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Recent Economic Developments in Canada:
January-April 1965

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Summary

During the fourth quarter of 1964, Canada continued to experience buoyant output and demand trends along with falling unemployment and relatively stable prices. 1/ In the October-December period, a further growth of consumer spending and a sharp upturn in total business spending on fixed capital (both in real terms) stimulated a 2.3 per cent rise in industrial output over the third-quarter. Price movements over these three months were moderate and the amount of unemployed as a per cent of the labor force (seasonally adjusted) fell from 4.5 per cent in September to 4.0 per cent in December despite the continued growth of the labor force. However, the volume rate of inventory accumulation continued to ease and the value of exports fell back from the high third-quarter level.

Even with the modest fourth-quarter short-fall in exports, Canada ended the year with a balance of payments position much improved over that for 1963. The merchandise trade surplus increased by nearly \$200 million to \$700 million and the current account deficit decreased by \$100 million to \$453 million. 2/

1/ For a review of earlier developments see, "Recent Economic Developments in Canada, November 1964 to January 1965," dated February 23, 1965.

2/ All data expressed in Canadian dollars unless otherwise noted.

In spite of the very favorable growth of domestic and foreign demand which, during 1964, absorbed an ever larger proportion of an ever growing labor force, Canadian government officials have expressed a clear concern over the labor situation. During 1964 the civilian labor force grew 2.0 per cent and it is expected to grow at an even faster rate between now and 1970,

Concern over the ability of the economy to absorb this rate of growth led the Minister of Finance to present a stimulative budget for fiscal 1965-66 on April 26. To spur consumer and investment spending over the coming months, he called for a 10 per cent reduction in the basic rate of personal income tax. In addition, the accelerated capital cost allowance program, which was to have terminated on June 13 of this year, was extended to December 1966, and the scope of the program was broadened to cover the purchase of new grain storage facilities. As a result of these and other tax changes, the Treasury's cash requirement for 1965-66 was set at \$525 million--about \$100 million more than the estimated outturn for 1964-65. (See Table 1.)

Table 1. Canada: The Budgetary Position

	1964-65		1965-66	
	Budget forecast	Estimated Outturn	Projected Before Tax	Projected After Tax
Revenues	6700	7136	7525	7350
Expenditures	7155	7219	7650	7650
Surplus or deficit	- 455	- 83	- 125	- 300
Other Treasury payments (net) ^{a/}	<u>440</u>	<u>345</u>	<u>225</u>	<u>225</u>
Total cash requirement	895	428	350	525

a/ Excludes repurchase of maturing government debt.

Canadian officials believe that the rapidly growing labor force, together with existing and planned additions to plant capacity, will provide the resources required to achieve the 5 per cent increase in real GNP forecast for 1965 over 1964 without significant increases in prices and wages. Currently, these officials expect prices to rise approximately 2 per cent in 1965 or about the same as during 1964.

In a move to strengthen the participation of Canadian residents in financing economic growth, the Minister of Finance proposed the establishment of the Canada Development Corporation. Its purpose would be to supply risk capital to Canadian industry, thereby lessening dependence upon foreign markets. The Corporation's funds would be derived from the sale of shares to the federal government and to the public. Restrictions would be placed upon the ownership and voting rights of the shares of the Corporation to ensure that it is essentially Canadian owned.

Aggregate output still rising

There was a significant acceleration in the rate of Canadian industrial output during the fourth quarter of 1964 that carried over into the early months of 1965. Between July-September 1964 and January 1965 the index of industrial production moved up 11 points (5.2 per cent) to 224. This compares with an average quarterly rise of one point during the January-September 1964 period. (See Table 2.)

