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MONETARY POLICY AND INFLATION

The following passages are from a statement by Mr. Louis Rasminsky, Governor of the Bank of Canada, at a meeting of the Canadian Club of Montreal on February 2:

...For some time now, monetary policy has been strongly directed toward the reduction of inflationary pressures, and credit conditions have been steadily tightening. The cost of money, which is, of course, greatly influenced by external as well as domestic developments, has risen almost continuously since September 1968, to record levels.

The economic purpose of tight credit conditions is to influence businessmen and consumers to reduce the rate of increase in their total spending and so lessen the pressure of demand in the economy. These decisions, to spend or not to spend, are, of course, influenced not only by the cost of credit but also by its availability. Over the past year or two, it has taken longer for a general restriction of availability to develop than it has for the cost of credit to increase. It is true that there was a substantial decline in the amount of long-term bonds issued in the domestic bond market in 1968 and a further reduction last year. But part of the decline was offset by increased borrowing in foreign markets. So far as the mortgage market is concerned, the willingness of borrowers to pay high interest rates resulted in the flow of funds into mortgages being relatively well maintained until the second half of 1969, when this too tapered off.

As regards bank loans, it took some time for the restrictive monetary policy to have a substantial impact on their availability. This occurred partly because in the autumn of 1968, when the present restrictive phase of monetary policy was initiated, the banks were very liquid, and partly because they have shown themselves willing, under the pressure of loan demand, to see their liquidity run down to considerably lower levels than had occurred in the postwar period. By the early months of 1969, the combination of the restrictive policy of the central bank, on the one hand, and the continued expansion in bank loans, on the other, had reduced the banks' ratio of more liquid assets to total assets to a not-excessively-comfortable figure of 30 per cent, and by April 1969 this had fallen below 29 per cent, to a new low. In that month, moreover, the Bank of Canada announced that it was using its power to raise the minimum secondary reserve ratio of the banks, which had the effect of impounding about $250 million of the banks' liquid assets, thus making them unavailable to finance further loan expansion. As interest rates rose, there were several increases in the bank rate, which has been at 8 per cent since last July.

The central bank has continued to keep the cash and liquid positions of the banks under pressure in order to maintain an appropriate degree of tightness in the credit system. The ratio of the banks' more liquid assets to their total assets has moved down to around 26 per cent; the banks clearly have few resources to spare for additional lending.

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