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Recent Economic Developments in Canada:
October 1965 - March 1966

16 pages

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Summary

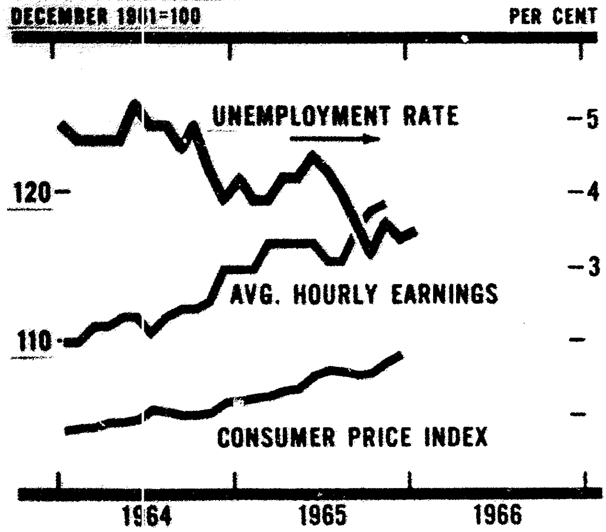
The vigorous expansion of the Canadian economy continued during the period under review, but sustained demand growth has placed domestic resources under mounting strain, and has led to the gradual erosion of price stability and foreign trade surpluses.[1/] (See Chart I and Table 1.) Between the second and third quarters of 1965, GNP rose 2.3 per cent, as consumption, investment and government spending moved to higher levels.[2/] Business activity continued to grow in the final quarter, judging from the further rise in retail spending, additional increases in industrial output and the sustained downward trend of the unemployment rate. With reduced margins of unused capacity (especially skilled labor), Canadian prices and wages have moved up sharply in recent months, after remaining relatively stable throughout 1964 and the early part of 1965. In addition, imports spurted during 1965: for the first nine months of the year, they were 11.3 per cent higher than during the same period in 1964. Exports, on the other hand, rose only 3.7 per cent, and the surplus on trade account fell from $539 million in 1964 to only $78 million in 1965. (See Table 1.) Most of the decrease in the total trade surplus represents reduced surpluses with countries other

1/ For a review of earlier developments see "Recent Economic Developments in Canada, September-October 1965", dated November 9, 1965.
2/ Unless otherwise indicated, all data are stated in terms of Canadian dollars.