Table 2. Canada: Main Economic Indicators 1964-1965
(Monthly or Monthly Average)
(Seasonally Adjusted)

	1964						1965	
	I	II	III	IV	Nov.	Dec.	Jan.	Feb.
Index of industrial production	211	212	213	218	220	221	224	n.a.
Retail trade (\$m)	1,651	1,634	1,673	1,682	1,687	1,674	1,672	n.a.
Exports (\$m)	665	705	725	674	652	712	654	n.a.
Imports (\$m)	613	633	615	635	610	683	n.a.	n.a.
Unemployment as per cent of labor force	4.8	4.9	4.8	4.4	4.3	4.0	4.3	4.0
Consumer expenditures (\$m)	8,751	8,772	8,937	9,052	-	-	-	-
Gross business expenditures on fixed capital (\$m)	2,561	2,492	2,453	2,616	-	-	-	-
Change in inventories (\$m)	148	141	112	79	-	-	-	-
Gross national expenditure (\$m)	13,710	13,862	13,938	14,058	-	-	-	-

Source: Dominion Bureau of Statistics

Domestic demand components appear to have been the major factors in the acceleration of industrial expansion in the last quarter of 1964. In particular, consumer spending rose more sharply in the fourth quarter than it had during the previous two; also, gross business expenditures on fixed plant and equipment increased noticeably in the fourth quarter after falling during the middle six months of 1964

(both on a seasonally-adjusted and on a volume basis). On the other hand, the value of exports dropped off during the October-November period after having risen quite strongly during the first nine months of 1964.

In January, the latest month for which most data are available, industrial output continued to rise; however, consumer spending, as measured by the value of retail sales, eased relative to the previous three months, and the value of exports was down from the fourth quarter '64 level.

Unemployment continues to fall

The recent acceleration of business activity brought about further reductions in the unemployment rate, despite the continued growth of the labor force. Unemployed as a percentage of the labor force (seasonally adjusted) averaged 4.8 per cent in the third quarter and only 4.4 per cent in the fourth. (See Table 3.) The downward trend continued at least through March 1965 when the rate reached 3.9 per cent--the lowest since May 1957. By mid-February, the labor force (seasonally adjusted) was 100,000 or 1.5 per cent above the third quarter average.

Table 3. Canada: Labor Market Indicators 1964-1965
(Monthly or Monthly Average)
(Seasonally Adjusted)

	1964				1965		
	I	II	III	IV	Jan.	Feb.	Mar.
Civilian labor force (Th)	6,884	6,909	6,947	6,955	7,032	7,050	n.a.
Unemployment as % of labor force	4.8	4.9	4.8	4.4	4.3	4.0	3.9
Average weekly hours in manufacturing	41	41	41	41	41	n.a.	n.a.

Source: Dominion Bureau of Statistics.

To date Canadian employers have, to a large extent, satisfied their additional labor requirements by drawing upon new entrants into the labor force rather than extending the average work week. For example, in manufacturing, average weekly hours remained stable throughout 1964 and showed no change in January 1965. (See Table 3.)

Domestic prices show mixed trends

Throughout 1964, Canadian price indices showed divergent trends. Consumer and export prices as well as average hourly earnings showed a rising tendency; on the other hand, the prices of imports, industrial materials and other wholesale goods eased or held steady. These trends continued into the early months of 1965. (See Table 4.)

Table 4. Canada: Price Indices 1964-1965
(Monthly or Monthly Average)

	1964				1965			% Change Jan. 64 to Jan. 65
	I	II	III	IV	Jan.	Feb.	Mar.	
Consumer prices (1949=100)	134.4	135.1	136.0	136.1	136.9	137.2	137.3	+2.01
Wholesale prices (1935-39=100)	246.2	245.6	244.7	245.3	246.6	246.4	246.7	-0.12
30 industrial materials (1935-39=100)	258.4	258.4	258.6	257.8	256.7	255.2	n.a.	-1.09
Export prices (1948=100)	129.6	130.5	131.8	132.5	132.0	n.a.	n.a.	+2.00
Import prices (1948=100)	132.4	133.2	131.7	130.1 ^{a/}	n.a.	n.a.	n.a.	0.00 ^{b/}
Average hourly earnings in manufacturing (\$)	1.99	2.01	2.04	2.04	2.08	n.a.	n.a.	4.52

^{a/} October.

^{b/} October 1963 - October 1964.

Source: Dominion Bureau of Statistics.

Undoubtedly, the stability of import prices, as well as the high volume of Canadian imports, acted as a moderating influence upon the rise in consumer and export prices and contributed to the stability of wholesale prices during 1964. In the first quarter of 1965, however, the relative importance of this influence appears to have abated somewhat. For example, the consumer price index rose 0.8 per cent on the average between the last quarter of 1964 and the first quarter of 1965; throughout 1964 average quarterly changes were quite minor.

