

THE CANADIAN ECONOMY: SITUATION AND PROSPECTS

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OVERALL PERFORMANCE

Although the very recent performance of the Canadian economy has been somewhat mixed, Canada can look back at the 1970's as a whole as a period in which it generally performed very well compared to the other industrial countries and, at the same time, she can look forward to the next several years as being very promising indeed.

The strong elements in the Canadian economy over the last year have been job creation, merchandise exports, a rapidly expanding manufacturing sector, a deceleration in wage increases, some deceleration in non-food prices, and a sharply improved profit picture. At the same time, the unemployment rate is still too high, inflation in general remains a worrisome problem and total output growth is still below potential. Capital formation has been sluggish in Canada in recent years, but this is improving although the steady approach to full capacity utilization suggests that some bottlenecks may occur before the necessary additional capacity is actually in place. The Canadian dollar has had a bit of a rough time over the last two years, but that seems to have settled down. The recent moderate strength in the dollar would seem, in part, to reflect a renewed international awareness of Canada's energy resources. Even though energy costs have increased sharply in Canada as they have throughout the industrial world, Canada is in a far better position

to meet its current and future energy needs than most industrial countries.

In 1978, Canada's real Gross National Product (GNP) rose 3.4 percent; somewhat below our potential but still an improvement over 1977's 2.7 percent increase. For 1978, Canada's growth performance was about average for the OECD as a whole but, of the major OECD countries, only the Japanese and U.S. economies were stronger than Canada's. Over the 1970's as a whole, the only major industrial nation to out-perform Canada in this regard has been Japan.

One of the most significant and positive features of Canadian economic activity in 1978 was the sustained increase in employment. Total employment in Canada rose 3.4 percent between 1977 and 1978. This represents 324 thousand new jobs in 1978 in contrast to an average of only 190 thousand new jobs each of the preceding three years. In general, Canada's record on job creation has been consistently ahead of all of the other major industrial nations. Although U.S. employment has grown more rapidly in the last couple of years, for the 1970's as a whole Canadian employment growth has averaged around 3 percent per year, the U.S. around 2 percent per year. Apart from Norway, no other major industrial country even comes close to this rate of job creation.

In spite of Canada's excellent record in job creation, the growth in employment has been unable to keep pace with the increase in our labour force (which was up 3.7 percent in 1978) primarily because of a steady increase in the participation rate.

In consequence, Canada's unemployment rate remains a problem having averaged 8.4 percent in 1978. Although not dramatic, some improvement has occurred over the last twelve months with the seasonally adjusted rate dropping from a peak of 8.6 percent in March 1978 to 7.9 percent in the last three months. Obviously we still have some way to go before we can be satisfied, but things are slowly improving in this regard. Because of our rapid labour force growth, Canada has to run just that much harder than other countries simply to keep the unemployment rate from rising.

On the inflation front, although Canada's rate of inflation, as measured by the Consumer Price Index, rose from 8.0 percent in 1977 to 9.0 percent in 1978, this was primarily due to food prices, which are notoriously volatile, and to the depreciation of the Canadian dollar. The increase in non-food prices continued to slow down in 1978 as they have done in the last several years. Wage increases have also continued to moderate.

Inflation, of course, is not a problem unique to Canada. Although Canada's inflation rate was high in 1978, in several countries, such as France, Italy and Sweden, it was even worse. For the 1970's as a whole, of the major industrial countries only Germany and the U.S. have a better record, and that of the U.S. was only marginally better.

FOREIGN TRADE

The major source of strength in the Canadian economy in

1978 was our export performance. Real Exports of goods and services were up 8.5 percent compared to 7.4 percent in 1977. Real exports of merchandise alone were up 8.3 percent, and the strongest category of merchandise exports was manufactured products. In contrast, real imports of goods and services were up only 4.1 percent in 1978, reflecting in part the depreciation of the dollar.

As a result of this strength in merchandise exports, Canada's merchandise trade balance showed a record surplus of \$3.4 billion in 1978, up from \$2.7 billion in 1977. At the same time, a record deficit on the service account meant that our current account deficit increased from \$4.2 billion in 1977 to \$5.3 billion in 1978. This increase was aggravated by a once-and-for-all abnormal outflow of dividends paid to non-residents in the fourth quarter of 1978, which resulted from the removal of controls on dividends and the impending expiry of certain deferred tax advantages associated with tax reforms made back in 1972.

MANUFACTURING

In the crucial area of manufacturing, 1978 saw a sharp turnaround in both output and employment. Capacity utilization rose steadily, investment in machinery and equipment started to take off, and business income, particularly corporate profits, strengthened considerably.

In 1978, manufacturing output rose a sharp 7.5 percent compared to 3.8 percent in 1977 and, as previously mentioned, 3.4

percent for total output in 1978. The strength in manufacturing has been rather broadly based with the most significant increases in output occurring in machinery, chemicals, rubber and plastics, clothing, textiles, leather, furniture, and paper and allied products.

