

L.5.2

RFD 501

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

September 10, 1964

Recent Economic Developments in Canada,
June-August 1964

10 pages

David G. Hayes

This article was prepared primarily for internal circulation, and should not be cited or quoted. The views expressed do not necessarily represent the views of the Board of Governors of the Federal Reserve System.

Recent Economic Developments in Canada, June-August 1964 1/Summary

Although the Canadian economy is operating at a much higher level than last year, the current expansion showed some signs of hesitation in the second quarter. The seasonally-adjusted values of manufacturing shipments, building permits and new orders declined between April and May, and the index of industrial production slipped 2.7 per cent from its all time high in April to its lowest level this year in May. Seasonally-adjusted employment fell in April, May, and June, and the rate of unemployment rose from 4.7 per cent in April - May to 5.2 per cent in June. However, retail trade, manufacturing inventories, and housing starts advanced moderately in May. (See Table 1.) In addition, foreign demand remained strong as exports rose by \$16 million in May and \$110 million in June. (See Table 2.) Prices have remained stable during the period, with both the wholesale and consumer price indices virtually unchanged. (See Table 4.)

Public financial policies, however, have tended to be somewhat anti-inflationary. In the fiscal policy area, federal government receipts were considerably in excess of expenditures during April, May, and June. The cumulative surplus for the first fiscal quarter was \$350 million compared to \$20 million for the same period in 1963. (See Table 8.) Interest rates, which had been falling since March 5, edged up in mid-June, and by August 13 the three month Treasury Bill rate was 29 basis points above its June 10 level. Longer-term government rates rose much less, resulting in a noticeable flattening of the yield curve. (See Table 5.)

1/ Canadian economic developments during the preceding three months are reviewed in "Recent Economic Developments in Canada, March 1964-May 1964", dated May 13, 1964.

- 2 -

Table 1. Key Economic Indicators: 1/ April-June--1963 and 1964

<u>Index of Industrial Production</u>	<u>March</u>	<u>April</u>	<u>May</u>	<u>June</u>
1963	194	193	195	--
1964	211	215	209	--
<u>Manufacturing inventories</u> (millions of dollars)				
1963	4803	4815	4823	--
1964	4882	4935	4952	--
<u>Manufacturing shipments</u> (millions of dollars)				
1963	2352	2344	2391	--
1964	2686	2631	2482	--
<u>Value of building permits</u> (millions of dollars)				
1963	213	257	206	--
1964	243	258	210	--
<u>Housing starts</u> (thousands)				
1963	109	104	119	--
1964	101	105	115	114
<u>Total retail trade</u> (millions of dollars)				
1963	1522	1523	1538	--
1964	1654	1627	1649	--
<u>Employment</u> (thousands)				
1963	6275	6306	6279	6347
1964	6598	6580	6573	6569
<u>Unemployment as per cent of labor force</u>				
1963	5.8	5.5	5.7	5.9
1964	4.6	4.7	4.7	5.2
<u>New orders</u> (millions of dollars)				
1963	2328	2333	2413	--
1964	2698	2685	2509	--

1/ All indices seasonally adjusted.

The foreign exchange market was relatively quiet in June and July. The spot rate fluctuated narrowly about par, and the covered arbitrage incentive favored Canada by about 30 basis points. On August 3, the Canadian forward dollar (in U.S. cents) was at a discount for the first time since March and the spot rate advanced noticeably. By August 13 the arbitrage incentive had turned in favor of the U.S. for the first time this year. (See Table 9.)

Although signs of weakness were present in the business situation, they were not universal. In May the seasonally-adjusted value of retail trade rose 1.3 per cent and manufacturing inventories 0.3 per cent. Both increases represented reversals of downward trends registered in preceding months.

