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POST-WAR MONETARY POLICY

Statement by Mr. G.F. Towers, Governor of the Bank of Canada, at a hearing of the Standing Committee on Banking and Commerce of the House of Commons, March 18th, 1954, on Bill 297 amending the Bank of Canada Act.

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As background for any discussion of financial or economic policies in the post-war period, it is worth recalling some facts about the over-all production and price changes which took place in Canada during that time:-

(a) From 1946 to 1953 our total production of goods and services rose by about 32 per cent in physical volume.

(b) The price level rose less in Canada, relative to pre-war, than it did in the United States, and it rose considerably less in Canada than in most other countries.

Since there were virtually no idle resources in Canada during these years, an increase in monetary demand over what actually occurred would have resulted mainly in higher prices and only to a minor extent in increased production. On the other hand, it is probable that the rise in our price level could not have been held substantially below that which occurred in the United States without sacrificing an appreciable part of the increase in production which was achieved here. If this is so, then Canada came close to attaining the optimum combination of results, i.e. an increase in production close to the maximum physically possible, combined with an increase in our price level which was close to the minimum possible in view of the upward sweep of United States and world prices. This, however, is a matter on which each will have his own judgment, and I only mention here the facts about our production and price changes so as to establish some kind of a practical background against which monetary policy and its effects can be viewed.

To begin with, let me mention briefly the effects of the war on our financial structure and describe that structure as it stood on March 31, 1946,

the date which I am going to take as the starting point of the post-war period in the field of finance. I pick this date because it represents the commencement of the first fiscal year after the end of the war, and the year in which the budget came back into balance.

During the seven fiscal years 1940-46 inclusive, the Government had managed to cover approximately 57 per cent of its expenditures by current revenue. In the process it had collected in taxes an amount which, it was commonly thought, was fairly close to the maximum which could be obtained even in war-time without a serious adverse effect on the willingness to work. Nevertheless, the Government had budgetary deficits totalling more than $10,000 millions over the seven fiscal years under discussion. The counterpart of these tremendous deficits was, of course, equally vast sums of money flowing into the hands of the public. To the extent that these sums could not be recovered by borrowing from the public, borrowings from banks had to remain outstanding and constituted a net addition to the amount of money in the hands of the public. In view of the limitations on the supply of civilian goods and services which could be made available for sale during the war years, the inflationary possibilities of the situation were clearly very substantial. This was the reason why great efforts were made in Victory Loan campaigns to persuade people to buy and hold Victory Bonds during the war.

Despite strenuous attempts to finance the war by taxation and non-inflationary borrowing it became clear by the autumn of 1941 that these defences against inflation had to be supplemented by further measures if the gathering spiral of prices and costs was to be held in check. The Government introduced an overall price ceiling and wage control. At one time or another it instituted the rationing of a number of commodities, and in some cases it also used subsidies in order to enable maintenance of the price ceiling on certain goods. These controls taken together made it easier for people to save, and particularly in the case of rationing imposed

some degree of involuntary saving on the public. Added to what I am sure would have been a high level of voluntary and patriotic saving in any case, they brought personal saving up to the extraordinarily high level of 25 per cent of disposable personal income in the year 1944. This saving obviously had an important bearing on the amount of Victory Bonds which the public was able and willing to buy.

Over the whole period from March 31, 1939, to March 31, 1946, there was a great increase in the accumulated liquid savings of individuals and corporations, corresponding to the budgetary deficit which I have already mentioned plus the Government's non-budgetary cash requirements. The public's holdings of Government securities increased by more than $8,000 millions, to three and a half times their pre-war total, and the public's deposits at the chartered banks rose by $2,700 millions to more than double their pre-war level. The bank deposit component of the public's war-time saving had as its main counterpart the $2,500 million increase in the chartered banks' holdings of Government securities over this period. There was only a small net increase in bank loans.

