EXTRA

BANK OF CANADA

ADDRESS BY THE GOVERNOR AT THE SECOND ANNUAL GENERAL MEETING OF SHAREHOLDERS OF THE BANK OF CANADA, FEBRUARY 23, 1937

A balance sheet and profit and loss account as at December 31, 1936, was sent to all shareholders with the notice calling this meeting. In referring to these statements, I propose to deal only with the items which show a material change on the year.

Our note issue as at December 31, last was $135,735,457, compared with $99,677,228 at December 31, 1935, an increase of $36,058,229. On the year, our active note circulation, that is, the amount of Bank of Canada notes in the hands of the public, increased $28,773,502, while chartered bank notes decreased $9,779,577. Using average figures of the daily circulation for the year 1936 as compared with 1935, the net increase in the total active note circulation has been $12.2 millions, or 7.2 per cent, a result mainly due to the enlarged volume of the country's business, coupled with a rise in the level of prices.

As at December 31st last our holdings of Dominion and provincial government securities, maturing within two years, amounted to $61,299,024, and those having a maturity longer than two years totalled $99,016,389. Compared with December 31, 1935, the total increase in our security holdings was $46,032,570. This addition to our portfolio more than offset the increase in our active note circulation, and was one of the factors leading to an increase of $12.6 millions in the chartered banks' cash reserves.

It may be of interest to analyze a little further the changes in our position which caused the chartered banks' cash to increase by the amount which I have mentioned.

(Figures shown in millions of dollars)

	Changes producing a decrease in chartered banks' cash	Changes producing an increase in chartered banks' cash
Increase in sterling and U.S.A. funds		4.9
Decrease in advances to Dominion Government	3.5	
Increase in investments		46.0
Increase in Capital and Rest Fund	5.7	
Increase in notes in active circulation	28.8	
Increase in Dominion Government balances	1.7	
Increase in Other Banks' Balances	1.3	
Other net changes		2.7
	41.0	53.6
	Deduct	41.0
Increase in chartered banks' cash reserves (notes of and deposits with Bank of Canada)		12.6

Thus, disregarding the minor changes, one can say that the increase of $46 millions in our security holdings was offset to the extent of $34 millions by our new capital and the enlargement of our active note circulation, leaving some $12½ millions as an addition to the chartered banks' cash.

You will have noted that Issued and Paid Up Capital has been increased by $5,100,000 since our last meeting. On June 23, 1936 an Act was passed amending the Bank of Canada Act in a number of respects, the most important of which was the creation of an additional 102,000 shares of Class B stock to be issued to the Minister of Finance at the price of $50 a share—the par value of the stock—and to be held by the Minister on behalf of the Dominion of Canada. This stock was issued by us and paid for by the Minister on September 11, 1936. As the holder of these Class B shares, the Minister, with the approval of the Governor in Council, is entitled to appoint to the Board of the Bank six directors, each of whom has two votes prior to the annual general meeting in 1940, at which time the number of directors elected by Class A shareholders will have been reduced to three.

I am sure that I speak, not only for myself, but for other members of the Board as originally constituted, when I say that we welcome the new directors, and have had occasion to appreciate their counsel and co-operation at the meetings which have taken place since the date of their appointment last September.

Auditors are now appointed by the Minister instead of by the shareholders, and a number of other alterations have been made in the Act, many for the sake of greater clarity of meaning or convenience of operation. The form of our notes is to be changed, and we are hoping to put out the new issue by the end of the summer.

These modifications in the Act made it necessary to revise also our By-laws, a new form of which received approval by Order in Council on December 16, 1936.

PROFIT AND LOSS ACCOUNT

In 1935, after providing for contingencies and reserves, we had available for distribution some $764,000, but our operations in that year covered a period of about nine and a half months only. If the Bank had been in operation for a whole year on the same basis as the nine and a half months, 1935 would have shown a figure of, say, $965,000. This compares with some $2,008,000 for the year 1936. The considerable improvement this year is due to a number of factors. In the first place, as I mentioned last year, we had to incur at the commencement of operations various expenses, many of which would normally be non-recurrent. The expense of note issue, in particular, has this year been very much less. On the other hand, the change in the form of our notes will again involve us in exceptional expense in the year 1937. Then, as you may remember, the decline in the price of silver in 1935 had a marked effect on our profits. Under our Act, we have for three years, 1937 being the last year, to acquire 1,671,802 ounces of silver, annually, if the Government instructs us to do so, and in 1935 the depreciation in the value of our holdings was no less than $489,000 odd. In 1936, however, while there was still a considerable loss, it was limited to $135,211. While some of our expenses have been much reduced, and the loss on silver was diminished, the increase in our profits is still more due to a rise in our earnings, mainly because of our increased holdings of securities.

