CANADA'S ECONOMIC OUTLOOK FORECAST FOR 1973 TO 1975

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The Canadian economy is still in the middle stage of a longer-term upturn from the 1969-1970 mild business recession. Though a gradual slowdown in economic growth is expected later this year and in early 1974, it is expected that this slowdown will be temporary and that the Canadian economy will grow quite strongly during the second half of 1974 and 1975. A similar pattern of economic growth is expected in the U.S. economy, though, as is usually the case, there will be important differences as well as similarities between the two countries with respect to the pattern of economic performance of different sectors of the economy. Table 1 shows the various economic aggregates and components of our Canadian forecast for the years 1973 and 1974, together with our preliminary forecast for 1975.

CONSUMER SPENDING

Unlike the situation in the United States, the Canadian consumer has not become overly pessimistic as measured by the survey of consumer spending attitudes. This is particularly significant since there is normally a six to nine-month lag in terms of change in consumer attitudes and an actual change in consumer expenditures. The continued buoyancy in consumer attitudes in Canada is probably to a large extent explained by the fact that job growth has been much faster in Canada than the United States this year, resulting in the Canadian unemployment rate dropping to 5.3% on a seasonally adjusted basis in June from 6.7% in December 1972. Reflecting this surge in job growth, personal incomes have also been rising more strongly in Canada than in the United States this year.

After-tax income growth has been especially strong in Canada in 1972 and 1973 in view of personal tax reductions and increased welfare benefits, including the major increases introduced last year in unemployment insurance payments. The federal budget in February, 1973 contained sizable personal tax reductions and increased pension payments which have now been passed by Parliament and are expected to result in an estimated $1.6 billion increase in disposable incomes during the next twelve months. We estimate that the indexing of personal income taxes in 1974 for changes in the cost of living will result in rebates, primarily to lower income Canadians, amounting to about $500 million next year. These fiscal incentives, together with delayed but sizable tax rebates this spring and summer, recent increases in several provinces' legal minimum wages and increased welfare benefits will be largely channelled to lower-income Canadians during the forecast period and will, therefore, tend to be spent rather than saved. This, in turn, is expected to provide an important cushion to the extent of the temporary slowdown expected in consumer spending in 1974, especially for essential items such as food, clothing and services.

The federal government has recently announced that it will introduce a revised Family Income Support Program to Parliament this autumn as the first step toward an overall reform of Canada's income security system. This program will raise monthly child allowance payments to $20 per child from the existing $7.21 payment. Benefits will be taxable, however, with the expected result that increases in family disposable incomes will largely be channelled to lower income Canadians. Benefits will also be increased to allow for changes in the cost of living. Government estimates are that the total annual cost of this program will be $1.83 billion compared with $640 million currently, but that tax revenues will increase by about $350 million. The net increase in disposable incomes, therefore, will amount to approximately $840 million in 1974. A quick passage of this bill is expected since there have already been indications of support from the opposition federal parties as well as from the provinces. As with the other fiscal incentives discussed above, these child allowances will tend to be spent rather than saved and will provide an important degree of support to consumer spending on essential items such as food, children's clothing and services in 1974 and subsequent years.

Although after-tax incomes are expected to grow by over 10% in 1973 and 1974 and by just under 10% in 1975, we expect that the Canadian consumer will be influenced by a number of unfavourable developments later this year and in early 1974. Consumer credit will likely be less readily available and the interest rate on consumer loans has already recently been increased slightly by two of the major chartered banks. Adverse publicity given to higher short-term interest rates and continued high mortgage rates this year is expected to dampen consumer spending plans during the second half of 1973. The rapid acceleration of prices recently, especially for food and housing and a somewhat higher unemployment rate are also expected to exert a negative influence on consumer attitudes later this year.

For the year 1974, we expect that consumer spending will grow by about 7½% on a year-to-year basis. This will be less than average growth in a historical perspective, and much slower than in the exceptionally strong 1972-1973 period. The average annual growth of total consumer spending in the 1962-1972 decade was 8.2%, while the average growth in the 1967-1972 period was 8.5%. Our preliminary forecast is that consumer spending will be much stronger in 1975 than in 1974. At this time, we expect a consumer spending increase of about 9½% to 10½% in 1975 based on strongly rising incomes, reduced inflation, a lower unemployment rate and a more accommodative borrowing environment.