During the war period and up to March 1946, consumer prices rose by about 20 per cent in Canada, and wholesale prices by about 40 per cent. This was generally felt to be a good record - certainly no other belligerent did better - but a situation had been built up, here and elsewhere, which made some post-war increase in prices inevitable. As a result of war-time deficits, which were even greater proportionately in the United States and in most other countries than they were in Canada, the public in all belligerent countries had accumulated extraordinarily large holdings of liquid assets, either in the form of money or Government bonds. As soon as the restraints imposed by patriotism were removed, the public in all these countries would want to use their liquid assets to buy things which they had gone without during the war, but which could not yet be available in the volumes desired. Particularly if price controls and various other controls were removed quickly an upward surge of prices and costs was certain to occur.

In the United States, by the spring of 1946, the early termination of price controls was being discussed and was clearly in prospect. In the event, the powers of OPA were allowed to expire on June 30, 1946, and although they were partially reinstated several weeks later, general price control was brought to an end in the United States about October. U.S. consumer prices increased by about 15 per cent and wholesale prices by about 25 per cent between June and December 1946, and by the latter part of 1948 were 30 and 50 per cent respectively above the June 1946 level.

It was clear that price increases in the United States could not fail to bring about a roughly comparable rise in the Canadian price level, with some lag, unless our exchange rate rose in relation to the U.S. dollar. Actually our exchange rate, which throughout the war had been at a discount of 9 per cent versus the U.S. dollar, was brought to parity at the beginning of July, 1946, and this helped to cushion the first impact on Canada of early decontrol in the United States. I do not believe that it would have been possible for us to receive further protection of this kind against the effect of rising external prices, by having the Canadian dollar stand at a really substantial premium over the U.S. dollar. On the other hand, while the rise in United States prices was bound to produce some price increase in Canada as in every other country, it did not in any way set an upper limit to that increase. The increase could have been much greater here than in the United States; this did in fact happen in many countries.

Although the most immediate source of upward pressure on Canadian prices came, therefore, from outside our boundaries and was largely beyond our powers to control or offset, the situation within Canada was also a matter for concern because it did contain some strong inflationary possibilities. As I have already mentioned, the Canadian public had greatly increased its holdings of liquid assets in the form of bank deposits and Government securities, which had risen from about $6,000 millions before the war to about $17,000 millions. Many of the

holders were keen to use these liquid assets over the next few years to buy things which they had not been able to get during the war. Individuals wanted to build houses or to buy cars, or to improve their household furnishings or clothing, for example. Industry in general wanted to move ahead as rapidly as possible with the capital development which it had forgone during the war and which has been such a prominent feature of our post-war economy. The desire to make such expenditures, backed by an amount of liquid assets nearly triple the pre-war level, contrasted with a level of Gross National Product which was slightly more than double pre-war. There was clearly danger that we might try to catch up on our deferred expenditures too quickly - that as price and wage controls gradually had to be removed and particularly as subsidies were terminated, our own actions might give added impetus to the upward push on our prices which originated in the United States.

However, as we faced the post-war period the threats to our economic stability were not all of an inflationary character. Canada had never been prosperous except when exports were high, and the Western European countries, whose markets are very important to our export industries, had suffered severe physical and economic damage from the war. The reconstruction loans which we had made to these countries would prevent any collapse of our exports to them, but were far from guaranteeing the high level of exports needed for our prosperity. By 1946 it was apparent that Russia was out to promote disruption and hold back reconstruction in Western Europe, but it was not realized then that Russian attitudes and actions would be so extreme as to produce effects on public psychology, and on military budgets, which would add to inflationary influences in the United States and elsewhere. Similarly, General Marshall's bold and unprecedented proposals for United States assistance to European recovery and the rebuilding of world trade were still veiled in the future. The level of exports which we were to achieve through the later forties

was not foreseen. It seemed possible that we might experience the paradoxical situation of serious unemployment arising from disruption of our export trade with overseas countries, at the same time that our price level was increasing sharply under the pressure of rising prices in the United States.

The factors in the outlook which I have mentioned - some inflationary and some deflationary - were not the only ones to be considered in deciding what policies the Bank of Canada should adopt in the post-war period. Weight - great weight - had to be given to the desirability of encouraging the most rapid possible transition to civilian activity of the one and three-quarter million people who would be leaving the Armed Forces or ceasing the production of war supplies. It was also essential that private capital development - reduced to a relatively low level during the war - should be expanded rapidly so as to increase our productive capacity. The more production could be increased, the better chance there was of avoiding inflationary price increases, as long as capital development did not proceed so rapidly as to create domestic inflationary pressures on its own account.

