MONETARY POLICY AND INFLATION

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of Canada has also been of great assistance in enabling the central bank to keep the liquidity of the banking system under control. In the last 12 months there has been no increase in the amount of Government of Canada market issues outstanding. This fact has been of help to the Bank of Canada in its policy of squeezing liquid assets (largely Government securities) out of the banking system and getting them absorbed by non-bank investors. In 1968, by way of contrast, the Canadian dollar market issues of the Government of Canada outstanding increased by over $1 billion and, despite successful efforts to achieve some increase in non-bank holdings, it was not possible in the circumstances of the time to avoid a large increase in bank holdings of Government securities, and consequently in bank liquidity.

So much by way of description and explanation of the anti-inflationary policies that have been followed. The main burden has necessarily fallen on the broad instruments that influence the total level of demand, or of spending, in the economy, that is, on fiscal and monetary policy. Other policies which deal with the supply side of the equation – which aim at increasing the efficiency and mobility of our resources – are of basic continuing importance. Such policies, including important activity in retraining and developing labor skills, have been and are being actively pursued by the Government. But unfortunately they yield their valuable fruits only over a considerable period of time and make little contribution to the urgent problem of controlling inflation now.

RESULTS OF RESTRAINTS

What, then, can we say about the effectiveness of the policies which have been followed? I believe that there is considerable evidence that these policies have had an important influence on the total level of spending, though this slowdown of spending appears, up to the present, to have had more impact on the level of output than on the rate of price increase. However, we can claim, as a minimum, that the acceleration in the upward push of prices has been stopped. Had vigorous policies of demand restraint not been used, the increase in our prices and costs would certainly have been even greater than has been the case.

Some considerable slowing down in the rate of economic expansion occurred in both Canada and the United States in 1969. In the United States, where the over-all stance of monetary and fiscal policy has also been restrictive, the signs are very clear. The growth in total output, which was running at an annual rate of 6.5 per cent in the first half of 1968 and has slowed to 2.5 per cent by the first half of 1969, averaged about 1 per cent in the second half of last year. The Canadian economy continued to grow at a very rapid rate in real terms up to the end of the first quarter of 1969. Since that time I think there can be no question that the pace of expansion has slowed markedly, but the conventional measures of activity are extremely difficult to read owing to the number of major strikes which developed in the second quarter of the year and continued to affect important sectors of activity until well into the fourth quarter. For this reason, I am inclined to believe that the underlying rate of growth in the Canadian economy since the first quarter of last year may have been a bit stronger than is suggested by such indicators as gross national product or industrial product or industrial production.

In contrast to the U.S. situation, where the labor market remained very tight all through 1969, the over-all unemployment rate in Canada is currently close to 5 per cent. In some parts of the country it is considerably higher. Unfortunately, the persistence of a somewhat easier labor market in Canada in 1969 has not as yet been accompanied by any discernible improvement in the performance of prices and costs. On the contrary, the consumer price index over the past 12 months increased by 4.6 per cent, compared to an increase of 4.1 per cent over the preceding 12-month period. On the cost side, the evidence is no more encouraging. Average weekly wages and salaries in Canada continue to show a year-to-year gain in the range of 7 to 7.5 per cent, which was greatly in excess of the trend of productivity increases, let alone of the negligible productivity growth that actually occurred over the past year.

To sum up, we have been witnessing a situation in which the growth of the economy has been markedly slower for almost a year, while prices and costs have continued to rise at an extremely unsatisfactory rate. Does this mean that our policies are not working? I do not think so. Since the middle of last year there has been evidence that business is finding it increasingly difficult to pass on all the increase in its costs in the form of higher prices. This is reflected in the squeeze in profit margins which has been developing in recent months. I think this development suggests that the policies of restraint are beginning to bite. As it becomes increasingly difficult to absorb large increases in costs in this way, business corporations will have to intensify their efforts to slow down cost increases....