INFLATION

It is becoming increasingly apparent that the accelerated pace of the Canadian economic recovery during the fourth quarter of 1972 and the first half of 1973 has greatly reduced the remaining slack in the Canadian economy, thereby making it difficult to expect much of a slowdown in the rate of increase in prices in coming months. Official estimates of the real growth rate of the Canadian economy at full potential range between 5¼% to 5¾% per year, depending on the time period considered. Real output thus far in 1973 has been more in the order of 8% to 8½% higher than the comparable year-earlier period. Recent estimates by government sources suggest that there is little spare plant and equipment capacity in a number of Canadian industries. Reflecting domestic as well as international economic conditions, price increases have been quite dramatic for a number of industrial commodities during the past year and, in many cases, have not yet been fully reflected in prices at the retail level. Finally, the sharp appreciations of a number of countries' exchange rates relative to the Canadian dollar will be reflected in much higher

TABLE I AN OVERVIEW OF THE
($ Billions,

	Actual			
	1970		1971	
	$Billions	% Chg.	$Billions	% Chg.
Current $ GNP	$ 85.6	7.3%	$ 93.4	9.1%
Constant (1961) $ GNP	64.0	2.6	67.8	5.8
GNE Implicit Price Deflator (Index 1961 = 100)	133.7	4.6	137.8	3.1
Consumer Spending	50.1	5.5	54.0	7.8
Durables	6.8	-2.9	7.8	14.7
Semi-Durables	6.6	3.1	7.2	9.1
Non-Durables	16.2	7.3	17.4	7.4
Services	20.4	7.4	21.6	5.9
Business Investment	11.4	9.6	12.3	7.9
Non-Res. Construction	5.4	12.5	6.0	11.1
Machinery & Equipment	6.0	7.1	6.3	5.0
Residential Construction	3.6	-5.3	4.6	27.8
Inventory Build-up	+0.1	-	+0.2	-
Government Spending	19.8	14.5	22.3	12.6
Current	16.6	16.9	18.5	11.5
Fixed Capital Formation	3.2	3.2	3.8	18.8
Current Account Deficit or Surplus (NIA Basis)*	+1.0	-	+0.2	-
Exports of Goods & Service	21.2	12.8	22.3	5.2
Imports of Goods & Service	20.2	2.0	22.1	10.0
Corporate Profits				
Before Taxes	7.7	-7.3	9.0	16.9
After Taxes	4.7	-7.8	5.6	19.1
Personal Disposable Income	54.1	6.3	59.3	9.6
Consumer Prices (Index 1961=100)	129.7	3.3	133.4	2.9
Unemployment Rate (%)	5.9%	-	6.4%	-

(p) = Preliminary 1975 Forecast

Source: Statistics Canada and L.O.M. Ltd., June, 1973

CANADIAN ECONOMY, 1973 TO 1975

unless otherwise stated)

				Forecast			
1972		1973		1974		1975 (p)	
$Billions	% Chg.	$Billions	% Chg.	$Billions	% Chg.	$Billions	% Chg.
$103.4	10.7%	$116.1	12.3%	$126.3	8.7%	$139.3	10.3%
71.7	5.8	76.4	6.6	80.5	5.4	86.2	7.1
144.2	4.6	152.0	5.4	156.9	3.2	161.6	3.0
60.3	11.7	67.5	11.9	72.6	7.6	79.9	10.0
9.0	15.4	10.4	15.6	10.6	2.0	11.8	11.3
8.1	12.5	9.1	12.4	9.6	5.5	10.4	8.3
19.4	11.5	21.7	11.9	23.7	9.0	26.3	8.5
23.7	9.7	26.3	11.0	28.7	9.3	31.4	9.3
13.0	5.7	14.4	11.0	16.3	13.0	19.5	19.8
6.1	1.7	6.7	9.8	7.9	14.5	9.6	21.0
6.9	9.5	7.7	11.6	8.4	9.1	9.9	17.9
5.4	17.4	5.9	10.0	5.6	-5.1	5.6	-
+0.5	-	+1.2	-	+0.9	-	+1.0	-
24.5	9.9	27.3	11.4	30.1	10.3	33.5	11.3
20.5	10.8	23.1	12.7	25.6	10.9	28.7	12.1
4.0	5.3	4.2	5.0	4.5	7.1	4.8	7.0
-0.8	-	-1.1	-	-0.1	-	-1.1	-
24.5	9.9	28.8	17.7	31.9	10.7	36.2	13.3
25.3	14.5	29.9	18.1	32.0	7.2	37.3	16.5
10.8	20.6	13.1	21.3	14.2	8.4	16.5	16.0
7.0	25.0	8.7	24.3	9.6	10.3	11.4	18.7
66.3	11.8	73.0	10.1	80.5	10.3	88.2	9.6
139.8	4.8	148.1	5.9	154.2	4.1	158.1	2.5
6.3%	-	5.7%	-	6.0%	-	5.4%	-

domestic prices for a number of imported consumer products this year.

