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Excerpts of an address by Mr. Donald Fleming, Minister of Finance, to the Investment Dealers Association of Canada, Murray Bay, Quebec, June 19, 1958

... In my Budget Speech Tuesday evening (June 17) and in the White Paper which I tabled in the House of Commons on Monday I reviewed in detail the economic forces in operation during 1957 and the early months of 1958. Today I should confine the review to some of the more salient features.

ECONOMIC REVIEW

Some slow-down in economic activity was to be expected after the excessive pace of 1955 and 1956, a pace which was straining our resources of men and materials despite very large borrowing abroad.

The most important change which emerged during 1957 was the decline in the importance of business capital investment as a dynamic force in our economy, particularly investment in our resource industries. A somewhat larger decline in capital investment occurred in the United States.

Although business capital investment ended the year on a weaker note than it had begun, the reverse was true of housing. The expansion of housing investment had come to an end in the middle of 1956 when the keen competition for loan funds resulted in a shortage of mortgage money and brought about a decline in home-building. During 1957, however, the competition for loan funds became less active as the year progressed and, more important, in August and again in December government funds in a total amount of $300 million were made available to augment the loan funds supplied by insurance companies, banks and other private lenders.

Government expenditures contributed to the maintenance of economic activity. At all three levels of government they rose by almost 7 per cent despite some decline in defence expenditures. Transfer payments especially rose rapidly and for the latter half of the year they were an important element in sustaining and increasing personal income and consumer demand. The largest elements in this increase were the greatly increased payments from the Unemployment Insurance Fund, larger payments to the aged, the blind and the disabled, larger veterans' allowances and pensions, and increased family allowances.

In 1956, and again in 1957, a substantial part of our investment programme was financed from abroad. The deficit on current account in 1957 amounted to $1.4 billion. This deficit was financed to some extent by direct U.S. investment in Canada but sales of securities, as in the previous year, were the major source of external capital. A good part of the rapid rise in imports which took place in 1956 and early 1957 was the result of heavy imports of machinery, equipment and industrial materials connected with our capital programme. The importation of these items helped us to escape some of the pressures connected with the high level of domestic investment. The converse of this situation is that the decline in investment in machinery and equipment has fallen to a very considerable extent on imports which have shrunk markedly in the last few months.

I have reviewed the main changes in the strength of the underlying economic forces during 1957. The reduction of the pressures and demands which characterized 1956 led to a mood of greater caution with regard to new capital ventures and was reflected in a declining rate of increase in job opportunities. Despite these conditions, there were more people at work in each month of 1957 than in the comparable month a year earlier. The increases over the preceding year became smaller as the year progressed and in January, February and March of 1958 employment was slightly lower than a year earlier. However, by April 1958 employment was again higher than a year earlier.

To some extent the pressures generated in 1956 did not have their full effect on prices until 1957. Thus, the consumer price index, which began to rise in mid-1956, continued upward until last October, and experienced another short period of increase in the first four months of this year. Wholesale prices, on the other hand, reached a peak in January 1957, declined 1.4 per cent during the succeeding ten months, and have risen again moderately since November. The rise in consumer prices offset about half the increase in average wage rates so that advance in real income during the year was about 2 per cent.

In the absence of immediate inflationary pressures I would not expect any general increase in prices during the balance of 1958. But this is not something we can take for granted. It is the duty of all groups and classes in our society to ensure that the prospects for a sound recovery are not dimmed by a spiralling of costs or that efforts to stimulate recovery do not lend strength to a new inflation. Inflation remains a very real danger against which we must remain on guard.

I have dealt with some of the more significant economic trends which have developed over the past several months -- with the declining strength of business capital investment and with the consequences from an employment standpoint of the slackening of demand. The natural economic effects of these tendencies have been softened and reduced by government action on a number of fronts. I have already referred to the large amount of money made available for housing. In addition, in line with the government's intention to proceed with a comprehensive programme of national development and at the same time to alleviate current unemployment, a major programme of public works is now being implemented.