BANK RATE

Our Bank Rate has remained unchanged throughout the year at 2½ per cent. Cash having been in plentiful supply, there has been practically no need for loans or rediscount facilities. Advances to banks were made on two occasions during 1936, but only for relatively small amounts and for short periods.

PREMISES

During the past year the Bank has given a good deal of consideration to the premises occupied by Agencies. At Toronto the premises were inadequate but could, we felt, be reconstructed at a reasonable cost. We therefore purchased the building from the Dominion Government, and are proceeding with a remodelling of the interior. As a result of structural alterations, space will be provided for our Securities and Exchange Divisions, which have been located in rented quarters in Toronto since the opening of the Bank. In Regina, the building formerly occupied by our Agency was sold, and our Agency is now in temporary quarters. Recently we acquired a suitable building lot and we plan to commence the erection of premises in the early spring. At Calgary, we purchased from the Dominion Government the premises occupied by our Agency. At other points, Vancouver, Winnipeg, Montreal, Saint John, Halifax and Charlottetown, our Agencies are in rented quarters, which are adequate for the present.

You have probably observed recent newspaper announcements to the effect that construction of our new Head Office at Ottawa will be commenced in the near future. In planning the building, we gave first consideration to the practical convenience and efficiency of the working quarters, and placed special emphasis on the security provisions of the vaults and other safe-keeping equipment. The building will be five storeys above the ground level, and two storeys below. In general, an effort has been made to achieve a simple and dignified effect in a modern adaptation of a classical style. The exterior will be of stone and the interior in harmony with the architectural effect of the general building design. It is expected that the building will be ready for occupancy about March 1938.

SAVINGS

During the past year, the Dominion and provincial governments of Canada raised a little over $160 millions of new money, if we include guaranteed issues. In the same period, the chartered banks' portfolios of Dominion and Provincial issues rose by $160 millions, and Bank of Canada showed an increase of $46 millions in its holdings of government securities. On balance, therefore, other institutions and the general public, though of course taking a part of the new issues, may be regarded as having parted with $46 millions of their existing holdings, or a greater amount than this in so far as they took up a portion of the new issues.

This does not necessarily mean, of course, that the savings of the public have been diminished—on the contrary, they have, in fact, increased. For supposing that on balance we may regard all new issues as taken up by the banks, then the governments, who received the proceeds, would have spent this cash, and the deposits of the general public in the chartered banks would have been swollen by the same amount. A considerable proportion of these deposits takes the form of savings deposits. Again, if the banks buy from the public pre-existing issues, that only means that the sellers receive a cash balance in place of the securities in which their savings were previously invested, and these cash balances, which again may largely be savings accounts, represent to that extent a *change* in the form of the public's savings, and not a diminution or increase. Finally, the public has saved by purchasing out of income securities previously held outside Canada.

REDUCTION OF FOREIGN DEBT

A combination of circumstances has greatly encouraged the repatriation of a substantial amount of Canadian external indebtedness. For one thing, our balance of international payments has been exceptionally favourable; and for another, conditions in the domestic market have facilitated the issue of bonds payable in Canadian dollars to replace obligations in other currencies.

It is not possible to state the exact amount by which our external indebtedness has decreased, but there are various ways in which we can gain some idea of the sums involved. For example, we know that the net retirement of issues payable in other currencies (including optional payment bonds) was about $202 millions in 1936. Some of these bonds, of course, were owned in Canada, and to that extent the refunding has not produced any net change, although it has relieved the issuer of the liability to pay in United States dollars or sterling.

Preliminary estimates of our balance of international payments during 1936 indicate that we may have had available over $300 millions on current account; that is, after making allowance for all items other than capital movements. Of this favourable balance, provisional estimates put the amount used for repatriation of obligations held outside the country at $145 millions.

