

Bulletin

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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 do-

mestic 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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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

MR. TRUDEAU TO TOUR PACIFIC

The Prime Minister has announced that he plans to visit New Zealand, Australia, Malaysia and Singapore in May before going to Japan for a five-day official visit as a guest of the Japanese Government. While in Japan, he will visit Expo 70 at Osaka and take part in the celebration of Canada's National Day on May 27. The schedule calls for Mr. Trudeau's departure from Ottawa on May 10 and his return on May 29.

The Prime Minister's tour reflects Canada's growing interest in the countries on the "Pacific rim". Australia and New Zealand have long-established historical relations with Canada in the Commonwealth, and trade with them is increasing. Mr. Trudeau's visits will reciprocate those paid by the Prime Ministers of both countries to Canada last year and will serve to emphasize the importance Canadians attach to closer ties with their Commonwealth partners in the South Pacific.

Canada has important trading relations with Malaysia and Singapore, where Canadian investment is increasing. They are also recipients of substantial capital and technical assistance under the Canadian international development program. The Prime Minister's visit will renew the contacts he has established with the Prime Ministers of Malaysia and Singapore.

ROCKETS TO STUDY ECLIPSE

Four *Black Brant III* rockets will be launched early next month in a study of a total eclipse of the sun, from a temporary site in Nova Scotia.

The rockets, which were built by Bristol Aerospace, Winnipeg, will carry payloads weighing between 50 and 60 pounds to an altitude of 100 miles to probe the effects of the eclipse on climate and radio communications. The project will be conducted by the National Research Council and will take place on March 7 from the Port Dufferin area on Nova Scotia's eastern shore.

The first launching will take place one hour before the eclipse, the second just before totality, the third at totality and the fourth just after. None of the payloads carried by the rockets is retrievable. The scientific information will be transmitted from the complex electronics payloads to ground receiving stations.

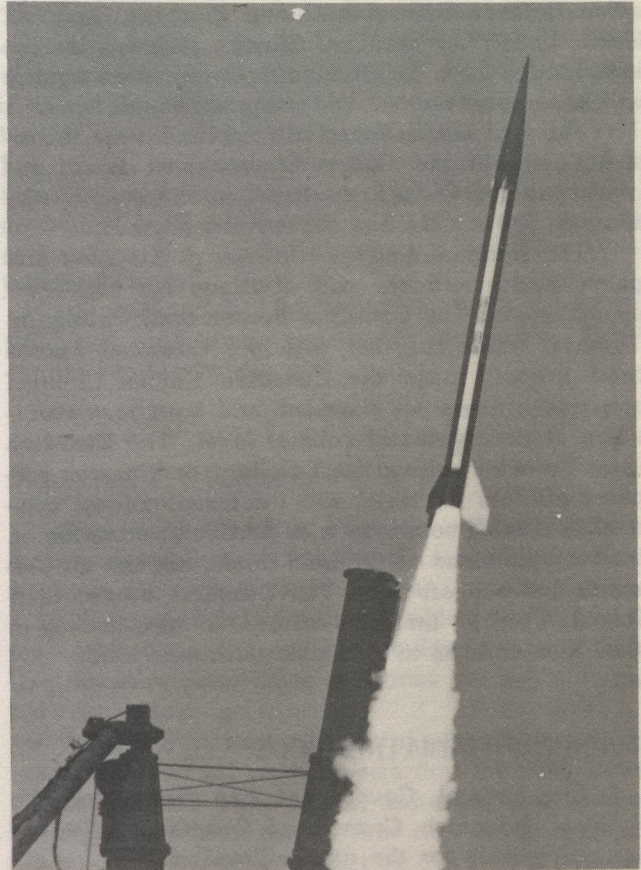
In addition to designing the rockets, Bristol is also building the payloads, and installing in them the scientific experiments. Besides NRC equipment, scientists from Britain will place instruments in one of the payloads.

The NRC probe is taking place in Nova Scotia because the eclipse will cut a path 75 miles wide along the east coast of the province, then travel across Cape Breton Island and into Newfoundland.

The four-rocket shot is part of a chain of upper-

atmosphere probes down the east coast of North America during the eclipse period. A series of rockets will be launched from several sites in the United States, and scientists from other parts of the world will be participating in the probe.

The *Black Brant III* is a simple, single-stage rocket powered by a solid fuel, which makes it easier to launch than liquid-fuelled rocket engines.



The Black Brant III rocket.

