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Recent Economic Developments in Canada, August-October 1964

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Recent Economic Developments in Canada, August-October 1964Summary

During the period under review, the Canadian economy showed strength both on internal and on external accounts. ^{1/} The domestic business expansion has moved into its forty-fourth month with little or no evidence of pressure on resource availabilities.

The continued strength on the external side was reflected in the (U.S.) \$265 million gain in adjusted official reserves between August and October. These gains are thought to reflect a continuing good export performance (exports were running at near record levels in August-September) and the resumption of large-scale Canadian borrowing in U.S. markets during September and October. Balance of payments data for the second quarter show a cut by almost 50 per cent in the deficit on current account from the first quarter and a resumption of substantial new net long-term Canadian issues abroad. The favorable current account figures reflect both the wheat sales to Communist countries and only modest advances in Canadian imports.

On the domestic side, seasonally-adjusted economic indicators suggest a renewed strengthening of the business expansion. At mid-September, the unemployed were only 4.5 per cent of the labor force, the lowest rate since June 1957, compared with 5.2 per cent in mid-June.

A number of indicators for August show a resumption of expansion. Industrial production rose almost 2 per cent in August, returning to the peak

^{1/} Canadian economic developments during the preceding three months are reviewed in "Recent Economic Developments in Canada, June-August 1964," dated September 10, 1964.

Note: Unless otherwise indicated, all figures are in Canadian dollars.

touched last April, but it is not expected to repeat the strong upward thrust that occurred in the second half of 1963. (See Table 7.)

Manufacturers' new orders rose again in August. Retail trade rose more than 1 per cent from May-June to July-August and new car sales in the latter months were almost 9 per cent higher than in the former.

A decline in recent months in residential construction is considered a temporary development, related to the spurt in construction of single-family houses last winter in response to the winter bonus program introduced in 1963. On November 15, the bonus program again goes into effect. In addition, anticipatory purchases of construction materials are expected in an effort to avoid the January 1 tax increase.

External position continues to strengthen

The external position (payments, trade and reserves) has strengthened notably during the period under review. The strengthening in part reflects unusually high exports (including shipments--at least through June-July--of wheat to Communist countries) at a time when the rise in imports has been modest. In addition, the signing on September 3 of the Canadian exemption to the U.S. Interest Equalization Tax has ended immediate Canadian uncertainties about continued access to lower-cost U.S. funds, and has coincided with a resumption of substantial Canadian borrowing in U.S. financial markets.

From the first to the second quarter, the overall Canadian payments position improved markedly. The current account deficit fell by almost 50 per cent to \$175 million. Further, short-term capital inflows dropped and long-term inflows were substantial for the first time since the IET was proposed in

July 1963. (See Table 1.) The bulk of the long-term capital inflow came from net sales of new Canadian securities to the United States.

Press reports indicate that gross prospective new Canadian security issues in the United States, after declining in July and August, now may be running at a quarterly rate of C\$400-500 million, following passage of the I.E.T. ^{1/} However, after subtracting the scheduled repayment of \$71 million to its U.S. parent by Union Carbide of Canada, and allowing for the 1963 rate of security retirements, the quarterly net new issues rate for the last months of 1964 may turn out to be in the range of C\$200 to C\$250 million.

For the second quarter, Canada's merchandise trade deficit with the U.S. was a little wider even though its merchandise trade balance with all other countries turned sharply favorable. (See Table 2.) The trade deficit with the U.S. partly reflected purchases of machinery and equipment, made to carry out the very substantial rise in capital investment, particularly by the manufacturing industries, which has occurred in 1964. However, capital inflow from the United States was up quite sharply, especially in long-term forms. (See Table 2.) As a result, the Canadian payments deficit on trade and long-term capital account was down by \$200 million.

The overall Canadian trade position continued to strengthen through August. On a customs basis, exports in August-September, aided in part by grain shipments to the Communist countries, were running at an average level of \$723 million per month, up roughly 3 per cent from May-June. (See Table 3.) Average monthly imports during May-June fell somewhat from the high March-April levels.