Taking into consideration amounts retired in 1935, and under way this year, the record is a surprisingly favourable one. We should, I think, guard against repatriation on a scale, or at a speed, which over-estimates the powers of absorption of our bond market, or imposes a strain on the Canadian dollar. Of the latter development there is as yet no sign, but there are indications of some congestion in the market for securities.

An unusually large favourable balance in our visible trade is characteristic of the early period of a Canadian recovery, and it is not surprising that the surplus of exports should have been particularly substantial on this occasion, in view of the liquidation of wheat stocks. It can be expected that a continuance of satisfactory conditions in the export field will further stimulate domestic activity, and cause the increase in imports to be more closely related to the increase in exports than was the case last year.

THE CANADIAN DOLLAR IN 1936

In a year in which the foreign exchanges were under an almost continuous strain, the Canadian dollar exhibited a remarkable steadiness, particularly in its relationship to the United States dollar. In general, it may be said that the Canadian and United States dollars drew closer together and moved in greater harmony than has been the case for some years. The range of fluctuations was less than 1¼ per cent, with the Canadian dollar, which was quoted below par in the earlier months, strengthening to close the year at a small premium. Vis-à-vis the pound sterling, which remained above its old parity throughout the year, the range was twenty points or approximately 4 per cent.

Movements of capital on a large scale, both before and after the abandonment of the gold standard by France, Holland and Switzerland in September, were factors contributing to fluctuations in the exchange value of the pound. After the adoption of the tripartite monetary agreement, on 13th October, the pound moved within a range of 1.027 per cent in Canada, and .962 per cent in New York.

Stability in foreign exchanges is of great benefit to the world at large. The fact that the United Kingdom, the United States and France found it possible to enter into a working arrangement designed to promote stability is most encouraging.

TREASURY BILLS

During 1936 the amount of Dominion Government Treasury Bills outstanding was increased from $105 millions to $150 millions. The average tender rate during the year was .85 per cent for 90-day Bills. The rate ranged from 1.198 per cent on the offering of January 2, 1936, to a low of .643 per cent on September 15, 1936, and the last offering of the year was sold at a rate of .746 per cent.

I referred last year to the desirability of an active bill market, and expressed the hope that we should make some progress towards the establishment of such a market in this country, at least in so far as Dominion Government Treasury Bills were concerned. One must recognize, however, that the goal is a long way off. I feel it is quite likely that if money conditions ever become less easy than they have been in the last few years, Treasury Bills may be rather neglected, and that holders may tend to allow their Bills to run off through a desire to obtain additional cash. Such a development would call for the refunding of a suitable portion—perhaps a substantial portion—of the Bills now outstanding. The market would then be short of assets which can properly be classified as second line reserves. I think it is probable that experience over a period of years, and of a variety of conditions in the money market, will be necessary before we achieve a satisfactory bill market in Canada.

RELATIONS WITH PROVINCES

Perhaps it would not be out of place if I were to make some general remarks on the nature of the relationship which it is possible for us to have with provincial governments. In this connection, we start from the indication given to us by the Bank of Canada Act, which says that "The Bank shall act as fiscal agent of the Government of Canada without charge, and subject to the provisions of this Act, by agreement, may also act as banker or fiscal agent of the government of any province". As a central bank we must have the closest relations with the Dominion Government, but it is not essential, though it may be desirable, that we should also have somewhat similar relationships with provincial governments, and this distinction our Act recognizes. The primary function of any central bank is to control the volume of credit (and to some extent of currency) in the country, and this task it could not perform without close co-operation with the central government. It is possible for the Bank to carry out its main functions without the same kind of co-operation with provincial governments; nevertheless, co-operation between the Bank and such governments can, we believe, be helpful both to the individual governments concerned and to the country as a whole. The Bank feels that any such relationship should be entered into on the understanding that it would be of a continuing character, for without a close and continuous connection the Bank would not be able to acquire that full knowledge of a province's position which would enable it to give the province the best service of which it is capable in the matter of expert advice. Impartial advice the province can, we believe, count upon receiving from us; but that, like patriotism, is not enough.

If such a connection is established, the Bank can perform for a provincial government much the same kind of services as it undertakes for the Dominion Government.

It would not be necessary for the Bank to become the sole banker of the province: existing connections could remain undisturbed.