Despite the recent modest declines in some sectors and hesitation in others, all economic indicators are still substantially above their second-quarter values of 1963. In July, employment increased more than seasonally and unemployment declined, bringing the seasonally adjusted rate of unemployment down to 5.0 per cent. Much of the gain in employment was made in manufacturing industries. Finally, capital spending in 1964 by all sectors is now estimated at \$10.8 billion--double the previous estimate and 16 per cent above last year's actual expenditures. Investment plans may not be realized however, because supply shortages of building materials, especially steel, and skilled labor may materialize later this year.

Domestic expansion shows some signs of hesitation

The current expansion showed some signs of hesitation in the second quarter. In May, the seasonally adjusted values of manufacturing shipments, building permits, new orders, and employment receded moderately; the index

of industrial production slipped 2.7 per cent from the all-time April high to 209--eliminating the entire gain made this year to date, assuming the adjustment for seasonal factors to be justified. In June, employment decreased for the third consecutive month; the rate of unemployment rose to 5.2 per cent--its highest level this year--and housing starts edged down marginally--all on a seasonally adjusted basis.

Table 2. Canadian Imports and Exports: U.S. and Rest of World
March - June 1963 and 1964
(million Canadian dollars)

	<u>March</u>	<u>April</u>	<u>May</u>	<u>June</u>
<u>1963</u>				
<u>Exports</u>				
U.S.	296	317	363	326
Rest of World	206	211	303	227
Total	502	528	666	553
<u>Imports</u>				
U.S.	350	383	410	365
Rest of World	129	172	200	168
Total	479	555	610	533
Balance, total	+23	-27	+56	+20
<u>1964</u>				
<u>Exports</u>				
U.S.	333	374	359	396
Rest of World	267	296	327	400
Total	600	670	686	796
<u>Imports</u>				
U.S.	412	504	n. a.	n. a.
Rest of World	166	205	n. a.	n. a.
Total	578	709	n. a.	n. a.
Balance, total	+22	-39	n. a.	n. a.

The fall in the index of industrial production combined a 3 per cent decline in manufacturing production (equally split between durables and non-durables) and a 6 per cent decline in the output of electric power and gas from corresponding April levels. Mining output edged up marginally. Building

permits declined 23 per cent in May--reversing steady advances in the preceding three months. Manufacturing shipments were off 6 per cent and new orders 7 per cent for the second month in a row. (See Table 1.)

Foreign demand remains strong

Foreign demand remained strong during the second quarter and exports registered consecutive monthly advances. (See Table 2.) In June sales totalled \$796 million--an increase of 16 per cent over May and 44 per cent over June of 1963. At this writing, import figures are not available beyond April because the Dominion Bureau of Statistics is reorganizing the composition of their Standard Industrial Classification. In April, however, imports did reach an all-time high of \$709 million and the trade account was in deficit for the first time this year.

Throughout the second quarter, there were moderate month-by-month reserve accruals, but no gains were recorded for July. (See Table 3.)

Table 3. Canada: Official Exchange Reserves, April-July 1964 ^{a/}
(in millions of U.S. dollars)

	<u>April</u>	<u>May</u>	<u>June</u>	<u>July</u>
Exchange Reserves				
U.S. \$	1588	1599	1602	n. a.
Gold	892	901	931	n. a.
Total	2481	2509	2533	2533
Net Change from previous month	+ 15	+ 28	+ 24	0

a/ End of month.

Prices relatively stable

The price stability recorded in the first quarter of 1964 was maintained during the second quarter. (See Table 4.) Even though import data are incomplete, it is thought that heavier imports continued to contribute strongly to this price behavior. In July, the two basic wholesale indices registered small declines but the consumer price index edged up marginally for the second consecutive month.

