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September 9, 1963

Recent Economic Developments in Canada,
June - August 1963 9 pages

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Summary

The improvement in domestic economic conditions in Canada, reported in the preceding review of developments,1/ has been extended during the past three months. Canada's foreign trade results for the first seven months of the year have been most encouraging, involving a surplus of $138.1 million as contrasted with a deficit of $131.6 million during the corresponding period of the previous year. Notwithstanding this general improvement, financial and foreign exchange markets experienced two periods of serious unsettlement, associated with foreign-investment tax proposals presented, respectively, in the Canadian Budget Message of June 13 and by President Kennedy in his message of July 18. Serious reserve losses were sustained ($20.4 million in June, and $190.6 million in July) and the Canadian dollar has held continuously below par since July 30. The Bank of Canada discount rate, which had been reduced from 4 per cent to 3-1/2 per cent on May 6 with the objective of promoting domestic expansion, was raised to 4 per cent on August 11 as defensive reaction to the increase in discount rate announced by the Federal Reserve Banks in the previous month.

The dramatic improvement experienced in Canada's external position during the second half of 1962 nevertheless continues to dominate most of the data so far available in 1963. Characteristically, Canada's balance of international payments registered a deficit on current account during the first quarter of 1963, compensated for by a surplus on the capital side (See Table 1). Primarily because of more favorable results on merchandise trade, the current-account deficit was running

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1/ See "Recent Economic Developments in Canada: March 1963 to May 1963" (June 11, 1963).

Table 1. Canadian Balance of International Payments, Annual Totals 1961-1962, and First Quarter 1962-1963

	1961 Total	1962 Total	1962 First qu.	1963 First qu.
Balance on mdse. trade	(+173)	(+155)	(-7)	(+62)
Balance on current account	-982	-848	-333	-243
Direct investment in Canada	+515	+525	+110	+ 65
Net sales of portfolio securities	+306	+282	- 64	+359
Other capital movements	+390	+248	- 77	-114
Total Payments Balance	+229	+207	-364	+ 67
Financing				
Special international assistance	--	+330	--	--
Changes in official reserves (increase -)	-229	-537	+364	- 67
Total Financing	-229	-207	+364	- 67

Source: Bank of Canada, Statistical Summary and Dominion Bureau Statistics, Canadian Statistical Review.

considerably below the year-ago rate for the same quarter. Flotation of new security issues abroad was at the very high rate of $435 million, as compared with $533 million for the full calendar year 1961. These transactions, the counterpart of the heavy outflow of U. S. long-term capital, contributed substantially to the U. S. payments deficit experienced this year.

The Budget Message

Financial markets eased moderately during the period between the reduction in discount rate on May 6 and the Canadian Budget Message of June 13. Controversial features of the latter, notably a 30 per cent tax on large-block sales of Canadian corporate stock to nonresidents, were intended to reduce the degree of U. S. control over Canadian industry. This measure proved seriously unsettling to the stock market and also induced some speculation against the Canadian dollar in the foreign exchange market. Following the announcement on June 19 that the tax proposal was being withdrawn, both markets recovered their previous levels. Some moderation was also introduced by the fact that the Federal budget registered a surplus of $52.1 million during the period April-July 1963, although that figure was somewhat below the $66.8 million surplus of the corresponding period of the preceding fiscal year.

Financial Developments

Policy developments both in Canada and in the U. S. combined to tighten Canadian financial markets generally in July. Early in the month, the Bank of Canada withdrew its standing price support of certain Government securities, and bond prices fell (i.e., yields rose) in all sections of the market (see Table 2.) Late in the month, yields rose further after the Federal Reserve Banks raised their discount rate and the President announced that he was recommending an "interest equalization tax" to limit foreign lending as part of a general attack upon the

Table 2. Canada: Selected Yields on Government Securities
May-August 1963

(in per cent per annum)

