end of the year, unemployment in that country had fallen to the lowest level in 15 years; the rate of price increase in 1968 was the highest since the Korean war. In the course of the year the U.S. consumer price index rose by 4.7 per cent compared to a rise of 4.1 per cent in Canada. This meant that international competition imposed less restraint on price increases in Canada than had been the case in earlier years. There are, however, some signs that we may be moving towards an improved situation in so far as external influences on our prices are concerned. In the United States a 10 percent surcharge on personal and corporate income tax became effective at mid-year and was accompanied by cuts in planned Government expenditure. The full effect of these measures has not yet been felt, although by the fourth quarter there was a noticeable slowing down of the growth of consumer expenditures. Monetary conditions in the United States, which had eased during the summer, tightened in the latter part of the year and have remained tight in the first months of 1969. While no one can be certain how effective these measures will be, it is encouraging that United States economic policy now appears to be clearly aimed at reducing demand pressures.

It is difficult to form a precise judgment as to the extent to which Canada's current inflationary problem originates outside the country and the extent to which it is due to domestic causes. However, one can hardly avoid the conclusion that even though unemployment averaged about 5 per cent last year the total volume of spending in Canada was at too high a level to be compatible with price performance which, in the prevailing circumstances, would have been acceptable. This conclusion is not a welcome one: we all naturally wish to bring inflation under control with a minimum of unused resources and unemployment in the economy. It is for this reason that I have advocated on earlier occasions that it would be desirable for the Government to make a systematic effort to bring the influence of informed public opinion to bear on decisions regarding increases in prices and incomes.

PRICES AND INCOME COMMISSION

I welcome the start that has been made in this direction by the Government's decision to try to reinforce the traditional policies of economic stabilization by establishing a Price and Incomes Commission. This decision has introduced a new and potentially constructive factor into the situation. For the first time there will be an official body charged with the responsibility of continuous analysis of price and cost developments, of making policy recommendations, and of educating opinion as to what actions and policies are consistent or inconsistent with reasonable price stability. It is encouraging to know that this Commission will soon be set up and begin to function.

As regards the traditional methods of economic stabilization, that is, fiscal and monetary policies, their stance is now such as to moderate demand pressures. The monetary policy which is being followed is one of restraint....The Government's budgetary deficit and its cash requirements in 1968 turned out to be much larger than had been planned, but the October budget provided for a balance in the fiscal year ending March 31, 1970, and for a considerable reduction in the Government's cash requirements. What is required now to deal with the problem of inflation is not, therefore, a drastically different setting of policy but rather the determination to persist with the present one – and if necessary to reinforce it from time to time – for as long as this is needed to reduce the domestic pressures that have contributed to the recent rates of price and cost increase.

This determined approach to policy is essential because inflationary expectations have now become very strong. The persistence of rising prices has resulted in a growing tendency on the part of many sections of the public to think of inflation as a normal characteristic of our society. This has developed to the point where firm evidence of progress in checking inflation will be required to break its hold on the economy....

MONETARY POLICY

...For most of the first half of 1968 the Bank gave top priority to the defence of the exchange value of the Canadian dollar. Bank rate reached a peak of 7 1/2 per cent in mid-March and was maintained at that level to the beginning of July. Market interest rates rose to the highest levels that we had ever experienced in this country up to that time. Bank liquidity declined and the rate of expansion of the banking system slowed markedly. The defence of the Canadian dollar – which involved many important measures in addition to those related to monetary policy – turned out to be completely successful and, by early summer, Canada's external financial position was again strong.

Once the exchange crisis in Canada had been overcome, a move to lower interest rates was generally expected and considered to be appropriate. Moreover, the view was developing that inflationary pressures were on the wane. Unemployment in Canada ranged between 5 and 5 1/2 per cent in the summer and a marked slowing of economic growth in the United States was widely regarded as imminent. As the Bank of Canada moved to make monetary policy less restrictive, and reduced the bank rate in three steps from 7 1/2 to 6 per cent, the banks bought Government of Canada securities in large amounts. Market rates of interest declined, though they did not fall back to the levels that had prevailed before the exchange problem developed. As a result of the large purchases of Government securities, there was a sharp increase in bank liquidity and in the total size of the banking system.

By the end of the summer it had become evident that the widely expected change in the economic

(Continued on P. 7)