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BANK DEPOSITS AND INFLATION.

In the two years between June, 1914, and June, 1916, the deposits of the British banks increased from $3,375,000,000 to $4,935,000,000, or by $1,200,-000,000. The banks' investment holdings in the same period increased from $570,000,000 to $1,490,-000,000, a growth of $920,000,000. These very large increases are made the text for some instructive comment in the London Economist's recently issued banking number, comment which is of considerable interest in Canada where the same conditions of large increases in bank deposits and holdings of securities by the banks have become established. Between July 31st, 1914, and September 30th, 1916, the total deposits of the Canadian banks increased from $1,159,314,585 to $1,468,313,018 and their holdings of securities from $100,726,968 to $269,429,326. Uninstructed students of bank balance sheets are apt to assume, remarks the Economist, that when the deposits rise this movement can only be due to an increase in the wealth of the community, and must, therefore, be a symptom of progress and prosperity. Both in Great Britain and elsewhere increasing bank figures are often pointed to as if they could only mean that, in spite of war, the world was increasing its wealth with surprising and satisfactory success. In fact, it is necessary to distinguish between the different processes by which an increase of deposits may be brought about. It can be done in many ways, of which the following are the chief:

(1) By an addition to the country's stock of gold, which is paid into the banks, making an increase in cash on one side and deposits on the other of the balance sheet.

(2) By the addition to the stock of legal tender paper currency, which is paid in with a like result.

DEPOSITS THROUGH LOANS.

(3) By an addition to the bank's discounts, loans and advances, which create deposits. If A borrows $5,000 from his bank, the bank gives him a credit in its books, so creating a deposit, while the advance to him is a corresponding asset A draws on his credit, but as long as he and those to whom he transfers it operate by cheque the increased deposit goes from one bank to another, and the volume of deposits is increased as long as the original advance to A is outstanding. If cash is withdrawn, deposits are reduced, but the cash, sooner or later, probably finds its way back to one bank or another.

(4) By an addition to the banks' investments. When the banks subscribe to Government loans—War Loan, Treasury bills, Exchequer bonds, or whatever the form may be—they transfer cash at the Bank of England to the Government; they hold securities instead of cash, and their deposits are at first unaltered. The Government draws on its balance at the Bank of England to pay contractors, or anyone else to whom it owes money; they pay the sums received into their banking accounts, so increasing deposits, and restoring cash at the Bank of England to the banks, which have thus had their deposits increased by the amount of the securities for which they have subscribed.

HOW INFLATION IS CAUSED.

It is clear, continues the Economist, that increased banking deposits created by subscriptions by the banks to Government loans are an addition to buying power in the hands of the public, without any corresponding increase in the volume of commodities that people want to buy, and are, consequently, likely to lead to what is usually meant by inflation—that is, a rise in prices due to too rapid increases in the volume of currency, since bank deposits are potential currency. What is wanted, in order to check the rise in prices, is not a manufacture of money by the banks, but a reduction of consumption, through saving, by investors. When investors subscribe for loans they hand over their bank balances to the Government, which pays them out, as above described, to contractors and others, who pay them in to the banks again, and the volume of deposits does not grow by the process. A present-day necessity in Great Britain, in the opinion of the Economist, is more real saving and real investment in Government securities. The public, it urges, should be induced, or, if necessary, forced, to save on such a scale that the Government may finance itself more out of the public's pocket and less out of that of the banks, and so that the banks may gradually liquidate their holdings of securities and be ready to make those advances to industry which the developments of peace are likely to require. In Canada, the effect of the munitions credits given by the banks to the British Government has been somewhat similar to that cited by the Economist regarding the British banks' loans to the Government. These credits have largely increased the deposits of the banks, as they have been mainly expended in Canada. Similarly other war financing of the Canadian banks has contributed to increase their deposits. But in the case of the last domestic War Loan there was more than sufficient "real investment" available, and the banks were not called on for any contribution.