^{1/} Toronto Globe and Mail, October 13, 1964, p. B-6.

Table 1. Canada: Summary Balance of Payments, 1963-1964
(millions of Canadian dollars per quarter)

	1963		1964	
	Jan. - June	July-Dec.	I	II
A. CURRENT ACCOUNT,^{1/} NET				
Merchandise trade	73	177	33	127
Interest and dividends	-151	-172	-173	-151
Travel	- 47	57	- 96	- 49
All other	-102	-115	-107	-102
Total current account deficit (-)	-227	- 53	-343	-175
B. CAPITAL MOVEMENTS, NET				
Short-term	23	24	306	76
Direct investment	29	36	25	60
New Canadian issues, net of retirements	288	28	54	164
Other long-term	- 25	- 49	- 84	- 58
Total capital inflow (+)	315	37	301	242
C. OVERALL BALANCE	<u>88</u>	<u>- 16</u>	<u>- 42</u>	<u>67</u>
D. FINANCING: CHANGES IN (- is increase)				
Official reserves	- 88	59	127	- 62
Other special official transactions including I.M.F.	--	- 43	- 85	- 5

^{1/} Gold production for export included in Current Account balance, but excluded from merchandise trade balance.

Note: Totals may not add because of rounding.

Source: Dominion Bureau of Statistics.

Table 2. Canada: Summary Balance of Payments with U.S., 1963-1964
(millions of Canadian dollars, quarterly rates)

	1963		1964	
	Jan. - June	July-Dec.	I	II
A. CURRENT ACCOUNT, NET				
Merchandise	-144	-109	-281	-296
Other	-206	-133	-268	-225
Total ^{1/} current account deficit (-)	-350	-242	-549	-521
B. CAPITAL MOVEMENTS, NET				
Total identifiable				
Long-term	331	88	62	234
Short-term	2	53	123	100
Total capital inflow (+)	333	141	185	334
C. BALANCE ON CURRENT ACCOUNT AND LONG-TERM CAPITAL^{1/}	- 19	-154	-487	-287

^{1/} Includes merchandise trade in gold.

Note: Totals may not add because of rounding.

Source: Canadian Balance of Payments data.

Table 3. Canada: Imports and Exports, 1964
(Seasonally adjusted, millions of Canadian dollars)

	<u>Mar-Apr.</u>	<u>May-June</u>	<u>July-Aug.</u>	<u>Aug.</u>	<u>September</u>
Monthly Rates:					
Exports	687	701	725	703	743 ^{e/}
Imports	636	621	620 ^{1/}	n.a.	n.a.
Trade Surplus	51	80	n.a.	n.a.	n.a.

1/ July

e/ Seasonal adjustment estimated.

Source: Dominion Bureau of Statistics.

Canadian sources now hope that the recent U.K. tariff increases may not pose a substantial threat to Canadian exports. In August, about \$98 million out of total exports of \$703 million were sold to the United Kingdom. Some 25 to 30 per cent of these exports may be affected by the U.K. surcharges but U.K. demand for a large part of the affected exports (such as newsprint and lumber) probably will not be much changed by the surcharges.

Canadian adjusted official foreign exchange reserves rose at an increasing pace through October, reportedly reflecting the rise in short and long term borrowing in the U.S., and the strong trade position. Including repayments of (US)\$ 112 million to the I.M.F., Canadian reserve gains amounted to (US)\$ 265 million in the three months August to October. These gains (adjusted to exclude IMF repayments), bring the Canadian reserve position to about where it was in mid-1963, before the I.E.T. was announced.