It had also to be borne in mind that, except within narrow limits, Canada could not in practice insulate herself from external price increases. As United States prices rose, Canadian prices would be pushed up first in import and export lines and then generally. This would automatically increase the legitimate working capital and bank credit requirements of business. To this extent, what appeared to be excess liquidity was required to finance business at the higher price level forced upon us by the rise in United States prices, and would be, so to speak, "mopped up".

With this background, let me turn now to the field of monetary policy. One possible course of action would have been to adopt the rigorous policy of preventing any increase in the volume of bank deposits held by the public during the early post-war years. Now, an increase in bank loans will cause a rise in bank deposits unless it is offset by

sales of Government bonds by the banks. In view of the prospective expansion of civilian business, and the effects of rising U.S. prices, there was certain to be need for a large increase in bank loans, and so the rigorous policy would have required large sales of Government securities by the chartered banks if the need for loans was to be met. The rigorous policy would also have involved the Bank of Canada in selling Government securities so as to reduce chartered bank cash reserves to the point where the chartered banks would have felt unable to increase their loans without liquidating security holdings. Following this policy would have caused a substantial rise in interest rates and a correspondingly substantial fall in the price of bonds, such as occurred after World War I. It would have tended to have the following effects:-

(a) It would have caused a very considerable degree of uncertainty among businessmen as to the basis on which they could carry out reconversion activities and plan capital expansion. This in itself would have hampered or delayed the absorption of Service men and women, war workers and war industry into peace-time activities, and would have caused an unnecessary degree of unemployment and disruption of business.

(b) The rise in bank loans would have been much less than that which actually took place. It would have been more difficult and expensive for business firms to build up their war-depleted inventories of civilian goods, or even to carry a depleted level of inventory at the higher current costs as U.S. prices rose. It would have been more difficult and expensive for business to carry the rising volume of receivables involved in the expansion of output.

(c)It would have been more difficult and expensive for provinces, municipalities and business concerns to borrow from the public by means of sale of securities. There would have been fewer bond

issues in the early post-war years and less expansion of hydro-electric capacity and other industrial plant and equipment, roads, schools, sewer and water facilities, and other forms of physical assets. Some essential projects would have been held back.

(d) Substantially lower prices for Government securities would have reduced the volume of selling of these bonds by individual and corporate holders - including insurance companies - in the early post-war years. To the extent that this selling was designed to provide funds for housing, or for the purchase of new issues of securities brought out by provinces, municipalities and corporations, some essential forms of capital development would again have been held back.

The rigorous monetary policy which I have been discussing would certainly have reduced the demand for labour and materials in Canada, but even this rigorous policy would not have insulated Canada from the effects of the upward sweep in world prices and in that sense would have been doomed to fail. The most which it could have done would have been to prevent a relatively small part of the rise in our price level which actually took place from 1946 to 1948, and if persisted in it might have helped to induce some perceptible fall in prices in 1949.

In fact, a rigorous monetary policy of the type described was not adopted. It was felt that the degree of possible benefit to our price and cost structure would not be commensurate with the damage done in hampering reconversion and holding back capital development.

I should add at this point that so far as I am aware no student of monetary affairs advocated the rigorous policy which I have described. Some have felt that a somewhat tougher policy than that which was actually followed would have been advantageous. However they usually do not define

specifically what is meant by a somewhat tougher policy, or spell out what difference they think it would have made in price levels, capital investment, employment and so forth. Their difficulty - and it is a real one - is in assessing how fierce a rearguard action against the effect of rising U.S. and world prices would have been required to produce a given and relatively small subtraction from the increase in the Canadian price level which actually occurred. For myself, I do not know how far - if at all - our price level would have been lower if a somewhat more restrictive policy had been pursued. What can be said is that, relative to its pre-war position, the price level is lower today in Canada than in any other country which was allied with us in World War II. This does not of course alter the fact that the rise in prices during this time has been very substantial.

