L.5.2 RFD 562

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

November 9, 1965

Recent Economic Developments in Canada
September-October 1965

17 pages

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Summary

The expansion of the Canadian economy was maintained in the second quarter of 1965 although at a somewhat less vigorous rate and such basic indicators as employment, new and unfilled orders, and retail spending suggest that total output expanded further in the third quarter.1/ Total employment averaged 30,000 more in the summer quarter than in the spring quarter. New and unfilled orders and retail sales advanced further in August. Labor market conditions continued to tighten, and the rate of unemployment in September was reduced to its lowest level since 1956. Skilled labor shortages persisted during the period under review in the Canadian construction industry and in the manufacturing centers of Ontario.

Seasonal influences contributed to some moderation in the advances of consumer prices in August, but there was no significant reduction in pressures on more sensitive commodity price indices in the period under review. Canadian financial markets continued generally tight in September and October, and, on balance, interest rate levels moved marginally higher over this two month period. Pressures continued on commercial bank liquidity, but bank credit and the money supply continued to expand as the chartered banks intensified efforts to sell certificates of deposit and deposit receipts.

1/ For a review of earlier developments see "Recent Economic Developments in Canada, April-August, 1965," dated August 16, 1965.

On the external side, Canada's imports continued to grow, but the balance of payments prospects improved with sales of $450 million of grain to the Soviet Union, announced in mid-August.

In the foreign exchange market, the spot Canadian dollar advanced to the 93.00 U.S. cents level in early October, but the forward dollar moved to a substantial discount of 50 basis points (0.50 per cent per annum) in September, and the discount widened to between 60 and 80 basis points in early November. As a result, an incentive to shift funds from Canadian to U.S. Treasury bills developed for the first time in several years, and the incentive in favor of Canadian over U.S. finance paper, which had been large during the second quarter, narrowed substantially. But tight conditions in Canadian financial markets, in part associated with year-end window-dressing in October by the chartered banks, limited the funds available to be shifted to the United States to take advantage of the large discount on the Canadian currency. However, the discount probably encouraged Canadian residents to hold on to U.S. dollar assets,covering their holdings' in terms of Canadian currency through the forward market.

Canadian gold and dollar reserves advanced by $134.0 million in the third quarter and by an additional $29.7 million in October to a total of $2,643.8 million. In addition, Canada's reserve position in the International Monetary Fund at the end of October amounted to $249.0 million. Total gold, dollar, and I.M.F. reserves at end-October were at the highest level since Canada was exempted from the United States' Interest Equalization Tax legislation. Press reports indicate that authorities on both sides of the border took action the second week in November to limit further increases in Canadian reserves in 1965 by persuading parties to Canadian private placements with U.S. investors to postpone consummation of the exchanges until 1966.

Economic indicators suggest continued expansion in third quarter. Because of distortions in the seasonal pattern of output, the underlying trend in industrial production is somewhat difficult to determine. The introduction of the winter incentive program for house-building and the shutdown of automobile production towards the end of 1964 followed by the sharp recovery in the first months of 1965 have made the seasonally-adjusted production index an unreliable guide to the course of actual output trends during 1964 and 1965. This index was unchanged during the second quarter but reached new highs in July and August. (See Table 1.)

Table 1. Canada: Main Economic Indicators, 1964-65
(seasonally adjusted, monthly or monthly averages)

	1964		1965				
	III	IV	I	II	July	August	Sept.
Index of industrial production	213	218	225	226	228	231	n.a.
Retail trade ($ m)	1,673	1,682	1,712	1,782	1,792	1,829	n.a.
Price index of 30 industrial materials (1935-39 = 100)	258.7	257.9	256.1	258.5	259.5	260.9	p/ 262.4
Unemployment as a per cent of labor force	4.8	4.4	4.0	4.3	4.3	4.0	3.6
Exports ($ m)	725	674	682	710	765	n.a.	n.a.
Imports ($ m)	615	635	671	700	737	n.a.	n.a.

p/ Preliminary.
n.a. Not available.
Source: Dominion Bureau of Statistics.

Higher levels of output during the third quarter are suggested by substantial rises in new and unfilled orders and in inventories. (See Table 2.) Unfilled orders in manufacturing rose 3 per cent in August after remaining stable from May to July. New orders for manufactures in July were up 2.2 per cent over the stable second-quarter level. Inventories rose 1.2 per cent in July and another 0.5 per cent in August over the second quarter level.