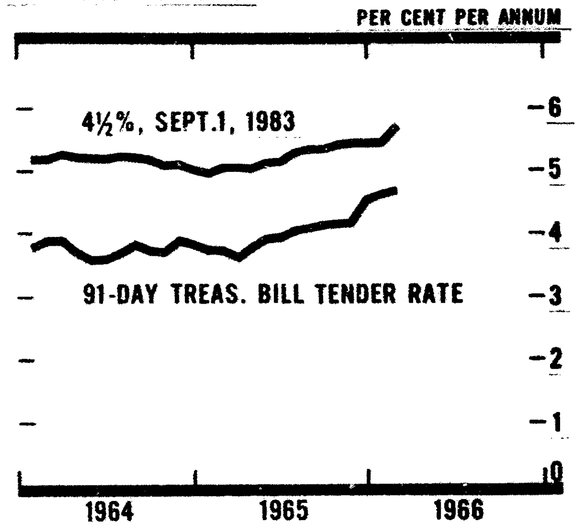
CHART 1

CANADA: MAIN ECONOMIC INDICATORS

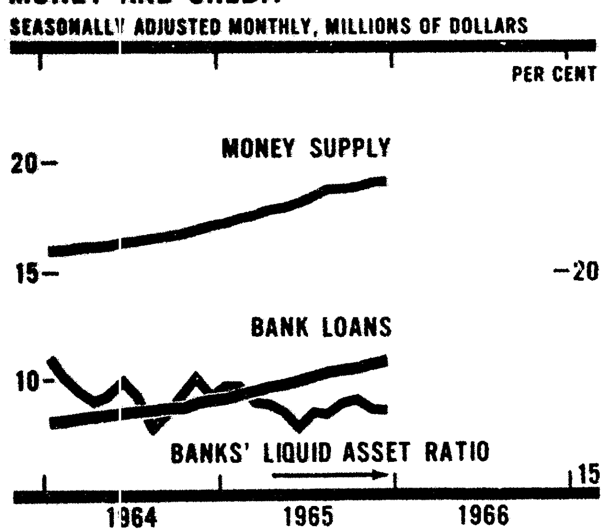
PRICES, WAGES, AND UNEMPLOYMENT



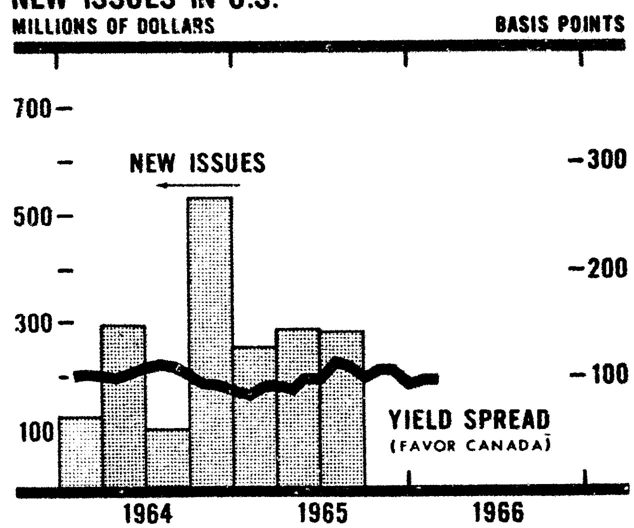
INTEREST RATES



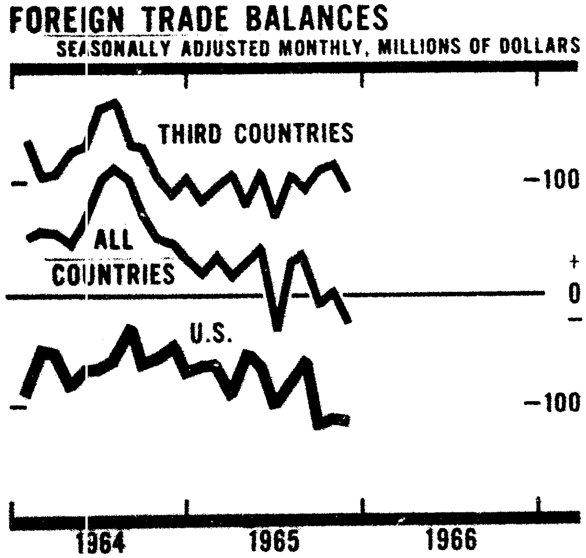
MONEY AND CREDIT



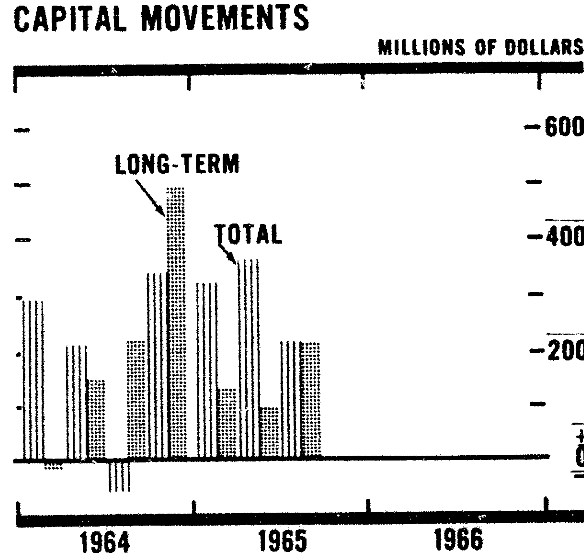
NEW ISSUES IN U.S.