With stronger output has come a strong resurgence in manufacturing employment. Manufacturing employment rose 3.6 percent in 1978, following a decline of 1.7 percent in 1977. Just as it is for total employment, manufacturing employment has been one of Canada's strong points vis-à-vis the other industrial countries. For the 1970's as a whole, Canada's manufacturing employment growth has been second only to that of Italy.

Capacity utilization has steadily increased over the last four or five quarters and is now close to 90 percent of theoretical full capacity. Many sectors are, of course, well above this, notably: chemicals, rubber and plastics, transportation equipment, clothing, wood products, furniture, and printing and publishing.

Corporate profits rose 16.7 percent in 1978 after being depressed for several years.

Capital formation in Canada has been sluggish in the last few years, as has indeed been the case in many industrial countries. In 1978, although housing and non-residential construction remained weak, investment in machinery and equipment did pick up noticeably during the last three quarters of the year.

INTERNATIONAL COMPETITIVENESS

In the international arena, the most important question with regard to manufacturing is the competitiveness of Canadian industry, particularly vis-à-vis our most important trading partner, the United States.

With regard to productivity, output per man-hour in Canadian manufacturing has significantly outstripped that in the United States over the last three years. In 1978, for example, output per man-hour in Canadian manufacturing rose 4.2 percent, in U.S. manufacturing, 2.7 percent. Productivity, of course, is only one element in an assessment of competitiveness. More important is the performance of unit labour costs which depend not only on productivity but also on labour compensation and currency values. Only in 1976 did Canadian unit labour costs get significantly out of line with those of our trading partners. Since then, the sharp depreciation of the Canadian dollar coupled with improved productivity growth and moderating wage increases have combined to fully restore Canada's competitive position in manufactured goods. From 1969 to 1977, unit labour costs in U.S. dollars increased 7.6 percent per year in Canada compared to 14.9 percent for Japan, 13.9 percent for Germany, and 10.1 percent for the U.K. Among Canada's major trading partners, only the U.S. had lower increases than Canada over the 1970's as a whole. Even so, in 1977 and 1978, Canadian unit labour costs (in U.S. dollars) actually declined while those in the U.S. continued to rise.

The fact that Canada's competitive edge is becoming especially pronounced against several Western European nations is not only important to Canada in the domestic markets of those countries, but also in the United States market where Canada must compete not only against U.S. domestic producers but also against Japanese and European producers.

PROSPECTS

What then are the prospects for the Canadian economy, not only in 1979 but over the next several years?

In its December, 1978 Outlook, the OECD forecast a 4 percent increase in real GNP for Canada. Along with Germany this is second only to that of Japan and well above the forecast increase of 3 percent for the OECD as a whole. The private forecasters in Canada, however, are on average not quite this optimistic, calling for a slight slowdown from the 1978 increase of 3.4 percent.

The major international weakness, as most people are aware, is expected to be the U.S. economy with an OECD forecast of only 2 percent real growth. Because the U.S. accounts for roughly 70 percent of both our merchandise exports and imports, how the U.S. economy performs is obviously of considerable importance to Canada. The expected slowdown in the U.S. will likely mean slower export growth for Canada. Also, if the Canadian economy outperforms the U.S. economy in 1979, and there is every indication that it will, then our imports

are not likely to slow down to the same extent as exports. In consequence, it is unlikely that our surplus on merchandise trade will improve significantly over the record \$3.4 billion surplus of 1978. This does not mean that exports won't remain an area of strength in the Canadian economy, only that they won't be as strong as they have been. Exports to markets other than the U.S. should continue to do very well as a result of the lower valued dollar together with reasonable growth in Europe and Japan.

Where the Canadian economy is expected to gain in strength, however, is in investment. Improved business confidence, improved profits, improved cost performance, and rising capacity utilization have all combined to set the stage for a steady improvement in investment spending. Surveys of investment intentions undertaken by Statistics Canada and the Department of Industry, Trade and Commerce indicates that capital spending in real terms could increase about 5 percent in 1979.

In summary, the Canadian economy is again expect to have a moderate overall performance in 1979, with some slowdown in exports offset by an improvement in investment spending. Some further improvement is expected on the unemployment and inflation fronts but they will likely remain troublesome.

Beyond 1979 there is every reason to expect a much improved performance. The U.S. economy should rebound to the benefit of Canada's exports and current account balance. In addition, given

the current investment climate in general together with the large energy investments that are now beginning to come on stream and that are expected to continue over the next five years or so, investment should continue to be a significant area of strength. Lastly, we have what appears to be a successful conclusion to the Multilateral Trade Negotiations. Tariff and non-tariff barriers will start to come down in 1980. The resulting increase in competition will not be without its problems for some Canadian industries but, on balance, should provide considerably enhanced trading opportunities which cannot help but benefit an open economy such as Canada's.

All in all, Canadian economic forecasters are expecting real growth to average between 4 and 5 percent in the first half of the 1980's.