Table 2. Canada: Advance Economic Indicators, 1964-65
($ millions; seasonally adjusted; monthly or monthly average)

	1964		1965			
	III	IV	I	II	July	August
Manufacturing						
New Orders	2,583	2,720	2,778	2,830	2,891	n.a.
Unfilled orders	2,640	2,778	2,852	2,946	2,947	p/ 3,043
Owned inventories	5,086	5,144	5,218	5,347	5,401	p/ 5,426
Building permits	282	320	274	324	323	288

p/ Preliminary.
Source: Dominion Bureau of Statistics.

Indicators of aggregate demand also suggest that spending on industrial output continued to expand in the third quarter. The monthly average of retail sales advanced strongly through August--the latest month for which total retail trade data are available--reflecting the continuation of the rise in personal consumption which occurred in the second quarter. (See Tables 1 and 3.) Department stores sales moved up strongly in September to a level 12.4 per cent higher than in September, 1964. According to the Toronto press new car sales in October moved at a faster pace than at the same time last year. A nationwide survey of consumer buying intentions, taken by ORC-Gruneau Research Ltd. for Maclean-Hunter Publishing Company and released at the end of October, reportedly shows substantial increases over 1964 in the percentage of families planning to buy new cars, homes, major appliances, and home furnishings during the next six months.

Domestic spending higher. Domestic spending continued to increase in the second quarter although the rate of increase was less vigorous than in the first quarter. (See Table 3.) Total domestic spending (up by $908 million) increased more slowly than during the first quarter of the year. In the personal sector, consumption continued to advance steadily (up $860 million in the second quarter), and private fixed investment (up $564 million) showed a strong, but decelerating, rate of expansion. Inventory accruals ($972 million) continued to add to aggregate demand as the automotive industry continued its recovery from strikes in the fourth quarter of 1964. The current account deficit widened to $1,044 million in the second quarter.

Labor market tightness continued; unemployment fell. The unemployment rate fell in August and in September touched 3.6 per cent, the lowest rate achieved by the Canadian economy since 1956. (See Table 4.) Substantially lower levels were reached in 1956 and in the post-war years prior to 1954, which suggests that further margins of slack are still available for additional reductions in unemployment.

Table 3. Canada: Gross National Expenditure, Quarterly, 1964-65
(seasonally adjusted annual rates in millions of dollars)

	1964			1965	
	II	III	IV	I	II
Personal expenditure	29,040	29,684	30,148	30,512	31,372
Government expenditure on goods and services	8,524	8,544	8,796	9,120	9,344
Gross fixed capital formation	8,828	8,720	8,380	10,052	10,616
DOMESTIC DEMAND (Ex. Inventories)	46,392	46,948	48,324	49,684	50,988
Change in inventories	448	388	232	1,208	972
Balance of payments, current account	-168	- 28	-672	-968	-1,044
Residual error of the estimate	12	84	132	116	32
GROSS NATIONAL EXPENDITURE	46,684	47,392	48,016	50,040	50,948

Source: Bank of Canada, Statistical Summary.

The reduction in the unemployment ratio in August resulted in part from the return to school of unemployed students (which reduced labor force and unemployment equally in absolute numbers) and in part from an increase in agricultural employment. In September, additional numbers of young people withdrew from the labor market, while bad weather temporarily delayed the harvesting of the grain crop on the Prairies and largely accounted for a decline in farm employment.

More acute labor shortages are reported in certain sectors and geographical areas of the economy. Skilled labor shortages in the construction industry continued to hold back output in that sector. In September, unemployment in Ontario and the Prairie provinces (the more heavily populated industrial and wheat growing centers) was 2.7 per cent of the labor force while the rates were 3.9 per cent in

Table 4. Canada: Labor Market Indicators, 1964-65
(seasonally adjusted; monthly or monthly average)

	1964		1965				
	III	IV	I	II	July	August	Sept.
Total labor force (th.)	6,947	6,955	7,084	7,140	7,162	7,189	7,091
Total employed (th.)	6,611	6,654	6,803	6,832	6,853	6,900	6,833
Unemployment as per cent of labor force	4.8	4.4	4.0	4.3	4.3	4.0	3.6
Not seasonally adjusted	3.4	3.8	5.8	4.2	3.3	2.8	2.5
Average weekly hours in manufacturing	41	41	41	41	a/ 41	n.a.	n.a.

a/ Preliminary.
Source: Dominion Bureau of Statistics.

British Columbia, 4.9 per cent in Quebec, and 6.2 per cent in the Atlantic provinces.