	May 1	May 8	June 12	June 19	July 10	July 17	August 7	August 14	August 28
Bank of Canada									
Discount Rate	4.00	3.50	3.50	3.50	3.50	3.50	3.50	4.00	4.00
Selected Canadian Market Yields:									
Treasury Bills:									
3 mos.	3.60	3.33	3.19	3.22	3.39	3.48	3.52	3.62	3.70
6 mos.	3.74	3.40	3.30	3.32	3.48	3.68	3.78	3.89	3.95
Bonds:									
1964	3.95	3.81	3.62	3.61	3.83	3.86	3.95	3.89	3.95
1965	4.47	4.26	4.07	4.09	4.31	4.38	4.52	4.54	4.64
1967-68	4.32	4.14	4.07	4.02	4.18	4.10	4.34	4.40	4.48
1975-78	5.00	4.92	4.88	4.89	5.02	5.04	5.18	5.18	5.26
1996-98	4.97	4.94	4.90	4.90	4.96	4.93	4.99	5.04	5.06
Differential of Canadian Yields over U. S. Yields:									
Treasury Bills:									
3 mos.	0.70	0.42	0.21	0.24	0.15	0.28	0.23	0.29	0.31
6 mos.	0.75	0.41	0.23	0.24	0.12	0.32	0.36	0.45	0.46
Bonds:									
5 years	0.75	0.58	0.36	0.30	0.33	0.23	0.55	0.61	0.64
20 years	0.98	0.94	0.86	0.86	0.96	0.96	1.11	1.12	1.20
35 years	0.94	0.93	0.88	0.87	0.90	0.89	0.97	1.02	1.05

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

U. S. balance of payments deficit. In the short-term sector, the uncovered yield spread between Canadian and U. S. 3-month Treasury bills narrowed, the differential in favor of the Canadian bill declining from 0.70 per cent on May 1, 1963, to 0.15 per cent as of July 11.

The Canadian dollar, which had weakened moderately after the announcement of the Federal Reserve action on discount rates on July 16, was subjected to intensified selling pressures following the President's tax request. On July 18, the market rate on the Canadian dollar momentarily reached its lowest level since the crisis of June 1962, and closed at 92.1 U. S. cents after heavy dollar losses had been incurred in support operations by the Bank of Canada. The rate strengthened again to 92.6 U. S. cents on July 22, after the Administration had promised to exempt new Canadian issues from the tax. When the forward Canadian dollar shifted from a slight premium to a discount, the covered differential of 0.32 per cent in favor of Canadian Treasury bills, prevailing on July 4, was entirely eliminated three weeks later.

During the month of August, interest rates continued to stiffen in most maturities, but the increase in yields occurred predominantly before rather than following the August 11 rise in Bank of Canada discount rate to 4 per cent. The exchange rate remained below par and covered arbitrage calculations on 3-month Treasury bills favored New York over Montreal by 5 basis points as of September 5. There is nevertheless some fragmentary information from New York banks suggesting that recent pick-up has occurred in the volume of short-term funds moving into Canadian finance and commercial paper on a covered basis. According to very partial information, the flow was reported at $48 million during the five weeks ending September 4, up from $13 million in the preceding five-week period.

Although A. E. Ames and Company reports no new issues floated by Canadian public authorities in U. S. funds following the U. S. policy announcements of mid-July, it estimates such sales of Canadian corporate bonds at $35.5 million for the period July 15-August 12, or at about the same high rate as during the earlier months of the year. No further sales were reported, however, during the two following weeks.

Stock-market prices in August recovered only a fraction of the ground lost during July, and Canada suffered a further $30.5 million loss in foreign-exchange reserves.

Employment, Retail Sales, and Prices

So far as domestic economic conditions are concerned, more strength is evidenced by sales performance, price experience, and prospective capital expenditures than by recent employment figures. The percentage of the Labor force unemployed, after reaching a high of 8 per cent late in 1960 and declining sharply during the following year, had fluctuated around the 6 per cent level throughout 1962. It declined to a seasonally-adjusted low of 5.4 per cent in April, 1963, but climbed back to 6.0 per cent by June, and continued at that level in July. The year-to-year increase in male employment, which had exceeded 3 per cent in the first and second quarters of 1962, was little better than 1 per cent in the first two quarters of 1963.