Table 4. Canada: Price Indices, monthly, March-July 1964
(1935-39=100)

	<u>March</u>	<u>April</u>	<u>May</u>	<u>June</u>	<u>July</u>
30 Industrial Materials	257.1	258.8	258.7	259.4	258.3
General Wholesale Index	245.6	245.6	245.9	245.4	244.9
Consumer Price Index	134.6	135.0	135.0	135.3	136.2
Food	131.3	131.8	131.2	132.5	
Non-durables	122.1	122.1	122.1	122.2	
Durables	114.7	114.9	114.7	114.7	
Services	162.8	163.4	163.5		

Interest rates begin steady increase in June

Interest rates on government securities, which had been falling steadily since early March, began to rise in mid-June. By August 13, the Treasury Bill tender had risen 29 basis points but rates on longer term issues rose much less; as a result, the yield curve tended to flatten out. (See Table 5.)

With the exception of public-utility issues, other long-term bonds showed interest rate increases similar to those observed for long-term governments. The 40-bond average rose 3 basis points between June and July. (See Table 6.)

Table 5. Canada: Selected Government Security Yields
January 1963 - August 1964
 (in per cent per annum)

<u>Dates</u>	<u>Treasury Bills</u>		<u>Bonds</u>			
	<u>3 mos.</u>	<u>6 mos.</u>	<u>Sept.</u> <u>1965</u>	<u>June</u> <u>1967-68</u>	<u>Jan.</u> <u>1975-78</u>	<u>Sept. 1996-</u> <u>March 1998</u>
<u>1963</u>						
Jan. 2	3.94	4.06	4.48	4.48	5.12	5.10
June 12	3.19	3.30	4.07	4.07	4.88	4.90
Sept. 11	3.78	3.98	4.60	4.48	5.27	5.14
Oct. 16	3.54	3.69	4.00	4.29	5.03	5.04
Dec. 31	3.74	3.93	4.20	4.42	5.16	5.02
<u>1964</u>						
Jan. 8	3.80	3.96	4.31	4.43	5.17	5.01
March 5	3.90	4.06	4.43	4.56	5.25	5.04
June 10	3.53	3.69	4.15	4.31	5.19	5.08
17	3.58	3.73	4.26	4.30	5.18	5.08
24	3.59	3.75	4.25	4.29	5.20	5.11
July 1	3.58	3.73	4.28	4.32	5.20	5.10
8	3.55	3.70	4.29	4.31	5.18	5.11
15	3.60	3.74	4.32	4.31	5.19	5.11
22	3.60	3.75	4.38	4.38	5.20	5.11
29	3.67	3.83	4.39	4.36	5.20	5.13
Aug. 5	3.75	3.89	4.43	4.39	5.23	5.13
13	3.82	3.96	4.51	4.42	5.24	5.10

Table 6. Canada: Municipal, Provincial, and Private Bond Yields:
May-July 1964
 (in per cent per annum)

	<u>May</u>	<u>June</u>	<u>July</u>
10 Provincials	5.53	5.53	5.59
10 Municipals	5.68	5.69	5.71
10 Public Utilities	5.54	5.53	5.51
10 Industrials	5.47	5.51	5.54
40 Average	5.55	5.56	5.59

Source: McLeod, Young, Weir & Co.

For Canadian borrowers, the trend of interest rates in the United States and Canadian markets, as measured by yields on comparable Canadian securities, was mixed during the period under review. The differential narrowed about 10 basis points for Government of Canada and Province of Ontario bonds in the two markets; on the other hand, the differential on a Quebec Hydro issue widened about 10 basis points because of a higher yield in Canada. (See Table 7.) Yields on bonds of Toronto Metro were stable in Canada but eased slightly in the United States.

