Federal and Provincial governments came up for renewed discussion at a three-day conference at Quebec City, March 31-April 2, 1964. At issue are conflicting views concerning appropriate sources of funds and distribution of responsibilities among the respective jurisdictions, particularly as they involve shared-cost welfare programs aimed at creating nation-wide standards of performance in the face of uneven fiscal capacity of the various provinces. Programs are of two types: (a) those which provide current welfare services, of which by far the largest is hospital insurance, estimated to cost the federal Treasury over $400 million in fiscal 1965; and (b) conditional grants in support of various capital programs, such as the trans-Canada highway, which are an inevitable element of a flexible federal policy to promote general economic activity and higher levels of employment.

The Quebec Premier detailed a plan for contracting-out of over 60 shared-cost programs involving federal payments to the provinces of over $1 billion in fiscal 1965, while wishing to remain a party to various of those programs that, though involving capital expenditures, are necessarily terminal in character. Quebec also jeopardized the future of the Canada Pension Plan by insisting on its intention of moving ahead on a provincial basis. Quebec's submission to the Conference re-emphasized its support for adoption of a "25-25-100" tax formula to cover the provincial portion, respectively, of personal income, corporate income, and inheritance taxation.

A rather bland communique, issued at the termination of the Conference, (a) indicated agreement that the federal government should immediately enter into negotiations with provinces concerning possible contracting-out from programs of permanent nature involving fairly regular annual expenditures; and (b) "gave consideration" to the immediate establishment of a tax structure committee, that would deliver an interim report before the end of 1964.

Subsequently, on April 20, the Prime Minister announced an agreement on new tax-sharing arrangements that provides the basis for a new contributory Canadian Pension Plan, applied uniformly across Canada. The federal government will make available to the provinces an additional 2 per cent in personal income tax abatement for the fiscal year 1965-66 (estimated to represent some $60 million), and a further 2 per cent in 1966-67. Under existing agreements, the provinces receive 18 per cent of personal income tax collections, about 22 per cent of corporate income taxes, and 75 per cent of federally-collected succession duties.

Table 5. Canada: Market Yields on Government Securities
Selected Dates January 1963 - April 1964

Dates		Treasury Bills		Bonds			
		3-mos.	6-mos.	Sept. 1965	June 1967-68	Jan. 1975-78	Sept. 1996-March 1998
1963							
Jan.	2	3.94	4.06	4.48	4.48	5.12	5.10
June	12	3.19	3.30	4.07	4.07	4.88	4.90
Sept.	11	3.78	3.98	4.60	4.48	5.27	5.14
Oct.	16	3.54	3.69	4.00	4.29	5.03	5.04
Dec.	31	3.74	3.93	4.20	4.42	5.16	5.02
1964							
Jan.	8	3.80	3.96	4.31	4.43	5.17	5.01
	22	3.74	3.92	4.25	4.50	5.18	5.01
March	5	3.90	4.06	4.43	4.56	5.25	5.04
	12	3.85	3.99	4.34	4.56	5.22	5.03
	25	3.88	4.04	4.48	4.61	5.25	5.07
April	1	3.87	4.02	4.49	4.61	5.28	5.10
	8	3.82	3.88	4.40	4.60	5.26	5.07
	15	3.68	3.83	4.41	4.64	5.26	5.09
	22	3.70	3.85	4.42	4.63	5.27	5.07
	29	3.70	3.85	4.39	4.64	5.26	5.07
May	6	3.69	3.86	4.32	4.49	5.21	5.05

Yields on securities fluctuate over a narrow range

Since the end of 1963, the range of fluctuation in the three-month Treasury bill has been only 22 basis points. From a low of 3.74 per cent per annum in late January, the bill rate hardened gradually in the course of February and the average tender rate peaked out in early March at 3.90 per cent, its highest level since early January 1963. It held relatively stable throughout March, then fell to a low of 3.68 per cent in mid-April, in keeping with a decline in the U. S. bill rate. Meanwhile, yields on longer term Government bonds have tended to harden at moderately higher levels, so that the spread between the 3-month bill and Government of Canada bonds due in 1996-98 widened from 21 basis points in early January to 37 basis points in late April. This wider margin is consistent with a policy of avoiding excessive incentives for short-term inflows of capital from the U. S. while mildly damping the vigorous domestic expansion.