The value of retail trade, however, reached $1,525 million in June, an all-time high. The figure represented a 1 per cent increase over the preceding month, and a 6 per cent increase over June 1962. The value of new motor vehicle sales alone rose 8.7 per cent during the month, with the increase heavily concentrated in American-type passenger cars. The consumer price index (1949=100) stood

2.5 points higher in July 1963 than in July 1962, with food items, health and personal care contributing most of the increase. The wholesale price index for thirty industrial materials, which had declined 6 points during the third quarter of 1962, subsequently moved higher and in July 1963 attained a level of 256.7 (1935-39=100), 5 per cent above its October 1962 low.

Grain Prospects

The country has been enjoying one of the best grain-growing seasons in its history. If favorable conditions continue, the 1963 wheat crop may exceed the record 702 million bushels harvested in 1952. Total 1963-64 wheat supplies are likely to be some 1,180 million bushels, the largest on record and a near-record supply of feed grains is also in prospect. With 90 per cent of grain elevator working capacity already filled, a serious storage problem is imminent. Having won not a single rural seat in the three Prairie Provinces, the new Liberal government repudiated its pre-election promise of higher price supports. The initial support levels announced by the Minister of Trade and Commerce on July 23 for wheat ($1.50/bushel) oats (60¢/bushel) barley (90¢/bushel) remained the same as during the preceding year, which has proved the most favorable marketing season within the living memory of Prairie grain farmers.

Canadian wheat prices have gained as the result of the devaluation of May 1962, as well as of long-term wheat contracts with Red China, now second only to the United Kingdom as an export market for Canadian grain and ranking fourth among all export destinations during the first halves of 1962 and 1963. On August 2, the Minister of Trade and Commerce announced completion of a new long-term wheat agreement with Red China under somewhat easier terms than the previous contract signed by the Canadian Wheat Board on April 22, 1961. It calls for purchase of 3-5 million long-tons (112-187 million bushels) of wheat over the period August 1, 1963-July 1966, at prices to be negotiated periodically. The terms are 25 per cent cash at time of shipment, and the balance in 18 months with interest. The first contract, covering 500,000 tons for delivery during the last half of 1963, has already been signed. The Canadian authorities will clearly be under considerable pressure to permit increased shipment of Chinese goods into Canada as one means of financing this trade.

Construction outlays and Investment prospects.

Housing starts in urban center (5000 population and over) totalled 12,735 in July, 12.4 per cent higher than in the preceding year. For the first seven months of the year, the increase was 6.3 per cent. The July increase was accounted for by starts in rental dwellings, up 69.2 per cent, rather than dwellings intended primarily for owner-occupancy, which were down 20.7 per cent, as compared with the preceding year. Seasonally adjusted, the annual rate of starts in July was 124,900 units, up from 105,100 in June and 104,200 in April but below the May figure of 131,400. Canadian construction contract awards for July totalled $369.2 million, compared to $282.6 million in July 1962.

A survey of capital spending intentions for all sectors of the Canadian economy, conducted in May and June, called for total outlays of $9.3 billion in 1963, 7 per cent higher than in 1962 and 3 per cent above capital spending plans as surveyed at the beginning of the year. Capital spending in the resource-based industries is now expected to exceed that of the previous year by 17 per cent, while added strength in the capital-goods producing industries is likely to raise capital spending in secondary industry substantially. The revised statement of investment intentions indicates that Canadian productive capacity is being expanded and modernized at an accelerated rate. The expected increase in business investment, if realized, would be the sharpest experienced since 1957. Nevertheless, the Labor Minister reported on the basis of a separate survey that unemployment in the coming fall and winter is likely to exceed the rate attained during the past year.