Leading indicators suggest continued growth of aggregate demand

During the last three months of 1964, selected leading indicators--new and unfilled orders, owned inventories, and building permits--moved up sharply, on a seasonally adjusted basis, from their third quarter levels. During January, there was some easing from these high peaks, but the levels reached were substantially above the first quarter values of a year ago. (See Table 5.) The sustained strength of these indicators suggests that underlying demand trends are still moving up.

Table 5, Canada: Leading Economic Indicators 1964-1965
(\$m, Monthly or Monthly Average, Seasonally Adjusted)

	1964						1965
	I	II	III	IV	Nov.	Dec.	Jan.
Manufacturing							
New orders	2,645	2,580	2,583	2,720	2,775	2,770	2,717
Unfilled orders	2,468	2,545	2,640	2,778	2,797	2,816	2,737
Owned inventories	4,929	4,971	5,086	5,144	5,176	5,124	5,157
Building permits	244	231	286	319	369	282	261

Source: Dominion Bureau of Statistics

These data also give one of the very few hints of developing inflationary pressure. In particular, throughout 1964 the growth of unfilled orders accelerated despite the more modest expansion of new orders. (See Table 5.)

Quite favorable balance of payments outturn for 1964

A strong export performance by Canada in 1964 contributed not only to the growth of aggregate demand but also to a very favorable (by historical standards) current-account position. The deficit for the year was \$453 million--about \$100 million less than that for 1963. (See Table 6.)

Table 6. Canada: Balance of Payments 1963-1964
(\$m)

	1963		1964				
	IV	Year	I	II	III	IV	Year
<u>Current Account:</u>							
Exports	2,014	7,082	1,730	2,107	2,183	2,128	8,238
Imports	1,810	6,579	1,607	2,048	1,827	1,966	7,538
Trade balance	<u>+204</u>	<u>+503</u>	<u>+33</u>	<u>+149</u>	<u>+356</u>	<u>+162</u>	<u>+700</u>
Services	<u>-325</u>	<u>-1,060</u>	<u>-376</u>	<u>-305</u>	<u>-141</u>	<u>-331</u>	<u>-1,153</u>
Surplus on deficit	-121	-557	-343	-156	+215	-160	-453
<u>Capital Account:</u>							
Short-term	+153	90	+338	+108	-230	-127	+89
Long-term	- 4	613	- 37	+116	+171	+477	+727
Balance	<u>+149</u>	<u>+703</u>	<u>+301</u>	<u>+224</u>	<u>- 59</u>	<u>+350</u>	<u>+816</u>
Current and capital account	+28	+146	-42	+68	+156	+181	+363
<u>Financing:</u>							
Reserves	-28	-60	+127	-62	-97	-54	-86
Changes in IMF position	---	-86	- 85	- 6	-59	-127	-277

Source: Dominion Bureau of Statistics.

However, Canadian officials expect a somewhat larger deficit for 1965. Imports will continue to rise particularly in those areas where capacity limitations will impinge upon domestic output, and exports are expected to be affected by the U.K. program and by reduced wheat sales to the Soviet Bloc.

During 1964 Canada experienced a sizable capital inflow--mostly in long-term forms--which exceeded the current account deficit by \$363 million. This overall surplus was used to add \$86 million to reserves of gold and U.S. dollars and \$277 million to Canada's IMF position. (See Table 6.) According to the Dominion Bureau of Statistics, Canada's fourth quarter reserve position was not affected by the short-term central bank credits extended to the Bank of England.

As in 1963, Canada's long-term capital imports from the United States exceeded the amount imported from all countries by about \$125 million.

Seasonal reserve losses continue through March

The January-March period of seasonal weakness in the balance of payments has brought with it a reduction in Canada's gold and foreign exchange position. Between end-December 1964 and end-March 1965, official holdings of gold and U.S. dollars fell \$120.2 (U.S.) million. This compares with \$129.5 (U.S.) million over the same period of 1964. However, on March 31, 1965 Canada's official holdings of international reserves totalled an ample \$2.5 (U.S.) billion. (See Table 7.)