The Canadian government recently developed programs to reduce the rates of unemployment in the eastern and far western sections of the country and to relieve labor shortages in portions of Ontario and the Prairie provinces. Under the Area Development Program, which became law June 30, 1965, the Department of Industry designated areas of pocket unemployment as eligible for capital grants to new industry locating in them. More recently, under the Government's Manpower Mobility Program and the fully reciprocal Canada and Quebec Pension Plans, labor movement to the tighter labor markets will be facilited. In addition, to relieve skill shortages within the unemployed population the Canadian government during the last three years promoted and obtained increased immigration to Canada from Western Europe.

Upward price pressures unabated. Although the rise in prices in the third quarter was substantially less on balance than in the second quarter, the reduction in the rate of advance was due largely to seasonal influences and did not indicate a change in the recent trend. Most price indexes rose by over 2.5 per cent from September, 1964 to September, 1965. (See Table 5.) Because of falling food prices during the summer months, the index for all consumer goods rose only 0.1 per cent between July and September.

Table 5. Canada: Price Indices, 1964-65

	Actual	Changes between successive dates				Actual	% Change
	1964		1965				Sept.'64-
	Sept.	Dec.	March	June	Sept.	Sept.	Sept.'65
Consumer prices - all goods (1949 = 100)	135.6	+1.2	+0.5	+1.7	+0.1	139.1	+2.6
Consumer prices - excluding food (1949 = 100)	137.0	+1.6	+0.6	+0.7	+0.7	140.6	+2.6
Wholesale prices (1935-39 = 100)	244.3	+1.7	+0.8	+5.2	-1.0	251.0	+2.7
30 Industrial materials (1935-39 = 100)	258.8	-2.6	+0.1	+4.1	+2.0	262.4	+1.4

Sources: Dominion Bureau of Statistics, Canadian Statistical Review; Bank of Canada, Statistical Summary.

The index of wholesale prices fell off 1.0 point during the period as the result of marginal declines in a majority of the component groups, most of which occurred in September. The index of industrial materials, on the other hand, moved up by 2.0 points during the third quarter, while in past years it typically declined. This particular reversal of past patterns suggests non-labor cost pressures in industry.

Money market tightened as money supply remained unchanged. The money market continued to tighten between July and October. Swings in interest rates during the period were associated with special factors such as the failure of the Atlantic Acceptance Corporation in June (which continued to have repercussions throughout the period under review) the marketing of $450 million Government debt in August, and the window-dressing activities of the chartered banks in preparation for year-end balance sheet positioning in October. Nevertheless, the trend of interest rates was generally higher reflecting reduced credit availabilities. (See Table 6.) The 3-month Treasury bill tender rate edged up from 3.93 per cent on June 30 to 4.15 per cent on October 27, largely staying parallel with movements in U.S. bill rates. The day-to-day loan rate on a per annum basis swung widely over the period but stayed well above the end-June rate of 3.48 and ended the period under review at 3.78 per cent.

Table 6. Canada: Money Market Indicators, April-July 1965

	June 30	July 28	August 25	September 29	October 27
Interest rates:					
3-month Treasury bills (% p.a.) a/	3.93	4.05	4.09	4.13	4.15
Day-to-day loans (% p.a.) b/	3.48	3.98	3.83	3.95	3.78
Money supply and bank loans:					
Money supply ($ m) c/	18,207	18,488	18,740	18,742	n.a.
Loans ($ m) c/	9,925	10,129	10,345	10,389	n.a.

a/ Weekly tender on Thursday following Wednesday shown; average yield.
b/ Weekly average of daily closing rates.
c/ Seasonally adjusted; average of Wednesdays in month ending with date shown.
Sources: Bank of Canada, Weekly Financial Statistics, and Statistical Summary.

Both money supply and outstanding loans of chartered banks continued to increase at rates of more than one per cent per month in July and August. In September, however, the seasonally adjusted money supply remained unchanged from its high August level, and total loans outstanding in September were up only slightly from their high August levels.

The money supply, unadjusted for seasonal variation, continued to expand moderately in October as the chartered banks increased their efforts to obtain corporate funds. According to press reports the volume of certificates of deposit outstanding (transferable with terms of more than one year) and deposit receipts outstanding (non-transferable with terms of less than one year) increased significantly in September and October.

Capital market rates continued rise. The entire spectrum of interest rates on Canadian Government debt continued to rise throughout the summer and in October as well. (See Table 7.) Between June 30 and October 27 bond yields advanced in Canada by 57 basis points from 4.41 per cent to 4.98 per cent on 1-year maturities and 30 basis points from 5.13 per cent to 5.43 per cent on 25-year maturities. The chartered banks and government accounts were net sellers in July; the Bank of Canada did most of the selling in August; while the general public were the large sellers in September and October.