Additional financial assistance being given to the provinces will enable them to proceed with needed capital improvements in the provincial and municipal fields. Social security benefits have been substantially increased during the past year. Benefits under the Unemployment Insurance Act have been expanded. The Unemployment Assistance Act was amended so that the federal government now participates equally with each province in the cost of assistance to those not drawing unemployment insurance.

Taxes were lowered. The exemption for children receiving family allowances was raised from $150 to $250 and for other children from $400 to $500. There was as well a reduction in the rate of personal income tax. The special excise tax on automobiles was lowered by one-quarter and small businesses were benefited by an extension of the corporate income bracket subject to the 20 per cent tax rate from $20,000 to $25,000. The total reduction in taxes amounted to $178 million in a full year.

Monetary policy also changed in the latter part of 1957. The money supply was expanded rapidly after mid-August, and partly for this reason and partly because of a reduction of demand in certain credit fields, monetary conditions in Canada generally became easier and interest rates declined substantially. Banks have now for some time been in a position to meet all credit-worthy demands for commercial and personal loans. Market rates of interest in almost all categories of borrowing have declined substantially.

I can conclude this analysis of our economic situation by saying that there are hopeful signs that we have reached the end of the recent decline. Moreover, the problem has moved more clearly into the domestic field. Although the influence of external demand was important as one of the origins of the current adjustment, the direct effect of the decline in certain basic exports has been less significant than the indirect effects on business capital investment. Now that capacity in a number of industries has overtaken or exceeded current demand it seems obvious that relatively less of our energies will for a time be directed to creating new capital facilities in the business sector. As a result we shall be able to devote more of our energies to filling some of the gaps which have developed over the last few years in housing, in municipal services and in other requirements for social capital in Canada, and in laying the basic foundations for the new period of business expansion which will not be long delayed. The policies of this government are assisting the growth in housing and social capital. The expanded role of social capital is illustrated in the 1958 Outlook for Private and Public Investment published by my colleague the Minister of Trade and Commerce. Present investment intentions of business for capital outlays in 1958 are about 11 per cent below the 1957 level. Planned outlays for housing, government departments and institutional services on the other hand are 14 per cent higher.

With all these factors in mind and with due regard for the resourcefulness of the Canadian people and the government's determination, I had no hesitation in budgeting on the basis of a resumption this year of the rise in incomes and production. Assuming normal crops, stable prices and no untoward external events, I based my revenue forecast on a gross national product of $32 billion, which is about 2 per cent above the record level in 1957.

GOVERNMENT FINANCIAL OPERATIONS 1957-58

Subject to final check when the books for the year have been closed, our revenues for the fiscal year which ended on March 31, 1958, were $5,047 million, our expenditures were $5,086 million and there was a deficit for the year of $39 million. The decrease in revenues of $97 million as compared with the forecast is less than 2 per cent. The expenditures were only $21 million or less than one-half of one per cent higher than I had forecast last December. I can assure you that we are endeavouring to exercise the closest possible control over our financial operations as these figures well demonstrate.

In addition to our budget outlays, we met substantial non-budgetary obligations. All were financed without any increase in the government's outstanding unmatured debt, by reducing our cash balances by $163 million.

Our public debt operations during 1957-58 included the redemption and refinancing of a very large volume of government securities. Net sales of Canada Savings Bond Series 12 amounted to $1,177 million and other new securities amounting to $1,350 million were issued, in addition to the refunding of treasury bills which matured weekly. During the fiscal year outstanding securities amounting to the very large sum of $2,650 million, including $1,050 million of previous Canada Savings Bond issues, were redeemed. After taking into account the net sales of securities amounting to $123 million from our securities investment and sinking fund accounts the unmatured debt held outside these government accounts was almost exactly the same at the end of the fiscal year as it was at the beginning.