Let me turn now to a description of monetary policy since the war. I shall preface my remarks by quoting from a statement made in the Bank of Canada's Annual Report issued in February 1944 immediately following a reduction in the Bank Rate. Having mentioned that the stage had now come when many were having to give thought to the economic problems which would arise after the war, the Report went on to say:-

> "One factor which will affect decisions is the prospective cost of borrowing. It therefore seems appropriate that the Bank should, by reducing its Rate, signify its intention to continue the kind of monetary policy which has brought about the current level of interest rates. A policy aimed at higher interest rates would only become intelligible if, after war shortages are over, consumers' expenditure and capital development were to proceed at a rate which would overstrain our productive capacity. I see no prospect of such a situation arising in a form which would call for a policy of rising interest rates.
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> "Admittedly, the rate of interest is only one of many factors influencing Canada's economic position, and it is probably not as

important an instrument of control as was once supposed. It remains true, however, that the prospect of unstable interest rates could make it exceedingly difficult for business to formulate long-term plans. Moreover, high borrowing costs would hamper new investment in plant, equipment and housing, would restrict the expansion of employment, and would seriously complicate the task of government financing."

Two things lay behind that statement:- First, our concern with business difficulties in the period of transition from war to peace, and secondly the rather widespread fears, which commenced to become apparent in 1944, that shortly after the conclusion of war and the completion of war financing bond prices would collapse as they had after the First World War. We felt it necessary to give a firm indication that chaotic conditions would not be allowed to develop. I would be the first to admit that there is much to be said against a central bank giving indications of policy so far in advance. At the time, it appeared to us that it was even riskier not to give such advance indication - hence the statement which I have just quoted.

In the event, the shift from war to peace in the economic field took place quickly and smoothly, with a minimum of unemployment. The relative magnitude of the shift was much greater than in 1919-20, and was accomplished much more satisfactorily. Looking back on those years, one might feel there had been too much concern about the problems of transition. In my opinion, however, it would have been wrong for people in positions of responsibility to have taken a complacent or cocksure view of the outlook. I believe that the various moves which were made, both in the domestic and international fields, to facilitate the transition contributed materially to the relative smoothness with which it took place.

From 1946 to 1949, the Bank of Canada directed its efforts to keeping chartered bank cash reserves from rising and restraining the use

of bank credit, without at the same time producing really unsettled conditions in the bond market. It must be said at once that under certain circumstances these two aims were a pair of horses which could not be driven in double harness. Concern with reasonable stability of bond prices and interest rates tended to have priority. This did not prevent a downward movement in long-term Government bond prices in 1948 of about 4 points, and a rise in yields of about .35 per cent.

Chartered bank cash reserves, which averaged $672 millions in 1946 and $670 millions in the following year, rose to $711 millions in 1948. The comparative steadiness of the absolute amount of these reserves in the 1946-48 period did not, however, prevent bank loans and deposits from increasing by $700 millions and $1,100 millions respectively during that time. The ratio of reserves to deposits had been comparatively high in 1946, averaging 11.4 per cent in that year, and was down to 10.4 per cent at the end of 1948. Over this period the banks reduced their holdings of Government securities by more than $300 millions.

During the post-war years the chartered banks made considerable purchases of provincial, municipal and corporate bonds. Their purchases of corporate securities were particularly large in 1947, and in that year there were also signs that some businesses were using bank credit to finance capital expenditure. By the beginning of 1948 it was apparent that businesses intended to make even larger capital expenditures than in the preceding year and that this would involve undue pressure on available labour and material resources. Accordingly, in February 1948,

the Bank of Canada suggested to the chartered banks that under existing conditions it was undesirable for capital expenditures to be financed through expansion of bank credit. We suggested that it would be preferable for borrowers to obtain such funds by the sale of securities to the public, except in the case of those borrowers, mainly small concerns, for whom a public issue would not be an appropriate means of financing. This suggestion, which had a marked restrictive effect on the extension of bank credit while it was being followed, was withdrawn in February 1949 when it became apparent that some decline in the physical volume of business capital outlays was in prospect.