For these reasons, we expect that consumer prices, which in June were rising by over 8% in Canada on a year-to-year basis, will still be rising by $4\frac{1}{2}$% to $5\frac{1}{2}$% by year-end. For 1973 as a whole, the Consumer Price Index (CPI) is forecast to increase by close to 6% in Canada. A much reduced rate of increase in consumer prices at the farm level come under sharp downward pressure. This forecast, of course, depends on favourable crops in Canada and the rest of the world during the forecast period. The overall CPI is forecast to rise by $3\frac{1}{2}$% to $4\frac{1}{2}$% in 1974, with the increase quite conceivably being in the $2\frac{1}{2}$% to $3\frac{1}{2}$% range in 1975.

GOVERNMENT POLICIES

Canada has the fastest growing labour force of any western industrialized nation. This has important implications for Canadian monetary and fiscal policies. In general, because of the need to create a large number of new jobs in the years ahead, Canadian government policies are likely to remain relatively more expansionary than comparable policies in the United States.

Canadian monetary policy was quite restrictive from the fall of 1968 to the spring of 1970, culminating, amongst other things, in the unpegging of the Canadian dollar in June, 1970 and its subsequent sharp appreciation to just over parity with the U.S. dollar. Since mid-1970 until the autumn of 1972, the monetary authorities were trying to compensate through monetary acceleration for the deflationary influences of that upward exchange rate adjustment. Thus, strong growth of the monetary aggregates, if interpreted in this context, cannot be viewed as having been overly expansionary or, necessarily, highly inflationary. Since the Canadian economy is highly exposed to world trade and financial developments, Canadian monetary policy has been quite sensitive to international interest rate differentials and the influence of short-term capital movements on the Canadian dollar exchange rate. The Winnipeg Agreement of June 1972 between the chartered banks and the federal government has since proved quite successful in helping to restrain upward pressure on Canadian short-term rates and on the Canadian dollar and the Winnipeg Agreement will likely remain an important tool of Canadian monetary policy in 1973, 1974 and 1975. Canadian short-term interest rates are likely to remain lower than comparable rates in the United States and, for that matter, lower than short-term rates in most western industrialized nations.

As U.S. monetary policy gradually becomes more restrictive, so too will Canadian monetary policy. Similarly, both U.S. and Canadian monetary policies are expected to turn somewhat more expansionary by mid-1974 and throughout 1975. In fact, even if U.S. monetary policy turns somewhat less expansive in 1975, it is expected that Canadian monetary policy will be relatively much more expansionary (or less restrictive) in view of the anticipated need to provide an accommodative borrowing environment to finance large scale resource-oriented investment projects. Canadian monetary policy will likely be generally less restrictive (more expansionary) than U.S. monetary policy in 1973 and 1974 because of the relatively greater need in Canada to stimulate job-creating growth and to avoid undesirable upward pressure on the Canadian dollar.

Canada is not expected to introduce mandatory wage and price controls during the forecast period, despite the likelihood that the United States will continue to have such a program. Unlike the situation in the U.S., mandatory controls in Canada would require provincial co-operation with the federal government. Such co-operation is difficult to obtain at the best of times, even for programs much less controversial than wage and price controls.

Besides the important recent and prospective fiscal policy changes discussed above in the section on consumer spending, the Canadian federal government has recently passed a bill to reduce the corporate tax rate to 40% from 49% for Canada's manufactur- and processing industries, as well as to have a two-year fast write-off on equipment expenditures for these industries. These incentives are in part to offset the U.S. export incentive under the Domestic International Sales Corporation (DISC) and, in part, to compensate Canadian manufacturing companies for the exchange rate increase vis-a-vis the U.S. dollar since 1970. Industry groups that will be most affected by these fiscal incentives are food processing, brewing, tobaccos, glass containers, steels, oil refining, chemicals, cement, structural steels and forest products.

The overall corporate tax rate for non-manufacturing industries remains at 49% in 1973 but, as a result of last year's federal tax reform it will be reduced by 1% a year until it reaches 46% in 1976. Thus, lower corporate taxes are assumed for 1974 and 1975. It is possible, however, that taxes will be raised sometime in the 1975-1976 period as a part of a domestic stabilization program if the Canadian authorities proceed quickly with certain major resource developments such as a Mackenzie Valley gas pipeline and the James Bay hydro power project.