During the first five months of the fiscal year interest rates generally as in the previous period continued to rise, reaching a peak in August. Thereafter the rates began to fall and this downward trend continued to the end of the fiscal year. The average interest rate paid on the government's unmatured debt was 2.98 per cent at the end of the fiscal year compared with 3.05 per cent at the beginning of the year. Treasury bill rates reflected a similar but more pronounced trend. The yield on the first issue in the fiscal year was 3.69 per cent. In August the yield rose to a high of 4.08 per cent, falling thereafter to a low of 2.27 per cent on the last issue of the fiscal year, and the most recent issue was at 1.76 per cent.

GOVERNMENT FINANCING 1958-59

For the new fiscal year which commenced on April 1st, I have estimated our budgetary expenditures at approximately $5,300 million, which is $215 million higher than our expenditures last year.

Admittedly this is a substantial increase but it includes all the new expenditures on health and welfare introduced by this government such as the increase in old age pensions and veterans' benefits and the initial cost of hospital insurance. It also includes large expenditures for national development which will improve our productive capacity and efficiency and in due course add to our collective wealth and income.

Furthermore, all these expenditures to which I am referring, by providing employment and sustaining private incomes, will help to maintain the level of the national income during this temporary period when export demand for certain of our staple products has been softening and during the pause which this has caused in some sectors of capital investment.

I emphasize that with respect to all government expenditure we shall continue to search for economies and to eradicate inefficiency, waste and extravagance wherever we find them.

The forecasting of revenue expectations in times like these presents an even more difficult problem than estimating expenditure. My forecast after the further reductions in taxation made by the budget is that our total revenues will amount to $4,652 million, which is $395 million less than our revenues in the previous fiscal year. I should point out that of this reduction more than one-half is the result of tax reductions made last year, and less than half is due to a decline in our tax base. Almost all of this decline is the result of a reduction in corporation profits.

The estimated budgetary deficit is, therefore, $648 million. In addition to this sum we must take account of our large cash requirements outside the budgetary figures.

During the current year, 1958-59, we will require about $400 million for housing loans, about $250 million for the C.N.R.'s capital investment and refunding programmes, nearly $250 million of cash advances to the St. Lawrence Seaway, the Northern Ontario Pipe Line and to other Crown companies and agencies; and other non-budgetary cash requirements, including the liquidation of the defence equipment account, will be about another $240 million.

Against this we shall have available in this fiscal year some $50 million in our securities investment account, about $65 million from the repayment of loans made in earlier years, and we can expect to receive net about $240 million of cash into our various annuity and superannuation accounts.

The net requirement of cash for these non-budgetary transactions, excluding the exchange fund account, is thus about $775 million, and this we shall need to borrow. We shall also need to borrow the funds to cover our budgetary deficit of $640 million, and our net new cash requirements in this fiscal year will therefore be of the order of $1,400 million.

In addition to this, some $1,950 million of our marketable funded debt will be maturing during this fiscal year, and these maturing securities will require to be paid off by an equivalent amount of new borrowing. In other words, during this fiscal year we shall need to sell bonds or other securities in a total amount of close to $3,400 million. This is a major financial operation and will require the closest co-operation between the Department of Finance, the Bank of Canada, the chartered banks, and all investment institutions and dealers.

We have already made a good beginning. Since April 1st we have sold issues totalling $950 million, of which $350 million was new cash. We still have before us the need to refund $1,350 million of maturing bonds and to raise more than $1,000 million of new cash.

We shall be making every effort to promote a good sale of Canada Savings Bonds next autumn, but whatever net new cash we obtain from that source will still leave us with a very large financing task.

This is an appropriate time to review the principles which should be observed in the development of a large programme of public financing by the government. Perhaps the most important general objective was referred to in the Speech from the Throne on May 12th as follows:

> "My Ministers remain mindful of the importance of financing their large programme of expenditures in such manner as will best safeguard against the recurrence of inflationary dangers in future."

This means that we must to the greatest feasible extent seek to raise the funds from private investors, both institutional and individual, and hold to a minimum the amount of financing done through the banking system, particularly where this is associated with over-all monetary expansion.