By 1949, it seemed that post-war inflationary pressures had come to an end. It is true that business activity in the United States, after a perceptible drop in 1949, picked up well in the first half of the following year. I am convinced, however, that serious inflationary pressures would not have returned to plague us had it not been for developments associated with the outbreak of hostilities in Korea. In 1949 the chartered banks' average cash reserves increased to $746 millions, and the banks were net buyers of Government securities.

I turn now to the period since June 1950. The events associated with the commencement of the fighting in Korea made it certain that fresh inflationary pressures would develop. It seemed proper to assume that the cold war would be of long duration. In these circumstances, it appeared to be unwise to rely on direct controls to combat inflation because such controls are likely to be unworkable, or at best short-lived, except in times of all-out war.

In the monetary field in Canada, the first complication arose from a tremendous influx of capital, mainly from the United States, based on a view that our exchange rate was too low and would be raised. This capital inflow is estimated to have been some $700 millions between early July and early October. Under the regime of the fixed exchange rate, the Government was obligated to buy all U.S. dollars offered to it at the established rate, and our reserves of gold and U.S. dollars rose by about

the same amount of $700 millions in this three month period. The Government ran out of funds with which to finance these purchases, and the Bank of Canada stepped into the picture by financing the Exchange Fund to the tune of $393 millions during August, September and early October. To avoid a consequential increase of a very large amount in the chartered banks' cash reserves, the Bank of Canada sold Government securities in the market, to the extent of a net $337 millions over this period. I should imagine that in relation to the size of the Canadian economy, and the period of time involved, this was the largest open market operation in central banking history. It counteracted the effect of the capital inflow on the banks' cash reserves but it could not in itself stop the inflow, and indeed by causing Government bond prices to be lower than they would otherwise have been, it made Canadian bonds more attractive to external investors. As the inflow showed no signs of abating but rather of increasing, the Government decided to let the exchange rate go free as of October 2nd. The speculative inflow of capital stopped at once and the Bank of Canada was then in a position to take steps to get the money market in better control.

In the face of the rapidly rising demand for bank credit, and indeed for funds from all sources, our objective was not to prevent any increase whatever in bank loans or to make security issues impossible, which would have spelled strangulation of business. Our objective was to induce restraint.

I should mention at this point that by the end of 1950 we had a distinctly better chance than in the earlier post-war years of exerting a restraining influence without having to go to extremes in policy. While the banks were still in a very liquid position, their holdings of Government of Canada securities represented some 36 per cent of their Canadian assets as compared with 53 per cent in March, 1946. Insurance company holdings of Governments were down to about 30 per cent of their Canadian assets compared with 55 per cent at the earlier date. And the general public's holdings of marketable Government of Canada bonds had been reduced by

$1,800 millions, i.e. from an estimated total of $10,600 millions to $8,800 millions. Government surpluses, used to retire debt, had clearly played a vital part in the process of reducing excess liquidity in the economy. So had the growth of the economy, and the rise in prices. Total public holdings of Government securities and bank deposits, measured in relation to Gross National Product, were appreciably less than they had been in 1939, and were only two-thirds as great as in 1946.

In order to mark the change in approach which became practicable after Canada went on a flexible exchange rate at the beginning of October 1950, the Bank raised its discount rate from $1\frac{1}{2}$ per cent to 2 per cent effective October 17th, and issued the following statement:-

> "At the time the reduction in Bank Rate took place in 1944, the Bank expressed the view that it did not then see any prospect of an economic situation in the post-war period of a character which would call for a policy of raising interest rates. The change to a 2 per cent Bank Rate is an indication that the earlier view no longer holds good under today's conditions when Canada faces the prospect of substantially increased defence expenditures adding to the pressure on the country's resources at a time of virtually full employment."

The banks found it necessary to sell Government securities in order to meet the rising demand for loans. Life insurance companies and other lending institutions, faced with increasing demands for capital funds, were also heavy sellers of Government securities. This involved falling prices and increasing yields in the bond market. As we passed the end of 1950, evidences of an inflationary psychology multiplied and bank loans were continuing to increase rapidly. Some type of direct holding action seemed necessary as a temporary supplement to the normal measures of restraint which were open to us. We therefore approached the chartered banks at

the beginning of 1951 and asked them to co-operate in a policy of keeping down bank credit.