Table 4. Canada: Adjusted Official Reserves, 1963-1964
(millions of U.S. dollars)

	Total	1964 changes				Total
	June 1963	July	Aug.	Sept.	Oct.	October 1964
Actual Reserves	2692	--	42.0	48.6	62.0	2686
Plus Adjustment for IMF transactions	--	--	5.0	50.0	57.2	--
Net Change in For. Position	--	--	47.0	48.6	119.2	--

Source: Department of Finance and IMF

The spot Canadian dollar rose steadily from 92.40 U.S. cents in early July to 93.06 U.S. cents on October 30 and touched 93.25 U.S. cents on November 20.

During the three months August to October, the rise in the spot rate was moderated by substantial acquisition of foreign exchange by the authorities. At the same time that the spot rate strengthened, the forward Canadian dollar swung 40-50 basis points from a premium of .3 to .2 per cent per annum to a discount of .20 per cent per year against the U.S. dollar.

Table 5. Canada: Spot and Forward Foreign Exchange Rates

	June 24	July 15	Aug 19	Sept 16	Oct 30	Nov 20
Spot Rate (in U.S. cents per Canadian dollar)	92.51	92.45	92.70	93.01	93.06	93.25
Forward Rate $\frac{1}{7}$ % per year; N.Y. discount (-) on Canadian dollar	.30	.17	-.34	-.27	-.20	-.13

As of November 5, the covered interest differential in favor of Canadian over U.S. 3-month prime finance paper was at 32 basis points.

Credit conditions tighten

Conditions in Canadian capital markets tightened considerably from mid-June through mid-September, as the high level of economic activity led to a heavy increase in the bank loans to the private sector. Substantial bank sales of government securities to finance these loans were only partially offset by Treasury repurchases out of its unexpectedly large cash surplus; bank liquidity fell, and interest rates rose across a range of maturities.

From mid-September through October, however, financial markets eased, in part because of a seasonal slowing in the increase in bank loans to the private sector, and in part because official purchases of foreign exchange added to the liquidity position of the banks. Interest rates fell moderately, and the U.S.-Canadian yield differentials narrowed considerably. (See Table 6.)

The commercial (chartered) banks sold off roughly \$321 million of government securities in the five and a half months ending in mid-September, to help finance the heavy increase of \$740 million in their loans to the private sector. The increase in loans leveled out after mid-August, partly reflecting normal seasonal movements; and after mid-September bank holdings of government securities rose somewhat.

Industrial production rises

During August seasonally-adjusted industrial production rose almost 2 per cent, returning to the peak reached last April. (See Table 7.) Manufacturing activity rose across a broad front between July and August. Particularly strong increases were registered in automobile production and in industries supplying construction materials, such as lumber, ferrous metal products, and concrete and clay products. Mining and fuel production fell.

Table 6. Canada: Recent Changes in Selected Financial Indicators, June-October 1964

	Changes (basis points) during ^{2/}				Outstanding week of Nov. 10 (%)
	June 17- Aug. 19	Aug. 19- Sept. 16	Sept. 16- Oct. 14	Oct. 14- Nov. 10	
1. INTEREST RATES ^{1/}					
Short-term:					
Day-to-day	+40	+3	-38	+19	3.69
3-month Treasury bills	+23	+2	-15	-1	3.68
6-month Treasury bills	+23	--	-14	-1	3.82
Government Bonds:					
2-3/4 1967-68	+17	+2	-12	--	4.37
2-3/4 1975-78	+6	-1	-3	-13	5.07
3-3/4 1996-98	+6	-2	-1	-4	5.07
					Outstanding ^{2/} Differentials Nov. 10 (%)
2. U.S.-CANADIAN COVERED YIELD DIFFERENTIAL (+ favor Canada):					
Treasury bills	-22	-6	-9	-4	-.14
Prime finance paper	+15	+24	-19	--	+.32
					Differentials week of November 5
3. BOND YIELD DIFFERENTIALS ^{4/}	June 18- Aug. 12	Aug. 12- Sept. 9	Sept. 9- Oct. 22	Oct. 22- Nov. 5	
Government of Canada 1974-75	+12	-2	-1	-10	.69
Quebec Hydro 1982-84	+9	-4	-11	-31	.62
Toronto Metro 1982-84	+18	-13	-10	-5	.95
					Level as of Nov. 4
4. COMMERCIAL BANKS	Changes (\$ million) during				
	June 18- Aug. 12	Aug. 12- Sept. 9	Sept. 9- Oct. 7	Oct. 7- Nov. 4	
General Loans	+293	+50	+13	+90	8198
Total Deposits	+105	-3	-103	+143	15891
Treas. bill and govt. securities	-138	-54	+34	3/+ 6	3/ 3658