Table 6. Canada: 40 Bond Yield Average

End of Month	10 Provincial	10 Municipal	10 Public Utilities	10 Industrial	40 Average
1963					
May	5.29	5.39	5.34	5.26	5.32
August	5.67	5.88	5.61	5.49	5.66
October	5.51	5.66	5.48	5.40	5.51
December	5.53	5.67	5.50	5.39	5.52
1964					
January	5.58	5.72	5.52	5.48	5.57
February	5.61	5.71	5.55	5.49	5.59
March	5.57	5.71	5.57	5.52	5.59
April	5.55	5.68	5.57	5.50	5.57

Source: McLeod, Young, Weir, & Company

Bond yields on securities other than those issued by the Federal Government have on the average fluctuated even more narrowly. The McLeod, Young, Weir average has varied over a maximum range of 2 basis points between the end of January and the end of April. Stability in the average has been due far less to any offsetting variations among its component series than to a rather widespread quiescence: during the same period, the widest range of fluctuation was registered by the provincial group, and this amounted to a mere 6 basis points. At 5.57, the 40-Bond yield average was 9 basis points below its recent peak, attained at the end of August 1963.

Similarly, the differential yields on corresponding Canadian securities quoted both in Canadian and in U. S. markets, which had generally tended to widen in the period following the announcement of the proposed interest-equalization tax, have for the most part fluctuated rather narrowly around levels somewhat below their recent maximums.

Table 7. Pattern of Differential Yields on Canadian Securities in U. S. and Canadian Markets
(per cent per annum)

	Pre-I.E.T. 7/3/63	Post I.E.T. Maximum	Latest Data 4/23/64
Government of Canada		(3/26/64)	
Canada (1975)	4.99	5.27	5.25
United States (1974)	4.30	4.46	4.51
Differential	+.69	+.81	+.74
Province of Ontario		(1/16/64)	
Canada (1981)	5.21	5.48	5.45
United States (1984)	4.43	4.56	4.60
	+.78	+.92	+.85
Quebec Hydro		(2/27/64)	
Canada (1982)	5.34	5.70	5.68
United States (1984)	4.62	4.65	4.70
Differential	+.72	+1.05	+.98
Toronto Metro		(3/12/64)	
Canada (1982)	5.34	5.59	5.59
United States (1979)	4.44	4.49	4.56
Differential	+.90	+1.10	+1.03

Source: Nesbitt, Thompson & Co. Ltd. Financial Notes

Stock markets active and strong

In contrast with the relative stability in bond yields, the DBS index of industrial stock prices hit record highs for six successive weeks beginning in early March. That upsurge moved the weekly average from 148.0 to 158.3, even before Texas Gulf Sulphur's announcement of a major copper-zinc-silver discovery near Timmins, Ontario, spurred feverish activity on the Toronto Stock Exchange. A record turnover of more than 28 million shares occurred on Friday, April 17.

Canadian dollar dips temporarily below par in late April

The Canadian dollar, which had fluctuated narrowly between a high of 92.65 U. S. cents and a low of 92.53 cents from late December until mid-April, dipped to 92.40 cents on April 30, its lowest quotation since the beginning of September. Somewhat perversely, the dip occurred despite a small increase in official holdings of gold and U. S. dollars reported for the end of April, whereas the earlier period of exchange rate stability came in the face of four successive months of minor decline in the official reserve figure. The bald figures, moreover, understate the recent strength of the Canadian dollar, inasmuch as the decline of $40.1 million reported for February occurred despite a $60 million repayment on Canada's outstanding indebtedness to the International Monetary Fund.

Table 8. Canada: Official Exchange Reserves and Related Items, November 1963 - April 1964

End of Month	Gold	U. S. Dollars	Total	Net Changes	U. S. $ quot'n on Cdn. $ (cents)	Memorandum items
	(millions of U. S. $)					
1963						
May	746.4	1965.6	2712.0	+40.6	92.75	
June	754.6	1937.0	2691.6	-20.4	92.78	First Gordon Budget
July	762.0	1739.0	2501.0	-190.6	92.48	U.S. I.E.T. Proposals Repay $80 million to IMF
August	767.8	1702.7	2470.5	-30.5	92.36	
Sept.	774.7	1793.6	2568.3	+97.8	92.81	Wheat contract with USSR
Oct.	784.4	1797.0	2581.4	+13.1	92.79	
Nov.	799.5	1831.5	2631.0	+49.6	92.76	
Dec.	817.2	1777.8	2595.0	-36.0	92.53	
1964						
Jan.	836.7	1745.7	2582.4	-12.6	92.57	
Feb.	849.7	1692.6	2542.3	-40.1	92.57	Repay $60 million to IMF
March	871.0	1594.5	2465.5	-76.8	92.54	
April			2481.1	+15.6	92.40	Italy converted $(C)20 million IMF drawing into $(US)