A central bank, not being gifted with divine powers, is never in a position to name the ideal amount of bank credit which should be outstanding at any given time. But when the increase is fast and furious, that is a clear indication that moderating pressures should be exercised if it is practicable to do so. I believe the co-operative arrangement with the banks made a distinct contribution to stability. After the arrangement was made in February 1951, the rise in the banks' total of Canadian loans and holdings of provincial, municipal and corporate securities tapered off, and by early 1952 the total had been brought back below the February 1951 level.

Government regulation of instalment finance was an important factor in bringing the total bank credit situation under control. In addition, in March 1951 the U.S. authorities abandoned their policy of pegging Government bond prices at par and there was an appreciable decline of bond prices in that country and in Canada. This had the effect of reinforcing the chartered banks' policies of credit restraint and tightening conditions in the capital market generally.

By the spring of 1952 some considerable reduction in the intensity of inflationary pressures was apparent and we felt it was possible to bring the special arrangements with the banks to an end in May of that year, leaving normal methods of central bank action to influence the total level of bank credit.

For some months following May, 1952, the increase in bank loans was relatively small. While one cannot be too precise about dates, and seasonal factors are a complication, I think it is correct to say that the most recent heavy upward movement in Canadian loans got under way about July or August of 1952 and, with some seasonal fluctuations, continued until about October of last year. During this period the banks found themselves under the necessity of reducing their portfolios of

Government securities by more than $200 millions in an effort to secure additional cash and to make room for at least part of the increase of some $700 millions in their loans. Their selling of Governments had its effect on bond prices and interest rates, particularly in the shorter maturities. Thus the Government of Canada two-year bond yield rose from 2.86 per cent in August, 1952, to 3.36 per cent a year later. On five-year bonds the rise was from 3.41 per cent to 3.64 per cent, with somewhat smaller increases in yields on longer term bonds which were under less pressure than the short term issues.

The Bank of Canada was not a willing buyer of securities during this period. We felt that it was desirable that banks should tend to be reluctant lenders and should scrutinize applications with increasing care. But the Bank of Canada has never carried its reluctance in such circumstances to the point of refusing to buy Government securities at any price. In the period between the end of August 1952 and August 1953 our holdings of Government securities increased by $88 millions, and the chartered banks' cash reserves rose by $53 millions. Because of the increase in Canadian deposits during this period, the rise in cash did not suffice to maintain the chartered banks' cash ratio. In August 1952 it had been 10.3 per cent and by August 1953 the ratio had fallen to 10.1 per cent.

With some indication in recent months of a slowing down in credit expansion and abatement of inflationary pressures, the banks have moved into an easier position. Since October they have added appreciably to their holdings of Government securities, whereas they had been net sellers over this period a year ago. Interest rates on Government bonds have declined - based on mid-month quotations the typical two-year rate has fallen from 3.36 per cent in August 1953 to 2.47 per cent in March of this year, and the five-year rate from 3.64 per cent to 3.16 per cent. Indeed the whole Government bond market has moved up, with fifteen-year securities on a 3.27 per cent yield basis in March as compared with the peak of 3.75 per cent in September 1953. There has been a similar and somewhat sharper reduction.

of yields in the United States market, where the upward movement of yields in the earlier part of last year had also been greater.

Before concluding my remarks, I think it might be appropriate to say something about the Government securities market in Canada. If a central bank is to be able effectively to perform its functions of regulating the amount of the commercial banks' cash reserves and in this way to exercise an influence on the whole credit structure and level of interest rates in the country, it badly needs a broad market in Government securities in which to conduct its operations. Now I may say that the majority of the world's central banks operate in countries where there is not a broad market for Government securities. They try to make their policies effective in other ways, perhaps by the purchase and sale of gold or foreign exchange or by special devices suited to local conditions, but they inevitably operate under a handicap. The last thirty years has witnessed the creation of a great many central banks - no country wants to be without one. But it is much easier to draft the legislation for setting up a central institution than it is to create the financial structure which assists or enables the bank to do an effective job.