^{1/} Interest rates on Canadian basis.

^{2/} Dates are approximate.

^{3/} As of November 10.

^{4/} Comparable Canadian securities in U.S. and Canadian markets.

Sources: Bank of Canada; Morgan Guaranty; Nesbitt Thomson; I.M.F.; and Federal Reserve.

Table 7. Canada: Seasonally Adjusted Industrial Production 1963-1964
(base, 1949 = 100)

	July <u>Weights</u>	1963 <u>August</u>	1964				
			<u>January</u>	<u>April</u>	<u>June</u>	<u>July</u>	<u>August</u>
Industrial Production	100	195	211	215	211	211	215
Mining	10	289	335	321	330	316	315
Nondurables	46	174	180	186	183	181	185
Durables	39	173	192	196	189	192	198

Source: Dominion Bureau of Statistics.

The May-July leveling downwards of industrial production may partly reflect a special seasonal adjustment problem in 1964. Two special factors tended to shift demand for construction and construction materials back into the fourth and first quarters, at the expense of spring and summer activity levels. These two factors were: (i) the new \$500 winter housing bonus, which encouraged a very sharp September-March (1963-64) rise in seasonally-adjusted residential construction; and (ii) the 4 per cent increase in the tax on construction materials, scheduled to take effect April 1, which led to anticipatory buying. Both these special factors again are operative this fall--the winter housing bonus went back into effect on November 15, and the final 3 per cent increase in the construction materials tax takes effect on January 1, 1965.

Manufacturers' inventory-shipments ratio falls

The seasonally-adjusted manufacturers' inventory to shipments ratio fell noticeably in August, breaking the ominous rise that had accompanied the post-spring leveling of industrial production. Roughly 76 per cent of the increase in owned inventories from end-March to end-August reflected accumulation of finished goods and goods in progress; while such inventories rose a little further during August, manufacturers' shipments rose much more, reducing the ratio to 1.96, its lowest level since last April.

Table 8. Canada: Inventories, Orders, and Shipments
in Manufacturing, 1963 - August 1964
(seasonally adjusted, millions of Canadian dollars)

	1963	1964				
	<u>Aug.</u>	<u>Jan.</u>	<u>Mar.</u>	<u>May</u>	<u>July</u>	<u>Aug. <u>P</u></u>
Inventories to Shipments (ratio)	2.05	1.88	1.82	2.00	2.03	1.96
Owmed Inventories						
Raw Materials	2121	2166	2163	2195	2209	2207 ^{e/}
Finished & Semifin. Goods	<u>2726</u>	<u>2787</u>	<u>2720</u>	<u>2777</u>	<u>2838</u>	<u>2859^{e/}</u>
Total	<u>4847</u>	<u>4953</u>	<u>4883</u>	<u>4972</u>	<u>5047</u>	<u>5066</u>
Shipments, total	2362	2633	2687	2483	2489	2587
New Orders	2421	2676	2699	2507	2555	2591
Unfilled Orders	2321	2481	2468	2546	2633	2636

Source: Dominion Bureau of Statistics ^{e/} seas. adj. estimated.
_{P/} Provisional

Order position strengthens in August

During August, seasonally-adjusted new orders in manufacturing rose 1.4 per cent, to \$2,591 million. Since the bottom last May, the level of new orders is up \$84 million. The outstanding orders backlog increased only marginally during August, because of the sharp rise in shipments. However, the size of the orders backlog is substantial. (See Table 8.)