Table 7. Canada: Official Foreign Exchange Reserves
November 1964-March 1965
 (US\$m)

	<u>1964</u>		<u>1965</u>			<u>Totals outstanding</u> <u>March 31, 1965</u>
	<u>Nov.</u>	<u>Dec.</u>	<u>Jan.</u>	<u>Feb.</u>	<u>Mar.</u>	
Changes in:						
Gold	+ 6.3	+18.3	+10.3	+ 4.6	+ 3.5	1,044.1
Foreign exchange	<u>+50.5</u>	<u>-87.4</u>	<u>-16.4</u>	<u>-24.1</u>	<u>-98.1</u>	<u>1,510.0</u>
Total	<u>+56.8</u>	<u>-69.1</u>	<u>- 6.1</u>	<u>-19.5</u>	<u>-94.6</u>	<u>2,554.1</u>

Source: Bank of Canada.

All of the decrease this year was effected by sales of U.S. dollars; in fact, official holdings of gold rose \$18.4 (U.S.) million to a total of over \$1 (U.S.) billion. By the end of March, gold holdings equalled 40.9 per cent of reported reserves. This compares with 35.3 per cent for the same month one year ago.

Money market ease continues

The easier conditions in the Canadian money market that began last fall continued during the period under review. By late April, selected market yields were below their early January levels. However, market yields have tended to move in broad swings and since early April the trend has been upward. (See Table 8.)

Table 8. Canada: Money Market Indicators

	<u>January</u>		<u>Feb.</u>	<u>Mar.</u>	<u>April</u>	
	<u>6</u>	<u>27</u>	<u>10</u>	<u>3</u>	<u>7</u>	<u>21</u>
Interest rates:						
Day-to-day	3.72	3.88	3.53	3.45	3.38	3.50
3-month Treasury bills	3.80	3.74	3.70	3.77	3.61	3.67
Money supply and bank loans:						
Money supply (\$m)	17,252	17,063	17,043	17,331	17,777	17,869
Bank loans	8,193	8,138	8,201	8,316	8,499	n.a.

Source: Bank of Canada

A significant expansion in general bank loans and the money supply has accompanied the overall easing of market rates. Between January 6 and April 21 the money supply (currency in the hands of the public and total chartered bank deposits) grew over \$600 million and general loans by the chartered banks increased about \$300 million. (See Table 8.)

On a seasonally-adjusted basis, the money supply and general loans continued to expand through February, the latest month for which these data are available. Since September 1964 the money supply has grown \$785 million (4.8 per cent) and general loans \$563 million (7.1 per cent).

Capital markets show firmer tone during March and April

Through January the government bond market continued to gain strength after the shake-out that followed the unsettling international

developments of late November 1964. However, conditions deteriorated again during February, first in anticipation of U.S. balance of payments measures, then in response to the steps that were taken. A firmer tone did not reappear until early March when market yields once again began to move down. By April 21, government bond yields, especially at the long end, were close to their late January levels. (See Table 9.)

Table 9. Canada: Capital Market Indicators
January-April 1965

	<u>January</u>		<u>March</u>		<u>April</u>
	<u>6</u>	<u>27</u>	<u>3</u>	<u>31</u>	<u>21</u>
<u>Government bond yields:</u>					
3 3/4% 1965	3.82	3.67	3.77	4.72	3.69
5 % 1968	4.68	4.51	4.86	4.67	4.58
4 1/4% 1972	4.85	4.81	5.01	4.95	4.89
5 1/2% 1976	5.01	4.95	5.12	5.09	5.06
4 1/2% 1983	4.97	4.97	5.12	5.06	5.04
5 1/4% 1990	5.03	5.02	5.12	5.09	5.08
<u>Stocks</u>					
73 industrials price index	197.8	204.1	202.8	206.1 _{a/}	209.2

Source: Bank of Canada

a/ April 15

Bond yields differentials narrowing once more

The firmer tone of Canadian capital markets during the March-April period brought about a resumption in the trend toward narrower differential between comparable U.S. and Canadian government bonds. Between March 3 and April 21, these spreads favoring Canada fell from 6 to 28 basis points. (See Table 10.)

