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REMARKS BY
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TO THE ANNUAL CONVENTION OF THE
INVESTMENT DEALERS' ASSOCIATION OF CANADA
QUEBEC CITY, JUNE 11, 1973

Remarks by Gerald K. Bouey, Governor, Bank of Canada
to the Annual Convention of the
Investment Dealers Association of Canada
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I am very pleased to have the opportunity of speaking to a group of investment dealers from across Canada quite soon after my appointment as Governor. The occasion is particularly pleasant because your invitation brings me to one of my favourite cities, Quebec, if only very briefly. I should very much like to stay here with you and to join in your discussions, but unfortunately I am not able to do so.

I plan to use much of my time today to speak of the way in which monetary policy is developing. Before taking up that topic, however, I would like to compliment M. Charron and Mr. Kniewasser on the organization of this Convention and on the choice of the future of your industry as its general theme. We in the central bank need good financial markets in which to implement monetary policy and perform our role in the management of the Government's debt. More generally the country needs a healthy capital market in order that savings can be channelled efficiently into the investment that is required to sustain vigorous economic growth. Your role in the development of such a capital market is vital.

You will be examining the future of your industry. The pace of change is such that I am sure you will not lack for topics. It is a bit startling to look back over even a relatively short span of years and take stock of the changes that have taken place in Canadian capital markets. Your own business has become a great deal more varied and complex than it was, as new activities have been added to your basic function in the markets for equities and longer-term debt. Foremost among such developments, one thinks of the money market. From a modest beginning, nurtured by the Bank of Canada, it has grown to occupy a place of great importance in the financial system. Some twenty years ago Government of Canada short-term bonds and Treasury Bills were the principal instruments available to that market. Now there is in addition a great array of provincial and municipal notes and bills, bankers' acceptances, chartered bank bearer notes, corporate and finance paper and an expanding supply of short-term bonds. And with this growth has come the development of many new techniques of inventory financing -- day loans, special call loans, buy-backs, off-street loans, and so on. There is no need for me to remind a group of investment dealers of the degree to which your industry has contributed to these developments, or of the extent to which the healthy and efficient operation of the money market depends on your skill and vigilance.

The extraordinary growth of links between national financial markets has provided another dimension to developments in Canada. International capital flows are nothing new for Canadians and certainly the arrangement of international investments is not a new activity for investment dealers. The growth of international markets has, however, opened up opportunities on a new scale. At the same time it must be admitted that international business can involve new risks for the participants and that it has added at times to difficulties in managing our affairs.

There have been striking changes also in other parts of the financial system. Most dramatic, perhaps, are those affecting the position of individuals and households. The growth of Canada Savings Bonds, to which the sales efforts of investment dealers have contributed greatly, is only one example of the enlargement of investment opportunities now offered individual Canadians compared to what was available in earlier years. There is now a much wider choice of deposit instruments at banks, trust and loan companies, caisses populaires and credit unions. One thinks also of mutual funds, of new types of insurance and annuity contracts and of the spread of private and public pension arrangements.

On the other side of their balance sheets, individual Canadians as borrowers also have more options open to them. Twenty-five years ago the consumer credit business was still in its infancy. Since then as more lenders have entered the business, the spread of the new lending techniques has enormously widened the access of consumers to credit. There has been a revolution of comparable importance in the market for residential mortgages. Among the major steps have been the spread of regularly amortized mortgages, the entry of government agencies as mortgage lenders and the provision of mortgage insurance, first by C.M.H.C. and more recently by private insurers. As a result of these changes there has been a significant widening of access to mortgage funds.

A full account of the new features of our financial system would take a long time. Private financial institutions have grown in number and in the variety of their borrowing and lending activities. Deposit insurance through government agencies affords protection for the public over and above that provided by careful supervision and inspection. In addition to the private institutions, we now also have a considerable range of governmental bodies contributing in their various ways to the financing of such sectors as housing, small businesses, and farming -- areas where it has been felt that governments could usefully complement the work of private institutions and markets.

In this context I want to make special mention of the Industrial Development Bank, which as you know is a subsidiary of the Bank of Canada. It is perhaps not generally recognized how rapidly the I.D.B. has expanded its operations in seeking to help the development of small and medium-sized business in all parts of the country. Its loan approvals have more than doubled over the past five years as have its total assets -- to almost $700 million -- and the number of its branches has increased from 28 to 48. The I.D.B. is now a large de-centralized financial institution, equipped with a highly qualified staff who operate in a business-like way in the specialized area of term financing.