Obviously the government must plan its bond issues in such a way as to make the maximum appeal to investors and must in so doing take account of the desire and needs of investors and of the general psychology of the investing public. This means that there must be a considerable proportion of medium-term and long-term bonds in any debt management programme as well as an appropriate amount of short-term securities.

From the point of view of the government also it is very desirable to achieve a well-balanced maturity distribution in our public debt. Excluding Canada Savings Bonds which are redeemable on demand, the average term to maturity of our funded debt measured from today is $5\frac{3}{4}$ years;

ten years ago the average term was $8\frac{3}{4}$ years; twenty years ago it was $10\frac{1}{2}$ years. If, for example, all maturing bond issues were refunded over the next five years for a consistent term to maturity of, say, only three years, then at the end of the five year period the average term of the outstanding debt would have shrunk to $3\frac{1}{2}$ years. If this steady trend towards a shortening average term is maintained, we shall soon be confronted with progressively larger and more frequent refundings which could impair the efficient operation of both the new issue market and secondary markets. Therefore, I hold the view that we should seize opportunities to create new long-term issues whenever these opportunities occur. I recognize that the large-scale placement of long-term bonds has been more difficult than money market operations in recent years for a wide variety of reasons but we must not shy away from a desirable course simply because it is a difficult course to follow.

Before considering further the programme of issuing marketable securities I should like to remind you of the importance of the Canada Savings Bond programme. As I indicated in my Budget Speech, there will be another issue of Canada Savings Bonds this autumn, which will be Series No. 13. This I trust is not an ill-omened figure, but on the contrary will inspire us to strong endeavours to make this the most successful issue ever made, particularly in terms of the amount of new money raised over and above the sums required to provide for the year's volume of redemptions of previous issues. You will recall that sales of the last Series reached the record total of $1,217 million or $317 million more than the previous record which was established in 1953. Even though as much as half of this record sale may have consisted of conversion by investors of part of their holdings of earlier series, it was nonetheless a tremendous merchandising feat to obtain applications from 1,293,000 Canadians. Investment dealers and banks alike deserve full credit for this achievement.

Turning now to consideration of marketable securities, it will be apparent that the Government will have to come to market with large scale offerings approximately every three months. We shall continue to provide a broad range of choice to investors as we did on the last occasion. The terms of new issues will be tailored to attract participation by all types of investors. To develop the full potential of any market, even the best merchandise must be sold. Within reasonable limits we wish to take any and every step that will improve our sales organization and sales promotion.

Government policy regarding the management of the public debt cannot follow any rigid formula; it must be adapted to economic conditions and to market requirements. While I do not propose to place an undue burden on the

the longer term bond market, it is most desirable to keep our maturing debt reasonably spread out over the years. To refinance maturing issues chiefly in the short term market would only build up greater difficulties for ourselves two or three years hence. It will be our aim to offer acceptable volumes of longer term bonds whenever suitable opportunities occur, and to spread the remainder sensibly between short and mid-term maturities.

While the prospective increase in our debt will be quite substantial during the next year or two, the net burden of the public debt will remain well below what we carried quite easily only a few years ago. While our net debt at the end of this year is higher than it was at any time during the past ten years, its burden while measured as a percentage of our gross national product will be significantly lower than it was three years ago.

The raising of a total of approximately $3,400 million by the sale of bonds or other securities is indeed a formidable undertaking. We hope to do it without causing an undue strain upon the financial resources of the Canadian investment market and with due consideration of the needs of provinces, municipalities and business in the same market. Moreover, the policy of the government has naturally been to seek to do its financing at the most favourable interest rates. In short, in the light of all these factors we shall need the fullest possible co-operation on the part of investment institutions and dealers, and I appeal to your patriotism as well as your good business sense in seeking your co-operation in this task.

Together we shall be offering to the Canadian people the best security in the world -- an opportunity to invest in Canada.

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