months was 4.7 per cent and over the first five months of this year the consumer price index has been rising at a seasonally-adjusted annual rate of more than 5 per cent. By far the largest component in industrial costs, wage and salary rates, has not been rising as rapidly as a few years ago. However, it is still increasing at a rate far in excess of the growth in output and an important leading indicator of costs, i.e., the average increase provided in new settlements, has in recent months turned up again.

The long period of continuous economic expansion we have enjoyed – over 100 months since the spring of 1961 – and the price increases of recent years have had a powerful impact on attitudes in our society. In the same way that the long years of serious underemployment and deflation in the Thirties produced a depression psychology that lingered well into the postwar period, so the recent long period of continuous prosperity, plus perhaps the fact that those few recessions which we have experienced in the past quarter-century have all been relatively short-lived, appears to have had a profound effect on attitudes. Many people holding key positions in different sectors of our economic life have had no personal experience of an economic setback, and one has the impression that there is now unusual confidence that good times can be counted on the last indefinitely. There is a disconcertingly widely-held view that inflation is a normal or even necessary concomitant of economic expansion and that public policies of restraint will not be carried to the point of dealing effectively with inflation, that almost any price or cost increase will soon be brought onside by the general rise in the price level. This attitude encourages various economic groups to try to improve their relative positions substantially without worrying unduly about the possibility that as a result they might be priced out of the market for their services or products. It is the same psychology which makes borrowers willing to tie themselves into contracts involving the payment of high interest rates over long periods ahead, and which leads investors to insist on a relatively high interest return in order to allow for a prospective erosion in the value of money.

MONETARY POLICY

...I would like now to talk about monetary policy. I intend to review briefly the monetary policy followed in recent years but before doing so I should like to take the liberty of reminding members of the Committee of the basic manner in which monetary policy works. Perhaps I should start by saying a word or two about how it does *not* operate. In our system, the central bank does not set any of the interest rates paid by or received by the general public. Nor does it make any qualitative decisions in regard to the allocation of credit to particular borrowers or groups of borrowers in the economy. Although there are some important federal and provincial government lending agencies, and also the Industrial Development Bank which is a wholly-owned subsidiary of the Bank of Canada, the allocation of credit and the determination of institutional and individual market rates of interest are basically settled in the private sector of the economy within the context of the general credit conditions that prevail. The central bank exerts an important influence to be sure, but it does so indirectly, by the effect that its policies have on general credit conditions, that is to say the over-all availability and cost of money. Changes in credit conditions in turn have an effect on the willingness and the ability of the public generally to raise the funds required to fulfil their spending plans, and hence on the total level of spending in the economy. Changes in credit conditions in Canada relative to those outside the country also have an important influence on flows of capital into and out of Canada and on the level of our exchange reserves....

I know that the view is sometimes expressed that high interest rates are themselves inflationary because they increase the costs of those who do succeed in borrowing money. While it is true that there is some effect in this direction, the much more important role of high interest rates is to provide an incentive for people not to spend and not to borrow. In its simplest terms, an anti-inflationary monetary policy operates by encouraging people to add to their holdings of financial assets and to avoid incurring financial obligations, that is, to increase their saving, in preference to increasing their spending, which exerts upward pressure on the prices of goods and services.

There are, of course, many factors other than monetary policy which influence credit conditions in Canada....

ROLE OF CENTRAL BANK

The task of the central bank is to assess all of the factors affecting credit conditions and to decide whether in all the circumstances it should attempt to reinforce or mitigate their effect and in what degree. It follows, therefore, that, while monetary policy cannot be expected to take responsibility for the whole mix of economic policies and for all the economic developments and attitudes that lead to a certain set of credit conditions, the central bank cannot avoid responsibility for attempting to use its powers to influence credit conditions, including the general level of interest rates, in the way it thinks appropriate from time to time – by seeking to maintain them if it regards them as about right in all the circumstances or attempting to bring about a change if it regards them as inappropriate to the economic situation and outlook....

INTEREST RATES

At the present time the average yield on long-term Government of Canada bonds is 7½ per cent compared with a peak of 7 per cent during the exchange

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