Table 7. Yields on Selected Canadian Securities
in Canadian and U.S. Markets May-July 1964

	May		June		July	
	7	21	4	18	3	16
Government of Canada						
Canada (1975)	5.25	5.22	5.17	5.17	5.17	5.17
United States (1974)	4.55	4.53	4.47	4.57	4.57	4.57
Differential	+ .70	+ .68	+ .60	+ .60	+ .60	+ .60
Province of Ontario						
Canada (1981)	5.45	5.41	5.41	5.41	5.43	5.43
United States (1984)	4.49	4.60	4.63	4.63	4.63	4.63
Differential	+ .86	+ .81	+ .78	+ .78	+ .80	+ .80
Quebec Hydro						
Canada (1982)	5.63	5.63	5.68	5.68	5.72	5.72
United States (1984)	4.70	4.70	4.69	4.69	4.69	4.69
Differential	+ .93	+ .93	+ .99	+ .99	+1.03	+1.03
Toronto Metro						
Canada (1982)	5.59	5.59	5.59	5.59	5.59	5.59
United States (1979)	4.58	4.58	4.54	4.54	4.54	4.54
Differential	+1.01	+1.01	+1.05	+1.05	+1.05	+1.05

Source: Nesbitt, Thompson & Co. Ltd.

Fiscal cutturn also moderately anti-inflationary

Government receipts outpaced expenditures during the second quarter, and the budget registered a surplus for each of the three months. The cumulative surplus from April to June 1964 was \$350 million compared with \$20 million one year ago. (See Table 8.)

Table 8. Government of Canada: Receipts and Expenditures,
April-June; 1963 and 1964
 (in millions of Canadian dollars)

	<u>April</u>	<u>May</u>	<u>June</u>
1963			
Expenditures	351	498	525
Receipts	361	580	453
Balance	+10	+82	-72
1964			
Expenditures	392	491	538
Receipts	464	701	606
Balance	+72	+210	+68

According to press reports, Canadian authorities are now sharply revising downward the estimated budget deficit for fiscal 1964-65 (ending March 31), as a result of these unexpected surpluses. These gains reflect large increases in personal and corporate income tax revenues stimulated by the current expansion. To be sure, the outcome from July to December should show the usual seasonal deficit; but some officials seem to be hopeful that the revenue inflow of the first quarter (1965) may be sufficient to produce a near balanced (or most optimistically a balanced) budget for the 1964-65 fiscal year. Such a result would mean that a seven-year cycle of heavy deficits in the national budget (beginning in 1956-57) would be at least temporarily broken.

Foreign exchange market relatively quiet

The foreign-exchange market was relatively quiet in June and July; the spot rate fluctuated narrowly about par and the covered arbitrage incentive continued to favor Montreal. (See Table 9.)

Table 9. Canadian-U.S. Arbitrage and Spot Canadian Dollar: Selected Dates
March-August 1964

		Arbitrage				Spot Rate	
		Treasury Bills				(U. S. cents)	
		Cdn. Bill	U. S. Bill		Fwd. Cdn. dollar	Cdn. Bill diff'l	
		<u>N. Y.</u>	<u>N. Y.</u>	<u>Spread</u>			
March	12	3.75	3.53	+ .22	-.04	+.18	92.59
	19	3.73	3.53	+ .20	+.04	+.24	92.57
April	23	3.58	3.44	+ .14	+.10	+.24	92.51
May	28	3.54	3.46	+ .08	+.14	+.22	92.54
June	4	3.46	3.46	.00	+.20	+.20	92.56
	25	3.50	3.45	+ .05	+.33	+.38	92.45
July	30	3.56	3.45	+ .11	+.14	+.25	92.56
August	6	3.63	3.47	+ .16	-.07	+.09	92.62
	13	3.71	3.49	+ .22	-.28	-.06	92.76
	20	3.75	3.48	+ .27	-.27	.00	92.75

In the first week of August the spot rate moved above par and the forward dollar was at a discount for the first time since March. During the second week the Treasury Bill differential was no longer large enough to offset the widening forward discount and the arbitrage incentive favored New York for the first time this year. Bank of Canada purchases of spot U.S. dollars were made intermittently during these two weeks.

This sudden change in the relative positions of the spot and forward Canadian dollar was attributed to grain dealers who forced U.S. banks to fulfill option contracts earlier than expected in connection with grain commitments to Eastern Europe. Later, a flow of U.S. funds into Canadian finance paper also contributed to maintaining the spot rate above par.