The developments of recent years have brought new challenges for investment dealers. The industry has responded by developing greater expertise, expanded research facilities, more efficient administrative techniques. Changing circumstances have called for consideration of such questions as the optimum size of firms and their capitalization, foreign ownership, fee structures, and regulation both by government bodies and by the industry itself. And of course the challenges are not likely to be less than they have been. For example, major energy and natural resource investments will call for skilful and imaginative financing. To take only one other foreseeable development, the computer is bound to have a major impact not only on the payments system but on the financial system generally. In this regard, I am impressed by what I have heard about the progress your industry, in co-operation with others, is making towards the development of a central depository system for securities.

These will no doubt be among the topics you will be covering and I wish you well in your discussions.

The changes of recent years have affected our business in the central bank as well as yours as private participants in financial markets. However, just as the essentials of your job remain the same, so do the essentials of ours. You try to bring savers and investors together as efficiently as you can. Our job is to regulate the pace of monetary and credit expansion in Canada in such a way as to help the economy achieve and maintain vigorous growth and high levels of employment. This means avoiding, insofar as possible, the waste of high unemployment on the one hand and the strains of worsening inflation on the other. It will come as no surprise to you that this is more easily said than done. There are a few things I'd like to say about the monetary policy we have followed in the changing economic circumstances of recent months.

At the beginning of the 1970s monetary policy in Canada faced a task which could be thought of as comprising two stages. The first stage of the task would be to help get the economy expanding rapidly enough for long enough to carry it back up to relatively high levels of employment and capacity utilization. Once this objective was in sight, the task would change to one of helping steer the economy onto a sustainable expansion path without inflationary over-heating, and keeping it on this path of high employment growth.

Thus in 1971 and 1972 the monetary policy followed in Canada was strongly expansionary. Its main objective was to help stimulate the unusually rapid gains in spending, output and jobs needed to bring the economy back up to more satisfactory operating levels as soon as possible. The chartered banks were provided with sufficient growth in their cash reserves to enable them not only to accommodate all normal credit demands without significant strain, but also to conduct an aggressive search for additional lending opportunities.

As a result the supply of bank credit in the form of loans, mortgages and similar investments registered substantial increases of 21 per cent in 1971 and a further 23 per cent in 1972. Although the banks were not able to add commensurately to their holdings of liquid assets from mid-1971 onwards, their overall asset growth nevertheless amounted to 19 per cent in 1971 and 15 per cent in 1972. In total, private holdings of currency and chartered bank deposits registered increases of much the same order of magnitude during this period.

For a time the response of the economy to this rapid growth in money and credit and to the expansionary measures introduced by the Government was less vigorous and clear-cut than one would have liked. As recently as the third quarter of last year, there were signs of at least temporary hesitancy in the pace of expansion, and the absence of any significant downtrend in the unemployment statistics was particularly disappointing.

Since the autumn of last year, however, the tempo of economic activity in Canada has picked up dramatically. Whatever lingering doubts there may have been about the underlying strength of the current expansion have been dispelled by the impressive economic advance since last fall. The extraordinarily rapid rates of increase in output that occurred in the fourth and first quarters were in part a catching-up after the strike dislocations which plagued the economy earlier. But if one compares the current level of major economic indicators with their levels a year ago, the record is still a remarkable one. Let me give you a few of the numbers. (These comparisons are based on the increase over the year to the most recent three-month period available.) The Gross National Product has risen by 13 1/2 per cent in value and by 8 per cent in volume. Industrial production is up by 9 1/2 per cent. These increases are in fact as large or slightly larger than the impressive gains recorded by similar measures in the United States over the same period. Among the major sources of demand, total consumer spending has increased by 13 per cent with spending on durable goods up by 22 per cent. Both our exports and our imports have increased by nearly 25 per cent. The strong gains in demand over the past year have also had a substantial impact on employment, which in February, March and April was almost 5 per cent higher than a year earlier. Moreover, the gains in employment over the past year have been substantial in all parts of the country, with the largest occurring in the Atlantic provinces and here in Quebec, where the increases were 6.3 and 5.2 per cent respectively. While the very strong demand for labour has been accompanied by an exceptional growth of the labour force, it has finally brought a significant reduction in the national unemployment rate -- from 6.9 per cent in September to 5.5 per cent in March and 5.4 per cent in April. This is a most welcome development.

