

SLOWDOWN IN BANK LOANS

A definite slowing in the rate of increase in bank loans occurred in May and June. The annual rate of increase in the aggregate of business and consumer loans in the second half of 1969 was less than 4 per cent. It is the case that, allowing for seasonal factors, some increase has occurred in the past few months when financial markets have been particularly tight and some outstanding commercial paper issued by corporate borrowers may have had to be financed directly or indirectly by the banks. Since the middle of the year the banks have kept their consumer loans from expanding, and as banks account for nearly half of the total amount of consumer credit extended, the rate of increase in total consumer credit outstanding in the economy has now slowed down considerably.

The effects of monetary policy on the banking system show up clearly in the broad aggregates. Despite some upward movement in November and December, the total assets of the banks have grown at an annual rate of only 2 per cent since mid-1969 - 5 per cent for the whole of the year. The total amount of currency outside banks and bank deposits held by the general public, the privately-held money supply as broadly defined, was lower in December than in the previous March and rose by less than 4 per cent in 1969.

CO-OPERATION WITH CHARTERED BANKS

In addition to relying on its normal techniques of operation, the Bank of Canada has asked for and received the co-operation of the chartered banks on a number of matters. In response to requests by the Bank of Canada, the large chartered banks have not been competing aggressively for large blocks of short-term funds through the sale of Canadian dollar instruments. As an additional measure to help to avoid too great a general escalation of short-term rates, and to protect Canadian interest rate levels against part of the very sharp rise in rates in the Euro-dollar market, the chartered banks in July agreed to place a ceiling on their swapped deposits, i.e., Canadian dollar funds which have been converted into a foreign currency and placed on term deposit with a bank, and which the bank has undertaken through a forward contract to convert back to Canadian dollars at maturity. In pursuit of the same objective I last week asked a number of other financial institutions not to frustrate the effect of the ceiling on swapped deposits by arranging similar transactions in other ways. In another field, in order to soften the impact of tight credit conditions on less prosperous areas of the country, the Bank of Canada has asked the chartered banks to have special regard for borrowers in those areas. We have also asked the banks to have special regard for small businesses throughout the country since, unlike large corporations, they do not normally have alternative sources of credit. The Bank has also expressed the view that

the chartered banks should maintain a reasonable continuity of lending on housing mortgages. Finally, in view of the higher bank loan rates now prevailing in the United States, which gives U.S. corporations an incentive to borrow here directly or through Canadian subsidiaries, it was suggested to the chartered banks that they should give priority in the use of their total loan resources to the credit-worthy demands of their Canadian customers.

Although the general impact of monetary policy has spread through financial markets and affected all financial institutions, the strong demand for mortgage funds and consumer credit has led to an increased rate of growth of non-bank financial institutions such as trust and loan companies and finance companies, who have been able to pay higher rates on the funds entrusted to them. This, together with the expansion of the commercial paper market, to which I shall refer in more detail in a moment, has produced some offset to the decline in the rate of expansion of bank credit.

TIGHTER CREDIT CONDITIONS

One of the reasons why monetary restraint has taken a considerable time to have its full impact is precisely this wide variety of sources of credit available to some borrowers. The rapid growth of the commercial paper market in the last half of 1969, frequently with short maturity terms that are not related to the real requirements of the borrower but rather to the desire of the investor to stay liquid, is a good example. There are, however, limits to the extent to which such channels for obtaining credit can expand, and the degree of strain that was evident in the commercial paper market towards the turn of the year may be an indication that the rate of expansion was somewhat overdone. Another example of the way in which the impact of credit restraint may be delayed is through the slowing-up on the part of some businesses of settlement of their accounts payable. This process tends to push the burden of credit stringency back onto large suppliers who may have better access to bank or other credit than their customers. Once again, there is a limit to the extent to which this channel can be used. My own impression is that, taking not only the banking system but all other channels of credit into account as well, credit conditions have become progressively tighter, reflecting the steadily growing impact of monetary policy on the availability of credit.

GOVERNMENT EXPENDITURES SLOWED

Fiscal policy has also been playing an important role in the effort to restrain the growth of total spending in the economy. The rate of increase in Government of Canada expenditures has slowed, and the over-all cash position of the Government has improved markedly over the last year. This is well known. What is probably not as well recognized is that the improvement in the fiscal position of the Government