In the stock exchanges, the Financial Post's index of industrials moved irregularly higher over the period. On October 27 the index had recovered two-thirds of the ground lost from highs posted in May, while the U.S. market had surpassed highs of May. The relatively retarded recovery north of the border reflected continued repercussions from the failure on June 17 of the Atlantic Acceptance Corporation, a medium sized sales finance company. In addition, a Royal Commission report (the Kelly Report) on the Windfall Scandal of 1964, released in mid-October, severely criticized both the rules and operations of the Toronto Stock Exchange and the limited public surveillance of them. The market, however, had discounted the Report and advanced after its release.

Table 7. Canada: Capital Market Indicators, June-October, 1965

		June 30	July 28	August 25	September 29	October 27
Government bond yields:						
4.50 %	1966	4.41	4.67	4.92	4.93	4.98
5.00 %	1968	4.89	4.98	5.06	5.03	5.17
4.25 %	1972	5.12	5.25	5.28	5.20	5.27
4.50 %	1983	5.15	5.30	5.36	5.36	5.42
5.25 %	1990	5.13	5.27	5.38	5.39	5.43
Stock index:						
Total industrials (1958 = 100) a/		193.9	187.9	195.3	199.2	203.9

a/ Figures for Thursday following Wednesday shown.
Sources: Bank of Canada, Weekly Statistical Summary; Financial Post.

The differential between U.S. and Canadian bonds was wider at the end of the period under review than at the end of June despite upward movements in U.S. Government bond yields in August and September. (See Table 8.) The uncovered spread between Canadian and U.S. Governments widened from a range 43 basis points on 1-year maturities to 96 basis points on 25-year bonds on June 30 to a range of 70 to 109 basis points on October 27. The inclusion of 1-year bonds in Table 8 reflects the extension on October 9 of the U.S. Interest Equalization Tax to maturities of at least one year; previous coverage was confined to maturities of at least three years.

<u>Wheat sale to U.S.S.R. reversed payments outlook</u>

Sharply rising imports in the first seven months of 1965 narrowed the Canadian trade account surplus, but the August announcement of the sale of 222 million bushels of wheat to the U.S.S.R. during the 1965-66 crop year substantially brightened the outlook. (See Table 1.) Through the first seven months of 1965, exports gained only 2.3 per cent and imports 11.1 per cent over the 1964 record.

In the first half of 1965, sharply rising imports more than offset a substantial increase in capital inflows. In the second quarter of 1965 the current account deficit was $360 million, while in the capital account large short-term inflow of $268 million and a

Table 8. Canada/U.S. Comparative Bond Yields, June-October, 1965

	June 30	July 28	August 25	September 29	October 27
1-year:					
U.S. 11/66, 4.0%	3.98	4.02	4.11	4.37	4.28
Canada 12/66, 4.5%	4.41	4.67	4.92	4.93	4.98
Differential (+ favors Canada)	0.43	0.65	0.81	0.56	0.70
3-year:					
U.S. 3/68, 3.75%	4.07	4.10	4.17	4.30	4.36
Canada 10/68, 5.0%	4.89	4.98	5.06	5.03	5.17
Differential	0.82	0.88	0.89	0.73	0.81
7-year:					
U.S. 8/72, 4.0%	4.15	4.16	4.25	4.37	4.38
Canada 9/72, 4.25%	5.12	5.25	5.28	5.20	5.27
Differential	0.97	1.09	1.03	0.83	0.89
19-year:					
U.S. 78-83, 3.25%	4.16	4.18	4.28	4.36	4.35
Canada 9/83, 4.5%	5.15	5.30	5.36	5.36	5.42
Differential	0.99	1.12	1.08	1.00	1.07
25-year:					
U.S. 2/90, 3.5%	4.17	4.18	4.25	4.34	4.34
Canada 5/90, 5.25%	5.13	5.27	5.38	5.39	5.43
Differential	0.96	1.09	1.13	1.05	1.09

Sources: Bank of Canada, *Weekly Statistical Summary*; Federal Reserve System.

small long-term capital inflow of $93 million produced a surplus of $361 million. (See Table 9.) Very large outflows to the United States in short-term forms were offset by larger inflows from other countries. There was an overall surplus of $1 million for the quarter, as Canada's gold and dollar reserves declined by $92 million, and the Canadian position in the IMF improved by $93 million.