Table 10. Canada: U.S.-Canadian Bond Yields and Yield Spreads January-April 1965

	<u>January</u>		<u>Feb.</u>	<u>March</u>		<u>April</u>
	<u>6</u>	<u>27</u>	<u>24</u>	<u>3</u>	<u>31</u>	<u>21</u>
<u>Less than 1 year:</u>						
Can. 3 3/4% 1965	3.82	3.67	3.79	3.77	3.72	3.69
U.S. 4 % 1965	3.72	3.84	4.00	4.02	3.95	3.94
Difference	+0.10	-0.17	-0.21	-0.25	-0.23	-0.25
<u>3 years:</u>						
Can. 5 % 1968	4.68	4.51	4.71	4.86	4.67	4.58
U.S. 3 3/4% 1968	4.06	4.07	4.11	4.13	4.12	4.13
Difference	+0.62	+0.44	+0.60	+0.73	+0.55	+0.45
<u>7 years:</u>						
Can. 4 1/4% 1972	4.85	4.81	4.06	5.01	4.95	4.89
U.S. 4 % 1972	4.19	4.15	4.18	4.19	4.17	4.17
Difference	+0.66	+0.66	+0.78	+0.82	+0.78	+0.74
<u>19 years:</u>						
Can. 4 1/2% 1983	4.97	4.97	5.06	5.12	5.06	5.04
U.S. 3 1/4% 1983	4.15	4.13	4.16	4.18	4.14	4.15
Difference	+0.82	+0.84	+0.90	+0.94	+0.92	+0.89
<u>25 years:</u>						
Can. 4 1/4% 1990	5.03	5.02	5.09	5.15	5.09	5.08
U.S. 3 1/2% 1990	4.20	4.16	4.19	4.19	4.17	4.18
Difference	+0.83	+0.86	+0.90	+0.96	+0.92	+0.90

Sources: B nk of Canada and Federal Reserve.

Last fall Canadian officials began a concerted effort to reduce the attractiveness of lower cost U.S. financial markets by reducing the yields on Government of Canada bonds. The consequent trend toward narrower differentials continued until early February when U.S. developments led to a deterioration of market conditions in Canada. Between January 27 and March 3 yield spreads favoring Canada rose from 6 to 13 basis points. (See Table 10.)

Canadian dollar eases then shows new strength

Between early February and late March a number of factors contributed to a general easing of the Canadian dollar in foreign exchange markets. The seasonal weakness in the Canadian balance of payments combined with a reaction to the U.S. balance of payments program and other technical factors to produce a 77 point fall in the spot rate between February 4 and March 25. Over this same period the forward rate strengthened noticeably, swinging from a discount of 0.27 per cent to a premium of 0.61 per cent. Since late March the spot rate has strengthened and the forward rate has remained at a premium close to 0.40 per cent. (See Table 11.)

Table 11. Canada: Exchange Rates and Arbitrage Calculations
February-April 1965

	<u>Feb.</u>		<u>March</u>			<u>April</u>		
	<u>4</u>	<u>18</u>	<u>4</u>	<u>18</u>	<u>25</u>	<u>8</u>	<u>15</u>	<u>22</u>
<u>Exchange rates:</u>								
Spot (U.S. cents)	93.09	92.95	92.60	92.45	92.32	92.64	92.76	92.67
Fwd. (per cent per annum)	-0.27	0.00	+0.14	+0.34	+0.61	+0.47	+0.47	+0.40
<u>3-month yield and yield spreads:</u>								
Treasury bills								
Canadian (covered)	3.36	3.63	3.82	3.97	4.18	4.00	4.01	3.95
U.S.	3.87	3.94	3.95	3.90	3.89	3.91	3.91	3.92
Difference	-0.51	-0.31	-0.13	+0.07	+0.29	+0.09	+0.10	+0.03
<u>Finance paper:</u>								
Canadian (covered)	4.15	4.50	4.62	4.72	5.04	5.10	4.97	5.08
U.S.	4.00	4.12	4.25	4.25	4.25	4.25	4.25	4.25
Difference	+0.15	+0.38	+0.37	+0.47	+0.79	+0.85	+0.72	+0.83

The development of a forward premium during March and April brought on a significant change in the covered differential on U.S. and Canadian Treasury bills. This difference favored New York by 51 basis points on February 4, but by March 25 it favored Canada by 29 basis points. Since March a narrowing of the forward premium has reduced the differential to 3 basis points. (See Table 11.)

On finance paper the covered differential favored Canada throughout the period under review by an ever growing margin. On February 4 the difference was only 15 basis points but on April 22 it was 83 basis points. (See Table 11.)

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