FOREIGN TRADE BALANCES



CAPITAL MOVEMENTS



than the United States rather than a substantial increase in the deficit with this country. (See Chart I.)

Table 1. Canada: Main Economic Indicators 1964-1965 a/

	1964	1965					
	IV	I	II	III	Oct.	Nov.	Dec.
Monthly Indices b/							
Industrial production (1949=100)	218	225	266	231	235	239	--
Retail trade ($m)	1,682	1,712	1,777	1,816	1,846	1,875	--
Prices and wages (Dec. 1961=100)							
Consumer prices	105.4	106.1	107.0	107.9	107.8	108.5	109.0
Avg. hourly earnings in manuf.	113.3	115.5	116.6	116.2	118.8	--	--
Unemployment rate	4.4	4.0	4.3	4.0	3.2	3.5	3.4
GNP components ($b) c/							
Consumption	30.1	30.5	31.3	32.1	--	--	--
Fixed capital formation	8.4	10.1	10.2	10.7	--	--	--
Government spending	8.8	9.1	9.4	9.5	--	--	--
Other	0.7	0.2	0.0	-0.2	--	--	--
Total	48.0	49.9	50.9	52.1	--	--	--
Balance of Payments ($m) d/							
Exports	2,130	1,825	2,189	2,262	--	--	--
Imports	1,969	1,867	2,217	2,114	--	--	--
Difference	+161	-42	-28	+148	--	--	--

a/ All data seasonally adjusted except prices, wages, and balance of payments

b/ Monthly or monthly average.

c/ Annual rates at 1957 prices.

d/ Quarterly totals.

Domestic and balance-of-payments developments have not as yet weakened the generally strong position of the Canadian dollar in the foreign exchange markets. However, in February, market conditions became somewhat unsettled, and the spot rate dropped from 93.00 (U.S. cents) on February 3 to 92.84 on February 17. Some of this lost ground was recovered later in the month; by early March the rate had firmed at about 92.92.

A major part of the Canadian expansion is still being financed by large-scale domestic bank lending and by new securities issues in the United States. (See Chart I.) For 1965, new bank loans totaled $1.7 billion; for the first nine months of last year, U.S. markets provided about $860 million of new long-term funds. Each of these totals was about double the corresponding figures for the same periods in 1964.

In order to maintain free access to U.S. capital markets, Canadian authorities, last December, agreed to keep their reserves (including the net creditor position with the IMF) within an appropriate range of $2.6 billion. In this connection, they announced their intention of using official holdings of U.S. dollars to purchase Canadian government securities in U.S. markets from U.S. residents. Purchases totaling $40 million were made in January and contributed to a $102 million exchange loss in that month. These reserves fell another $15 million in February to about $2.5 billion.

Against the background of growing inflationary strain, the Canadian authorities moved last December to tighten credit conditions further. On December 6, the discount rate was raised from 4-1/4 to 4-3/4 per cent, after a similar 1/2 per cent rise in Federal Reserve rates in the United States. Following this increase, the Treasury bill rate moved up 53 basis points to 4.69 per cent on February 24. Long-term bond yields remained at their previous levels until late February, when they rose about 24 basis points to as much as 5.71 per cent.

In addition, Canadian authorities are intensifying their efforts to improve labor availabilities and skills. A new Manpower Department was created last December to coordinate the government's vocational training programs and the immigration of skilled labor from Western Europe.

Labor market conditions tighten

The sustained strong rise in aggregate demand led to a further tightening of labor market conditions during the period under review, despite continued growth in the labor force. Between the third quarter of 1965 and January 1966, total employment expanded by a larger amount than the work force; as a result, the unemployment rate dropped from 3.9 per cent to 3.5 per cent. In addition, the average work week in manufacturing rose slightly in the final quarter of 1965. (See Table 2.)