Table 9. Canada: Balance of Payments, 1964-65
($ million)

	1964				1965	
	I	II	III	IV	I p/	II p/
Current account:						
Exports	1,730	2,198	2,182	2,130	1,825	2,190
Imports	1,695	2,048	1,828	1,969	1,866	2,222
Trade balance	+ 35	+150	+354	+161	- 41	- 32
Services (net)	-373	-298	-140	-322	-356	-328
Balance on current account	-338	-148	+214	-161	-397	-360
Capital account:						
Short-term	+311	+ 64	-281	-151	+170	+268
Long-term	- 15	+152	+223	+493	+155	+ 93
Balance on capital account	+296	+216	- 58	+342	+325	+361
Total balance:	- 42	+ 68	+156	+181	- 72	+ 1
Financing:						
Change in reserves	-127	+ 62	+ 97	+ 54	-118	- 92
Change in IMF position	+ 85	+ 6	+ 59	+127	+ 46	+ 93

p/ Preliminary.
Source: Dominion Bureau of Statistics.

Substantial gain posted in international reserves. In the third quarter of this year, Canadian holdings of both gold and dollars increased substantially, and the Canadian net creditor reserve position in the International Monetary Fund continued to improve as the result of the use of Canadian currency by other countries in their transactions with the Fund. (See Table 10.) Gold holdings rose $22.8 million and U.S. dollar $111.2 million. Gold and dóllar reserve gains in August alone totalled $106.5 million. The Canadian reserve position in the I.M.F. improved over the quarter by $76.0 million as the result of drawings of Canadian dollars by other countries, including the United States.

Total Canadian gold, dollar, and I.M.F. reserves at end-October amounted to a record total of $2892.8 million. Press reports indicate that anuthorities on both sides of the border took action during the second week in November to limit further increases in Canadian reserves in 1965 by attempting to persuade parties to Canadian placements with U.S. underwriters to postpone consummation of exchanges until 1966, when the Canadian balance of payments is expected to have a large current account deficit.

Table 10. Canada: Official Holdings of Gold and U.S. Dollars, December, 1964-September, 1965
(in millions of U.S. dollars)

	Level as of Dec. '64	Change: Dec. '64-March '65	Change: March '65-June '65	Change: June '65-Sept. '65	Level as of Sept. '65
Gold	1025.7	+ 18.4	+ 45.0	+ 22.8	1111.9
U.S. dollars	1648.6	-138.6	-119.0	+111.2	1502.2
Subtotal	2674.3	-120.2	- 74.0	+134.0	2614.1
Net I.M.F. sales of currency	60.0	+42.5	+ 86.5	+ 76.0	265.0
Total reserves	2734.3	- 77.7	+ 12.5	+210.0	2879.1
Reserve position in I.M.F.	197.5	+ 42.5	+ 86.5	+ 76.0	402.5
Gold as a percentage of gold and dollars	38.4	+ 2.5	+ 3.0	- 1.4	42.5

Source: Bank of Canada, Statistical Summary.

Spot Canadian dollar rose in August and forward discount emerged in September. After remaining below par of 92.50 U.S. cents in June and July, the spot Canadian dollar advanced to 93.00 cents in September and October. (See Table 11.) The premium on the forward Canadian dollar vanished during July, and was negligible in August. By September, a discount of 50 to 80 basis points emerged which provided an incentive for short-term transfers to the United States from Canada. Tight conditions in Canadian money markets in September and October, however, prevented the allocation of Canadian funds to this purpose.

Table 11. Canada/U.S.: Exchange Rates and Arbitrage Calculations, June-October, 1965

	June 30	July 30	August 26	September 30	October 28
Exchange rates:					
Spot (U.S. cents)	92.37	92.50	92.90	92.93	93.06
Forward premium on Canadian dollar	0.54	-0.20	-0.07	-0.54	- .67
3-month yields and differentials (% p.a.)					
Treasury bills					
Canada (covered)	4.31	3.79	3.87	3.47	3.42
U.S.	3.75	3.78	3.84	4.02	4.03
Difference (+ favors Canada)	+0.56	+0.01	+0.03	-0.55	-0.61
Finance paper a/					
Canada (covered)	5.22	4.73	4.92	4.52	4.64
U.S.	4.25	4.25	4.25	4.25	4.38
Differential	0.97	0.48	0.67	0.27	0.26

a/ Figures for Friday following Thursday shown.

The forward discount also had the effect of narrowing the covered spread between Canadian and U.S. finance paper rates. Canadian acceptance houses seeking to raise funds in the finance paper market encountered continued difficulties during the period (reflecting continued repercussions of the Atlantic Acceptance failure) so the closing of the covered differential favoring Canadian finance paper further contributed to tightness in this market in September and October. In addition, Canadian chartered banks reportedly made continued gains during October in the money market through the sale of certificates of deposit and deposit receipts. Reflecting this competition and the thinness of the finance paper market 90-day finance paper rates moved up from 5.00 per cent on October 22 to 5.50 per cent on November 5.

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