When the Royal Commission headed by Lord MacMillan was framing its recommendations for the creation of the Bank of Canada, it noted the fact that the new central bank would be somewhat handicapped by lack of a "money market" in Canada. At the time the Bank commenced operations the short-term market, outside the banks, was almost non-existent, and while there was a reasonably good market for middle and longer-term Government issues it was frequently difficult to trade in substantial amounts.

One of our first steps taken in co-operation with the Government was to institute a fortnightly issue of Treasury Bills sold by tender.

A few Treasury Bill issues had been made in pre-Bank of Canada days, but they were not a permanent feature of our financial structure. Moreover, as there was, practically speaking, no market for Bills outside the commercial banks, they were not highly liquid and carried relatively high interest rates.

While the Bank of Canada has never taken a commitment to purchase Treasury Bills at all times, we have never yet refused to buy. The Treasury Bill has become recognized as the most readily saleable obligation on the market, and as such has commanded a relatively low rate of interest. It has become the practice of the chartered banks to hold Bills as a form of second line cash reserve. The amount which individual banks hold naturally varies substantially, going down if a bank's cash requirements increase and rising if they have surplus funds available for very short term investment. While holdings of Bills outside the banking system have at times been fairly sizeable, a large non-banking market has not developed.

We have endeavoured in various ways to facilitate and encourage the growth of an outside market. A year ago the issue of Treasury Bills was changed from a fortnightly to a weekly basis, and the weekly offering was broadened to include 273-day Bills as well as the 91-day Bills which had been customary up to that time. There are now 39 Treasury Bill maturities outstanding at all times, making it possible for an investor to obtain Bills maturing in any given week within the next nine months. In its market purchases and sales of Treasury Bills during the past several years the Bank of Canada has progressively widened the spread between its buying and selling levels to create further incentive for the development of jobbing intermediaries. We have also made arrangements which enable dealers to avoid transit costs or interest charges in transferring Treasury Bills between Bank of Canada agency points. We believe that a

broader interest in Treasury Bills has been and is developing in this country as our financial resources increase and more people find it advantageous to make use of this medium for very short term investment.

Growth of the market for short term Government of Canada bonds - say those up to two or three years maturity - has so far been more impressive than developments in the Treasury Bill market. As I have already mentioned, in 1935 there was practically no market for short-term securities outside the banks. But at the present time, these securities are actively traded in by other buyers and sellers, and are held in large amounts by those requiring short term and highly liquid employment for surplus funds. Provinces and municipalities, as well as corporations, are important factors in the market. As an indication of the size of the holdings of non-banking investors other than Government accounts, I may say that at June 30th last their holdings of Government securities maturing within two years were estimated to be about $800 millions. In order to encourage the development of a jobbing interest in such securities, we have in the past year instituted purchase and resale agreements in respect of Government securities with a term of up to five years, with dealers who play a jobbing role in this area of the market.

As part of our programme to improve and broaden the money market for the benefit of lenders and borrowers and of our financial structure as a whole, the Bank of Canada has been a constant trader in Government of Canada securities since we opened our doors in 1935. While the total amount of our holdings of Government securities is necessarily determined by considerations of monetary policy, we have endeavoured to help make a market for all Government issues and have been very substantial buyers and sellers. In a sense, we perform a jobbing function, holding the inventories which are indispensable to a good market. Investment dealers and banks also operate in this way, although naturally on a smaller scale. We would be glad to see both dealers and

banks extend their operations of this character, and have the Bank of Canada play a smaller part, although we would always expect to be a substantial participant in the market.

While the development of an effective "money market" - and I put those words in quotes - might appear to be rather a technical affair primarily affecting the banking system, it is in reality a matter of much wider importance. A broad and responsive market in Government of Canada securities, and the existence of the machinery which makes such a market possible, helps to develop a better market for other securities and to channel funds where they are most needed for the development of the country. The rate of capital investment which will be required to provide for Canada's growth is so great that we need to encourage the most efficient use of our domestic savings in every way we can.