OFFICER TRAINING IN CANADA

The Minister of National Defence has authorized the establishment of a new headquarters to command the National Defence College and the Canadian Forces' staff colleges and military colleges, effective January 1. The commander of the organization, which has been designated Headquarters, Canadian Defence Education Establishments, is Major General W.A. Milroy of Edmonton and Calgary.

Initially, the new headquarters will command the three military colleges — the Royal Military College, Kingston, Ontario, le Collège militaire royal de St. Jean, St. Jean, Québec, and Royal Roads Military College, Victoria, British Columbia. It will also take command of the National Defence College, Kingston, the Canadian Forces College, Toronto, and the Canadian Land Forces Command and Staff College, Kingston.

RESULT OF SPECIAL REPORT

This is the first step in implementing a new unified system for officer-education in the Canadian Forces recommended by the *Report of the Officer Development Board 1969*. This three-volume report, the result of 18 months' work, included a complete implementation plan as well as conclusions and recommendations for officer-development in the Canadian Forces.

The Officer Development Board became the Canadian Defence Education Center Planning Group on March 1, 1969. It was the Group's task to plan the introduction of a modified officer-education system within current financial and manpower restrictions.

The new headquarters will implement the recommendations of the Officer Development Board and other policies on officer-education directed by the Minister and his civilian and military advisers.

The National Defence College at Kingston prepares senior officers and civilians for high-level appointments. The Canadian Forces Staff College in Toronto, which together with the Canadian Forces Staff School, forms the Canadian Forces College, prepares officers for command and staff responsibilities at the lieutenant-colonel level. The Canadian Land Forces Command Staff College at Kingston prepares officers for major and lieutenant-colonel command and staff positions with particular attention on combat operations of the land forces and the air elements that support them. The Canadian Forces Staff School, Toronto, instructs officers of captain rank in staff work common to all elements of the Forces.

SCIENCE INFORMATION BODY

The Federal Government has designated the National Research Council of Canada as the coordinating body for the further development of a national scientific and technical information system (STI). The decision follows recommendations made last autumn by the Science Council of Canada.

Canada already has a number of STI dissemination services, the largest of which are based in Federal Government departments and agencies. In order to cope with the current "information explosion", expansion of existing facilities will be necessary. It will be up to the National Research Council to see that all areas of science receive adequate coverage, and to minimize unnecessary duplication.

The integrated national system, encompassing the natural sciences and engineering, will be decentralized, and based on the existing resources and systems in industry, the universities, and Government, all linked together.

The STI system will be designed to meet the needs of users in all parts of Canada. It will be of particular benefit to small companies or organizations unable to maintain large research libraries. Primary emphasis will be placed on rapid response

to specific requests and to promoting an awareness of information sources. The system will be designed to respond to queries in either French or English, but will provide documentary information in its original language only.

A Board of Directors will be appointed by NRC to be responsible for formulating general policies for scientific and technical information services in Canada, and guidelines for their implementation. The members of the Board will be broadly representative of users and processors, and include representation from the National Library.

FOOD FIRMS CRUISE CARIBBEAN

Canadian food-producers recently displayed their products to buyers for Caribbean hotels, restaurants and institutions at a seagoing food fair. Organized by the Department of Industry, Trade and Commerce and staged on board the *Sunriver*, a ship owned by Saguenay Shipping Limited, Montreal, the floating fair visited Bermuda, the Bahamas, Antigua, Barbados and Trinidad and Tobago from mid-January to early February. Eleven firms took part.

The shipping company co-operating in the promotion operates a regular service between Halifax and the Caribbean, allowing exporters to plan shipments to suit their customers.

The increasing flow of tourist traffic to the Caribbean islands has put new pressures on hotels and stores catering to visitors. Canadian foods are expected to find ready acceptance in this market by virtue of their quality, packaging and attractive prices.

Aboard the *Sunriver* were samples of Canadian fish, meats, biscuits, desserts, processed fruit and vegetables, fruit juices and drinks, frozen pies, spices, peanut butter, frozen French-fried potatoes and other foods. Wines, liquors and tobacco were also included.

Representatives of most of the exhibiting companies travelled with the fair, and buyers for hotels, restaurants and institutions and potential buyers or agents visited it at the invitation of Canadian trade officials.

ORAL CONTRACEPTIVES COMMITTEE

National Health and Welfare Minister John Munro has announced the formation of a committee of seven physicians from across Canada to advise the Food and Drug Directorate on all aspects of the safety and efficacy of oral contraceptives. "I have taken this step because of the recent increased concern about undesirable side-effects associated with oral contraceptives," said Mr. Munro. "I feel that these distinguished physicians, with their close association with the clinical use of these drugs, will be able to provide valuable expert advice to ensure the safety of oral contraceptives on the market."