BUSINESS INVESTMENT

A major economic debate is shaping up in Canada about the impact on the Canadian economy of Arctic energy developments during the coming decade. Important econometric studies are being done by several Canadian and U.S. groups, and they will be reporting the results of their research in coming months. Despite the likelihood that a U.S. trans-Alaskan pipeline will be built, we expect that, in view of the U.S. energy crisis and concern about security of energy supplies, there will be increasing pressure from the U.S. government on the Canadian authorities to proceed with a Mackenzie Valley gas pipeline in the next few years. Even if all presently planned U.S. atomic energy plants, thermal stations, etc. were built by 1985, it is estimated that the U.S. would still have to import about 50% of its total energy requirements by that date, compared with 15% in 1972.

In general, we feel that the Canadian economy can support several major energy resource developments without severe economic disruptions during the next ten years provided that these projects are phased in and not bunched into a three or four year time span and that appropriate monetary and fiscal policies are adopted by the Canadian authorities. It is not expected that there will be severe upward pressure on the Canadian dollar during the construction phase of these projects because required inflows of financial capital would tend to be offset by merchandise imports of building materials, machinery and equipment in Canada's balance of payments. To the extent that these projects result in substantial exports of energy products, however, there will likely be some upward pressure on the Canadian dollar in relation to the U.S. dollar in the post-construction phase.

It is apparent that new projects, together with expansion of existing projects and other energy related spendings, could easily result in total energy industry commitments of about $60 billion in the next ten years. This will result in investment in the energy sector representing about 5% on average of Canada's GNP during this period, compared with about 3½% of GNP during the past two decades. The profile of anticipated capital spending in this sector, however, suggests that investment as a percentage of GNP will likely be closer to 4% in 1973 and 1974 but could rise to as much as 6% to 7% by the last half of the 1970's if such large projects as a Mackenzie Valley gas pipeline, development of the Athabasca tar sands and James Bay hydro, and construction of Ontario nuclear power plants and east coast deep water ports are undertaken. (There have also been recent proposals on the transmission of Arctic Islands natural gas by either pipeline, tanker, or resource-carrying aircraft which, though still economically unfeasible, could result in further major capital expenditures in the 1980's.)

When considering the likely economic implications of these expenditures, it is important to point out that the industrial and financial capacity of the Canadian economy to facilitate investments of this magnitude has increased considerably during the recent years and will be much larger in the coming decade. Moreover, it is likely that, as part of a general industrial development strategy, the Canadian federal and provincial authorities will seek to encourage, to the maximum extent possible, a relatively larger Canadian content in the physical as well as the financial sourcing of these projects than has occurred in the past.

CORPORATION PROFITS

Canadian after-tax corporation profits will likely rise by about 25% in 1973, now that the substantial corporate tax reductions for Canada's manufacturing and processing industries are assured. A slower pace of profit growth is forecast for the second half of 1973 until about mid-1974 as sales growth becomes less buoyant and costs continue to rise strongly. Much stronger growth is expected during the second half of 1974 as sales pick up, cost pressures become less acute and productivity improves. For 1974 as a whole, Canadian after-tax profits are forecast to increase by about 10%, much stronger than in the United States where an absolute decline is possible. Our preliminary forecast is that Canadian after-tax profits will increase in the 15% to 20% range in 1975.

CONCLUSION

The Canadian economy will remain in the upturn phase of its cyclical recovery in 1973, 1974 and 1975. The economic outlook for 1973 is excellent. The year 1974 will be characterized as a period of somewhat slower growth than in 1973, however, with the slowdown becoming apparent by the fourth quarter of 1973. This slowdown will be temporary, with stronger growth expected in the second half of 1974 and in 1975 in a much less inflationary environment.

Though a similar pattern of economic performance is forecast for the United States, the outlook is for a better relative performance in the Canadian economy than in the U.S. economy. The Canadian resource, manufacturing and construction industries are expected to be particularly buoyant in the years ahead. Despite short-term weakness, the outlook for Canadian merchandising and financial institutions is also excellent. Reflecting these relative strengths and the cyclical setting, it is expected that the Canadian dollar will be moderately stronger than the U.S. dollar in 1974 and 1975. Corporate profits will likely rise more strongly in Canada than in the United States during the 1973 to 1975 forecast period.

In summary, we do not expect a recession in either Canada or the United States in 1974, but rather a period of induced slower growth leading to a stronger, less inflationary and more sustainable period of growth by mid-decade.