BUDGETS AND INDEBTEDNESS

A country such as Canada, which is highly dependent on export trade in food-stuffs and raw materials, is exposed to wide fluctuations in business, due to conditions beyond our control. When we are severely hit by a depression, it is idle to suggest that governmental budgets should be balanced. Theoretically, such a result might be achieved by a heavy increase in taxation. In fact, the imposition of additional taxation of this order would probably defeat its own object by intensifying the depression. I do not suggest that possible economies should ever be disregarded, but rather that substantial increases in debt are, in any event, inevitable during bad times. It follows that a reduction in debt during more prosperous periods is essential. If we, as a country, increase our debt materially during depression, but never decrease it during better times, the ultimate result is obvious. The test which we face is our ability not only to balance budgets, but to achieve surpluses for the purpose of debt reduction.

Our estimate of the increase in Dominion, provincial and municipal debt in the six years ended March 31st last—including guaranteed debt—is over $1,800 millions. When figures become so large they cease to convey very much to the average man, but they definitely suggest that we must expect high taxation and need economical administration for many years to come.

The character of governmental responsibilities has changed materially during the present century. The budgets of 25 years ago—whether they pertained to the Dominion or to provinces or to municipalities—contained no expenditures for old age pensions or mothers' allowances, and the charges for hospitals and public health were much smaller than the amounts required today. Still less was there any unemployment relief. These social expenditures arise from an altered conception of public needs and governmental responsibilities. This change imposes a necessity for financial administration of a high order if the burden is to be equitably distributed or, indeed, if it is to be borne at all. Our system of government has the rigidity common to all federal states. That it does not adapt itself readily to fundamental changes is sufficiently obvious not to require emphasis.

SECURITY MARKETS

The improvement in corporation earnings, both actual and prospective, has led to a very material rise in the price of Canadian securities. To the extent that these increased prices reflect the re-establishment of our industries on a profitable basis, the development is a welcome one. The growing volume of speculation, however, is not so satisfactory. While governments can and should give the maximum possible protection against fraudulent practices in the sale of securities, the decision as to what securities shall be purchased, and at what prices, rests with the individual. But the extent to which the individual obtains credit to enlarge his speculative activities is a matter of public interest and concern. I believe that it was a wise move on the part of the leading Canadian Stock Exchanges to raise margin requirements during 1936, and I feel sure that they will have the co-operation of other lenders if—as may well be the case —further increases become necessary.

BUSINESS RECOVERY

Developments in Canadian business during 1936 have been distinctly encouraging. A substantial enlargement of the volume of trade has been accompanied by a further recovery in commodity prices; moreover, the price relationship between farm products and raw materials on the one hand, and manufactured goods on the other, has come into better balance than at any time since 1929. The extent of the recovery is shown rather strikingly by comparing some 1936 figures with those of the low point of the depression. Such a comparison shows that the estimated volume of business has increased 41 per cent; national income, 41½ per cent; car loadings, 23 per cent; retail trade, 20 per cent; external trade, in value: exports, 96 per cent, imports, 58 per cent; and employment 24 per cent.

It should be noted that the benefits of recovery have not been evenly distributed throughout the country, because of drought conditions in the West; and that the construction industry has been a laggard. Improvements in western agricultural results and in building trade activity are greatly to be desired, not only for the direct effects which would be produced, but also as a means of further stimulating general employment, enlarging railroad revenues and reducing relief costs.

In volume, business in Canada in 1937 will probably exceed the 1926-29 average; in value it may come reasonably close to the figures of those pre-depression years. Because of the increase in working population since that time, we must hope to do a substantially larger volume of business than we have ever done before, in order to attain a satisfactory level of prosperity. I believe that goal will be reached. The banker is traditionally a pessimist, so that it may not be thought surprising if I express the belief that the permanency of the recovery is open to question, in view of the unsettled state of world affairs. If this fear is not attributable entirely to professional caution, it indicates the necessity for tackling some of our pressing problems while conditions are favourable.

STATISTICAL SUMMARY

As from the beginning of this year we have begun the publication of a monthly Statistical Summary, which is intended to help students of finance and economics by selecting some essential data from the statistics scattered through a number of other publications, adding other new material, and presenting the whole without comment in a convenient was one of the factors leading to an increase of $12.6 millions in the chartered banks' cash reserves.

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(Figures shown in millions of dollars)

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