TRADE COMMISSIONER TO ALASKA

Mr. Jean-Luc Pepin, Minister of Industry, Trade and Commerce, has announced that a trade commissioner has been assigned to the Canadian Consulate General in Seattle with special responsibilities for the State of Alaska, which is part of the territory served by that office. This move was made because of the increased trade possibilities opened up by the oil boom in Alaska.

Mr. R.J. Archambault, the new appointee, will explore growing trade opportunities for Canadian goods and services, including engineering services, oil field equipment, pipeline construction supplies, residential and industrial construction, portable housing, road construction equipment and supplies. He will also help Canadian exporters develop sales of consumer goods such as clothing and processed foods, for which opportunities exist in the expanding Alaska market.

CANADIAN PROFESSIONALS RETURN

Canada's much-bewailed "brain drain" may not be as bad as many people think — and, may, indeed, according to Manpower and Immigration Minister Allan J. MacEachen, be a "brain gain". Speaking recently to a joint meeting of the Engineering Institute of Canada and the Association of Professional Engineers of Ontario in London, Ontario, Mr. MacEachen said that surveys made by his department indicated that from four to seven of every eight highly-qualified Canadians employed in the United States might be returning to Canada after one or two years. Because homecoming Canadians were not segregated in immigration figures, the repatriates had not previously shown up, the Minister stated, but their existence was revealed in the special studies made by his department.

"We are continuing our studies," Mr. MacEachen said. "It is difficult to get adequate information; but the indications are that a great many more highly-qualified Canadians come back than was suspected. Furthermore, they come back with the benefit of experience in advanced American methods and they make this experience and know-how available in Canada."

CONTINENTAL LABOR MARKET

The market in professional and scientific manpower is a continental one, according to Mr. MacEachen. There is a continuous circulation between Canada and the United States, and in some respects Canada has in recent years been at least breaking even — in the migration, for example, of U.S. teaching professionals to Canada, which now exceeds the traffic in the other direction. Canada is importing as many economists from the States as it is supplying.

Increased educational opportunities in Canada, coupled with social unrest in the United States, have

led to a significant increase in the number of Americans coming to Canada and Canadians returning home.

For the first half of the Sixties, the number of Canadians moving south was about 50,000 annually. The present flow is about 50 per cent of that figure, almost equalling the flow of immigrants coming to Canada from the United States.

OPPORTUNITY NEEDED

The way to keep qualified graduates in Canada, according to Mr. MacEachen, was to provide them with professional opportunities. "If we wish to keep qualified Canadians, we shall have to make it possible for them to use their talents," the Minister told his London audience. "We shall have to maintain a level of economic expansion capable of absorbing graduates in the sciences and professions and of giving them the kind of challenges they have been trained to meet."

He predicted that the demand for qualified scientific and professional personnel in Canada would continue to increase.

CAR CHECK CAMPAIGN

How many Canadian cars are rejected in compulsory and periodic motor-vehicle inspections? What are the major defects found in these inspections?

The Canada Safety Council, which supports such inspections for all provinces, provides figures indicating the answers to these questions during its spring car-check campaign.

Nova Scotia, now in its third year of compulsory inspections for all cars, reports that the main items needing repairs were lights, exhausts and brakes. This province also reports that its compulsory system has had a salutary effect on the upkeep of cars. The rejection ratio on first inspection in 1968 was 47 per cent, which dropped to 39 per cent in 1969 over the same January-September period.

The rejection rate for commercial vehicles, which came under the legislation only in 1969, was 42 per cent over the same period, but this is expected to improve on the same basis as the ratio for passenger cars.

Vancouver, which has had car checks for 30 years, reports a rejection ratio on first inspection of 29.8 per cent in the first six months of 1969. Over the years, defective headlights have been by far the biggest defect, followed by brakes, steering, stoplights and the exhaust system.

In Victoria, 55.6 per cent of the passenger vehicles inspected between July 1, 1968, to February 28, 1969, were rejected on inspection, compared to 51.9 per cent of the commercial vehicles. Of those rejected, 68.8 per cent had defective headlights, 14.3 had defective steering mechanisms, 12.3 had defective exhaust-muffler systems and 10.1 per cent defective brakes.

MONETARY POLICY AND INFLATION

(Continued from P. 2)

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 overall 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....