Table 2. Canada: Labor Market Indicators, 1964-66
(seasonally adjusted; monthly or monthly average)

	1964		1965				1966
	III	IV	I	II	III	IV	Jan.
Total labor force (th.)	6,939	6,978	7,075	7,138	7,146	7,196	7,303
Total employed (th.)	6,614	6,674	6,790	6,837	6,867	6,950	7,044
Unemployment as per cent of labor force	4.7	4.4	4.0	4.2	3.9	3.4	3.5
Average weekly hours in manufacturing	41.1	40.9	40.9	40.9	40.9	41.1 [a]	

a/ October-November.
Source: Dominion Bureau of Statistics.

In order to relieve these growing stringencies, which are particularly severe in the industrial areas of Ontario, government officials are continuing their efforts to improve labor supplies by encouraging the immigration of skilled labor from western Europe and by increased training of domestic workers. In late December, they established a new Manpower Department to coordinate these activities. On January 1, the new Department took over the technical and vocational assistance programs formerly administered by the Department of Labor, and the immigration section formerly with the Department of Citizenship. In addition, the new Department was given responsibility for administering the manpower mobility program, initiated in the summer months of 1965.

Price and wage increases accelerating

With increased strain on domestic resources, Canadian prices and wages have moved up sharply in recent months. Year-to-year percentage changes for the final months of 1965 were much greater than earlier in the year. (See Table 3 and Chart I.) For example, the consumer price index showed a year-to-year gain of 2.9 per cent in the fourth quarter of 1965 compared to only 2.0 per cent in the first. Similarly, average hourly earnings in manufacturing were up 5.9 per cent in October-November over the same period in 1964, compared to 4.7 per cent for the January-March quarter.

Table 3. Canada: Price Indices, 1965-66
(annual rates of change)

	1965				1966
	I	II	III	IV	Jan.
Consumer prices - all goods (1949 = 100)	+2.0	+2.3	+2.5	+2.9	+3.1
Wholesale prices (1935-39 = 100)	+0.2	+1.6	+2.7	+3.6	+4.2
30 industrial materials (1935-39 = 100)	-0.9	0	+0.6	+0.8	+4.4
Average hourly earnings in manufacturing	+4.7	+4.6	+4.3	a/ +5.9	n.a.

a/ October and November only.
Sources: Dominion Bureau of Statistics, Canadian Statistical Review; Bank of Canada, Statistical Summary.

Money and credit continue strong rise

Sustained demand growth is associated in large measure with the vigorous expansion of bank and non-bank credit. Bank loans, which had jumped 14 per cent in 1964, moved up at a larger and ever increasing rate in 1965. The increase over the full year was close to 20 per cent. (See Table 4 and Chart I.) The growth in non-bank consumer credit remained strong in 1965, but was somewhat less rapid than a year earlier.

The expansion of bank loans has impinged upon the chartered banks' liquidity positions. Through the year, the banks' liquid assets ratio declined modestly from a 17.15 per cent average for December 1964 to 16.76 per cent for December 1965. (See Chart I.) This compares to the minimum of 15.00 per cent set in agreement with the Bank of Canada. In addition, the ratio of more liquid assets to total assets fell from 32 to 30 per cent over this period, largely because of a $80 million sell-off of Canadian government bonds. The current standing of these two ratios suggest that the banks will be able to meet growing credit demands in future months, though perhaps not to the same extent as in 1965.

Table 4. Canada: Money and Credit, 1964-65
(millions of dollars)

	Actual	Year-to-year percentage change					Actual
	Dec. 1963	Dec. 1964	March 1965	June 1965	Sept. 1965	Dec. 1965	Dec. 1965
Bank loans[a/] [b/]	$ 7,932	+14.4%	+15.1%	+16.9%	+19.5%	+19.6%	$10,855
Non-bank consumer credit	2,755	+11.8	+ 8.9	+10.8	+ 9.8 [c/]	+ 9.6 [c/]	$ 3,300
Money supply of the general public[b/]	15,899	+ 7.5	+ 8.9	+10.8	+12.9	+12.0	$19,132

a/ Excludes day-to-day loans, call loans, and loans for the purchase of Canada Savings Bonds.
b/ Seasonally adjusted.
c/ November data.
Source: Bank of Canada, Statistical Summary.