Since the exchange crisis that occurred in the spring of 1962, Canada has added steadily to its holdings of gold, mainly on the basis of domestic mineral production, while allowing month-to-month variations to occur in its official dollar holdings. By the end of March 1964, the proportion of gold had risen above 35 per cent, as compared with a figure of 26 per cent in October 1962. Prospects for further reserve accruals are excellent, not merely because the reopening of the St. Lawrence to shipping will expedite the export of wheat under contract with the

USSR but also because a payment of $275 million (U.S.) is due from the U. S. Government in October in partial fulfillment of the agreement governing the joint development of the power potential of the Columbia River.

Royal Commission recommends transformation of Canadian banking system

The Report of the Porter Royal Commission on Banking and Finance was tabled in the Canadian House of Commons on April 24. The key recommendations, which cut cleanly through the present spectrum of bank and near-bank institutions, and have as their primary intent the equalization of competition rather than provision of a more effective system of monetary control, are as follows:

(1) any firm may elect to become a bank;

(2) banks, and only banks, shall enjoy the privilege of accepting deposits or comparable obligations from the public withdrawable in fewer than 100 days;

(3) all banks would be subject to various regulations, especially the maintenance of a cash balance with the Bank of Canada, but would be relieved of others, particularly the 6 per cent statutory ceiling on interest charges and the restraints against mortgage lending;

(4) under revised requirements, the secondary reserve in the form of a liquid asset ratio would be abolished, but banks would have to maintain balances at the Bank of Canada in the amount of 8 per cent against demand deposits, 4 per cent against obligations up to a one-year term, and nothing against longer term obligations.

In order to protect the freer competition that is opened up among existing institutions, the government's hand would be strengthened with respect to anti-trust action, including the power to unwind mergers.

The Commission also proposed (in line with the recommendations of Governor Rasminsky) that, in crucial conflicts between the Bank of Canada and the Government, the Government would be given the power to issue a directive to the Bank, but such directive would lapse after 30 days unless explicitly renewed.

Not all financial institutions are brought under the reserve requirements. As a matter of political realism, the 1500-odd caisses populaires, the French-Canadian counterpart of the American credit unions, are exempted from the banking requirement; but their 16 central organizations (all but 4 of which are relatively small) would have to maintain reserve balances with the Bank of Canada.

In addition, institutions which choose to remain as nonbank trust and mortgage loan companies would be permitted to operate under more liberalized provisions with respect to the composition of their investment portfolios.

The Commission made a number of relatively minor recommendations affecting the securities market and noted the need for more competition in the underwriting field but it did not go as far as to advocate a federal equivalent of our S.E.C.

Within the broad area of policy-making, the Commission takes the general position of relying on fiscal policy with the needs of domestic economic stabilization in mind and reserving monetary policy more particularly for serving international financial requirements. However, the Report deals less than adequately with broad questions of the relationship between monetary and fiscal policy: one reason for this was the Commission's decision to leave fiscal questions to be handled by the forthcoming Report of the Royal Commission on Taxation.

On one particular issue, U. S. - Canadian financial relationships, the Royal Commission reflects the usual Canadian ambivalence. On the one hand, the Commission holds (Chap. 5, p. 86) that it does "not look with favor on Canadian legislation which thwarts capital (in-)flows for reasons unrelated to our domestic economic need for them"; but, on the other, it also states (Chap. 18, p. 374) that "the balance of advantage is against foreign control of Canadian banks". As a consequence, the Report suggests strict provisions to regulate acquisition of control by foreigners.

This inconsistency is all the more blatant inasmuch as foreign currency deposits (chiefly Euro-dollar) of the commercial banks are excluded from any statutory reserve requirements. As a result, the expansion of such deposits, which already exceed 20 per cent of the total deposit liabilities of the Canadian chartered banks, remains marginally advantageous to them.

Perhaps in response to the rapid growth in the business of Canadian banks in U. S. dollar deposits, the attitudes of U. S. banks seem to be shifting. Heretofore, U. S. banks have not tended to compete actively for business in Canada. However, the National City Bank has already invaded the Canadian banking community by purchasing control of the smallest and newest chartered bank, and the only one that was already foreign-owned.