Unemployment--and total labor force-fall

During September, the seasonally-adjusted ratio of unemployed to the total civilian labor force fell yet further, to a level of 4.5 per cent, the lowest rate since June 1957. The ratio has declined a total of .7 percentage points since June, in a gently accelerating movement. (See Table 9.) A small part of the decline over these months reflects a fall in the civilian labor force; however, total employment rose, and total unemployment fell. Despite the decline in the unemployment rate, substantial unemployment remains, measured either as a per cent of the labor force or in toto--thus, at mid-September, the index of total unemployment was fully 57 per cent greater than in the base year of 1956.

Table 9. Canada: Labor Force and Unemployment,^{1/} seasonally adjusted
(Thousands of workers, index, or per cent)

	1964				
	<u>April</u>	<u>June</u>	<u>July</u>	<u>August</u>	<u>September</u>
Civilian Labor Force (000)	6906	6929	6975	6954	6914
Total Employed (000)	6580	6596	6628	6621	6605
Index of Unemployed (1956 = 100)	165	183	176	169	157
Unemployed as per cent of the labor force	4.7	5.2	5.0	4.8	4.5

Source: Dominion Bureau of Statistics

^{1/} Mid-month sample survey data.

Construction activity

While seasonally-adjusted construction starts and completions fell further in August, evidence suggests a renewal of the construction boom during the fourth quarter. The value of new construction permits rose almost 13 per cent from

end-May through end-August; over the same period the number of units under construction increased more than 5 per cent. The \$500 million winter residential housing construction bonus, so effective last year, again is operative as of November 15. In addition, the final 3 per cent increase in the tax on construction materials, scheduled for January 1, 1965, is expected to promote advance buying of materials.

Table 10. Canada: Construction Activity, 1963-1964
[seasonally adjusted million or (000) units]

	1963	1964				
	Aug.	Feb.	May	June	July	Aug.
New permits, total in \$ million	224	239	211	224	235	248
Under Construction, total (000 units)	64	86	66	66	68	69
Starts, total (000 units)	114	177	115	114	131	122
Completions(000 units)	106	119	89	105	114	104

Source: Dominion Bureau of Statistics

Retail trade strengthens

Seasonally-adjusted retail trade in July-August on average was more than 1 per cent higher than the average for May-June. However, August sales did not carry past the July level, and total retail trade remains below the levels touched last January. New motor car sales (a component of total retail trade) rose about 3 per cent between July and August; since June, car sales have risen almost 12 per cent.

Table 11. Canada: Retail Trade, 1964
(seasonally adjusted, C\$millions)

	<u>Jan.</u>	<u>April</u>	Average		<u>August</u>
			<u>May-June</u>	<u>July-August</u>	
Total Retail Trade, monthly rate	1670	1627	1639	1659	1658
New Motor Car Sales	192	189	185	191	204

Source: Dominion Bureau of Statistics.

Prices falling

Canadian wholesale and retail prices continued to fall through September, in the face of high levels of economic activity. Consumer prices fell .4 per cent between August and September and were unchanged in October, partly reflecting a seasonal decline in the price of foods; wholesale prices fell roughly .3 per cent over the same period, bringing the total decline since January to more than 1 per cent.

Table 12. Canada: Recent Price Movements, 1963 and 1964
(index, base 1953 = 100)

	1963	1964						
	<u>Sept.</u>	<u>Jan.</u>	<u>May</u>	<u>June</u>	<u>July</u>	<u>Aug.</u>	<u>Sept.</u>	<u>Oct.</u>
Wholesale	111.0	111.9	111.4	111.2	111.0	111.0	110.7	n.a.
Consumer	115.5	116.2	116.4	117.1	117.9	117.8	117.4	117.4

Source: OECD, Main Indicators, n.a. - not available