Chartered banks continue to lose U.S. dollar deposits

The chartered banks have been able to meet growing credit demands despite heavy withdrawals of U.S. dollar deposits by U.S. and Canadian residents. For 1965, these withdrawals totalled $850 million (See Table 5.) Most of this decline was offset by increased deposits from residents of the United Kingdom and other countries. The net fall of $333 million was financed by running off $275 million of U.S. dollar assets, mostly with U.K. financial institutions, and by switching $68 million out of other currencies. Over 1965, U.S. dollar loans to Canadian residents seem to have risen appreciably.

The banks' practice of keeping a relatively balanced dollar position seems to assure that any future drain (or reflow of funds) will not have an appreciable impact upon their role in financing the Canadian expansion.

Table 5. Canada: United States Dollar Assets and Liabilities of Chartered Banks,
(millions of dollars)

	Level at end of Dec., 1964	Changes from previous date					Level at end of Dec. '65
		March	June	Sept.	Oct.	Dec.	
Assets							
With residents of:							
United States	2,104	-204	-77	+259	+256	-448	1,890
United Kingdom	801	-151	-231	+67	-34	+22	474
Canada	641	+105	+73	+47	+26	+26	918
Other	504	-61	-39	-23	+42	+71	494
Total	4,050	-311	-274	+350	+290	-329	3,775
Liabilities							
With residents of:							
United States	1,793	-327	-260	-32	-2	-113	1,059
United Kingdom	44	+5	+38	+83	+73	-95	148
Canada	1,322	-161	-135	+129	+81	-20	1,216
Other	943	+101	+69	+201	+103	-71	1,346
Total	4,102	-382	-288	+381	+255	-299	3,769

Source: Bank of Canada, Statistical Summary.

Interest rates rise to new highs after Bank rate increase

The strong growth in credit demand has pushed Canadian interest rates to higher levels. (See Chart I.) This trend was given an added boost on December 6, when Bank rate was raised from 4-1/4 to 4-3/4 per cent. Between December 2 and February 24 the Treasury bill rate rose 53 basis points to 4.69 per cent. (See Table 6.) Long-term government bond yields showed little movement just after the Bank rate action, but they rose sharply in early February. (See Table 6.) This recent increase apparently reflects similar rises in U.S. markets and clearer signs of inflationary pressures in Canada.

Table 6. Canada: Money Market Indicators, November, 1965 - February, 1966

	Actual Nov. 4	Changes from preceding date: December 2	December 16	December 30	Jan. 28	Feb. 24	Actual Feb. 24
A. Interest rates							
91-day Treasury bills	4.16	0.00	+0.39	-0.01	+0.09	+0.06	4.69
90-day prime finance paper	5.50	+0.12	+0.26	0.00	-0.13	0.00	5.75
Government bonds							
4.50% 1966	5.08	-0.13	+0.24	-0.11	-0.27	+0.21	5.02
5.00% 1968	5.31	-0.01	+0.15	-0.10	-0.10	+0.13	5.38
4.25% 1972	5.34	-0.01	+0.10	-0.06	+0.03	+0.30	5.70
4.50% 1983	5.49	-0.04	+0.05	-0.05	0.00	+0.26	5.71
5.25% 1990	5.47	-0.02	+0.02	-0.03	+0.01	+0.20	5.65
B. Stock index							
Total industrials (1958 = 100)	206.3	-8.3	-0.9	+2.3	+8.5	a/ -1.4	a/ 206.5

a/ February 17.

Because Canadian yields were relatively stable from November to January at a time when U.S. rates moved up, yield differentials on comparable issues narrowed. (See Table 7 and Chart I.) Between November 10 and January 26, the spread on one-year issues moved from 82 basis points in favor of Canada to 8 basis points in favor of the United States, while differentials in favor of Canadian bonds on 25-year securities fell from 111 to 94 basis points. Yields rose in both countries about the same during February. (See Table 7.)

Table 7. Canada/U.S. Comparative Bond Yields, October 1965-February 1966
(per cent per annum)

	Nov. 10	December 1	December 29	Jan. 26	Feb. 16
1-year:					
U.S. 11/66, 4.0%	4.32	4.37	4.88	4.87	4.96
Canada 12/66, 4.5%	5.14	4.95	5.08	4.81	5.09
Differential (+ favors Canada)	+0.82	+0.58	+0.20	-0.08	+0.13
3-year:					
U.S. 3/68, 3.75%	4.47	4.56	4.93	4.89	5.13
Canada 10/68, 5.0%	5.41	5.30	5.35	5.25	5.42
Differential	+0.94	+0.74	+0.42	+0.33	+0.29
7-year:					
U.S. 8/72, 4.0%	4.49	4.54	4.71	4.75	5.01
Canada 9/72, 4.25%	5.43	5.33	5.37	5.40	5.68
Differential	+0.94	+0.79	+0.66	+0.62	+0.67
19-year:					
U.S. 78-83, 3.25%	4.42	4.43	4.51	4.45	4.72
Canada 9/83, 4.5%	5.50	5.45	5.45	5.45	5.69
Differential	+1.08	+1.02	+0.94	+0.98	+0.97
25-year:					
U.S. 2/90, 3.5%	4.38	4.40	4.50	4.47	4.71
Canada 5/90, 5.25%	5.49	5.45	5.44	5.45	5.65
Differential	+1.11	+1.05	+0.94	+0.94	+0.94

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

Trade surpluses diminishing

Because of domestic demand growth, Canada's foreign trade position deteriorated noticeably during the first three quarters of 1965, when the rise in imports far outstripped increased export sales. For the first nine months of 1965, Canada recorded a trade surplus of only $78 million, compared to $539 million during the same period in 1964. (See Table 8.) Nearly 80 per cent of the total decline represents reduced surpluses with countries other than the United States.

Table 8. Canada: Balance of Payments, 1964-65
(millions of dollars)

	1964				1965		
Current account:	I	II	III	IV	I	II	III
Exports	1,730	2,198	2,182	2,130	1,825	2,189	2,262
Imports	1,695	2,048	1,828	1,969	1,867	2,217	2,114
Trade balance	+35	+150	+354	+161	-42	-28	148
Services (net)	-373	-298	-140	-322	-355	-335	-142
Balance on current account	-338	-148	+214	-161	-397	-363	6
Capital account:							
Short-term	+311	+64	-281	-151	+192	+268	+1
Long-term	-15	+152	+223	+493	+133	+96	+219
Balance on capital account	+296	+216	-58	+342	+325	+364	+220
Total balance:	-42	+68	+156	+181	-72	+1	+226
Financing:							
Change in reserves	-127	+62	+97	+54	-118	-92	+114
Change in IMF position	+85	+6	+59	+127	+46	+93	+82

p/ Preliminary.
Source: Dominion Bureau of Statistics.

The small total surplus was more than offset by the usually heavy outpayments on services account. For the January-September period, Canada experienced a total current account deficit of $754 million. However, because of heavy short- and long-term capital imports, Canada was able to improve its foreign exchange and IMF position by $155 million during these nine months. (See Table 8.)

In contrast to developments in 1964, the total capital inflow in 1965 of $909 million came from countries other than the United States. In the first three quarters of 1965, long-term capital imports from the United States totalling $609 million, but this was more than offset by the repatriation of short-term capital to that country of $649 million. During the same period in 1964, Canada imported both short-term ($462 million) and long-term ($573 million) funds from the United States.

New policy to govern Canada's reserve position

Further reserve accruals were experienced in October and November, at a time when U.S. officials were preparing new steps to strengthen their own balance of payments program. (See Table 9.) In order to maintain Canada's free access to U.S. capital markets, Canadian authorities agreed to use their foreign exchange reserves to buy U.S. held Canadian government securities to the extent necessary to ensure that:

1. The net capital inflow to Canada did not exceed total current account requirements; and

2. Canada's reserves, including its net creditor position at the IMF, remained within an appropriate range of $2.6 billion.

Pursuant to this agreement, the Canadian government purchased $40 million of its own securities from U.S. residents in January. These purchases accounted for part of a $102 million decline in Canadian reserves during that month. Also in January, Canada sold $50 million in gold to the U.S. Treasury for U.S. dollars, and the Canadian authorities announced their intention to sell an additional $50 million in February. These sales have no effect upon Canadian reserves. Reserves fell another $14.8 million in February to a level of $2,547.6 million. (See Table 9.)

Table 9. Canada: Official Foreign Exchange Holdings and International Monetary Fund Position, September, 1965-January, 1966
(millions of U.S. dollars)

	Level on September 30	Change during the month of: Oct.	Nov.	Dec.	Jan.	Feb.	Level on February 28
Foreign Exchange							
Gold	1111.9	+11.8	+13.8	+13.3	-38.0	n.a.	n.a.
U.S. Dollars	1502.2	+17.9	+23.5	-29.9	-64.1	n.a.	n.a.
Total	2614.1	+29.7	+37.5	-16.6	-102.1	-14.8	2,547.6
Gold as a percentage of U.S. Dollars	42.5	0	0	+0.7	+0.2	n.a.	n.a.
I.M.F. Position							
Super gold tranche a/	265.0	-16.0	-23.1	-10.0	+60.5	n.a.	n.a.

a/ Net IMF sales of Canadian dollars.
Source: Bank of Canada, Statistical Summary.

Spot Canadian dollar weakens slightly in February

The demand for Canadian dollars remained generally strong over the year's end and into January, and the rate held above 93.00 (U.S. cents). However, in February, selling pressure pushed the rate to 92.84 on February 17. Market conditions became more settled thereafter and rate movements were quite minor. (See Table 10.)

Table 10. Canada/U.S.: Exchange Rates and Arbitrage Calculation, October, 1965-February, 1966

	Oct. 28	Nov. 25	Dec. 29	Jan. 27	Feb. 17	Feb. 24	Mar. 4
Exchange Rates							
Spot (U.S. cents)	93.06	93.01	93.00	93.08	92.84	92.88	92.92
Forward discount on Canadian dollar (per cent per annum)	-0.67	-0.67	-0.67	-0.60	-0.39	-0.45	-0.40
3-month yields and differentials							
Treasury bills							
Canada (covered)	3.42	3.39	3.74	3.88	4.19	4.07	4.15
U.S.	4.03	4.09	4.45	4.57	4.67	4.66	4.57
Differential (+ favors Canada)	-0.61	-0.70	-0.71	-0.69	-0.48	-0.59	-0.42
Finance paper							
Canada (covered)	4.64	4.89	5.33	5.40	5.61	5.53	5.60
U.S.	4.38	4.38	5.00	4.88	4.88	4.88	4.88
Differential (+ favors Canada)	+0.26	+0.51	+0.33	+0.52	+0.73	+0.65	+0.72

Source: Federal Reserve System.

With the easing of the spot rate in early February, the discount on the forward Canadian dollar became somewhat smaller. Partly as a result of this change, the covered spread on Treasury bills favoring the

United States narrowed by about 20 basis points, while that on finance paper favoring Canada widened by the same amount. Later in February, the forward discount widened out leading to a partial reversal of the earlier movements in covered interest differentials. (See Table 10.)