The recent acceleration of activity in Canada has brought us a good deal closer to the effective capacity limits of the economy than we have been for some time. While the overall unemployment rate is just below 5 1/2 per cent, the rate for men 25 and older has come down to 4 per cent, only about 1/2 of 1 per cent higher than the level for this group in the mid-1960s. Indeed there is already evidence of distinctly tight conditions emerging in the labour market for experienced workers in various regions of Canada. Moreover, order backlogs have increased and delivery dates lengthened in the case of a number of important basic materials, such as lumber, cement and certain steels, chemicals and paper products, as output in these industries nears capacity. I am well aware that the situation in both labour and product markets is by no means uniform across the country, and in assessing the situation we must continue to bear in mind regional disparities.

To date most of the increased price pressures that we have been seeing can be attributed to developments in international markets, where there has been an almost unprecedented rise in the prices of many basic foodstuffs and other primary commodities. We need to be alert, however, to the risk of adding to these externally generated pressures by allowing domestic demand to move up so rapidly that we become faced with generalized strains on our productive capacity.

The rate of growth in real GNP during the two quarters ending 1Q 1973 was close to 12 per cent a year on the basis of the preliminary estimates now available -- more than double the 5 - 5 1/2 per cent a year that is generally regarded as the maximum growth rate sustainable over the longer term in this country. It is true that a number of measures of economic activity such as automobile sales, housing starts and inventory accumulation appear to have reached such high levels that some pause in their upward climb seems very likely. Nevertheless, such forward-looking indicators as the survey of investment intentions and new orders for manufactured goods suggest that we can expect further strong growth in output and employment.

In the United States the economic expansion is also well advanced. By the early months of 1973 the rise in employment had brought the total unemployment rate down to 5 per cent and the rate for adult men in the labour force down to about 3.4 per cent. The recent emphasis in U.S. economic policy has reflected concern that the expansion is proceeding too rapidly and that the stage has been reached where further increases in demand at the same rate would add to inflationary pressures in product and labour markets and make it more difficult to avoid a subsequent letdown.

It has become popular in the United States to speak of the problem facing that economy as one of "re-entry". There is widespread recognition that the problem now is to moderate the pace of expansion so that the economy can grow at the rate needed to maintain high levels of activity and employment. An economy growing much more rapidly than its long-run potential growth rate must slow down sooner or later. The important question is how smooth this adjustment will be in terms of output, employment and prices. Needless to say the Canadian economic situation will be greatly affected by the outcome in the United States.

In the area of monetary policy, the Federal Reserve System has taken steps to slow down an extremely rapid rate of bank credit expansion. Since the beginning of this year Federal Reserve discount rates have risen in five steps from 4 1/2 per cent to 6 1/2 per cent. Other short-term interest rates in the United States have also risen sharply. The prime lending rates of the commercial banks are now generally at a nominal level of 7 1/2 per cent, which implies an effective level of about 8 1/2 per cent after taking account of the widespread practice of requiring compensatory balances.

Against this economic background we have been concerned about certain features of recent financial developments in Canada. So far this year bank loans have risen at an annual rate of almost 30 per cent, a distinct acceleration compared to the already rapid increase of 22 per cent in 1972. A 30 per cent rate of increase in bank loans is considerably higher than is needed to help finance continuing sustainable growth of the economy. If allowed to continue unchecked such rapid loan growth, and the associated rapid growth of money holdings in Canada, would pose a serious risk of adding to inflationary pressures and of reducing the chances of future stability of the economy. Some moderation is clearly needed.

The Bank of Canada has conducted its operations in such a way that the extraordinarily rapid expansion of bank loans this year has had to be financed in part by a reduction in bank liquidity in order to prevent it from being fully reflected in the rate of monetary expansion. In the circumstances the unusual strength of credit demands in Canada together with the relatively high and rising level of short-term interest rates in the United States have tended to push interest rates in Canada upward, particularly short-term rates including bank deposit and lending rates. Although the Bank of Canada has acted to temper the pressures in financial markets, it has been necessary to permit an upward movement of interest rates in order to exercise reasonable control over the monetary situation. The Bank of Canada raised its own lending rate by 1/2 per cent on April 9 and May 14 and by a further 1/2 per cent effective today.

In connection with these steps to bring about some moderation in the overall growth of chartered bank lending, the banks have given assurances that they will, in accordance with their normal policies, continue to pay particular attention to the needs of small businesses which do not have easy access to other credit sources and to applications for credit in the slower growth regions of the country. The banks have also been asked to resist unusual requests for funds from foreign corporations or foreign subsidiaries in Canada in order to give priority to requests by their Canadian customers for funds to be used for Canadian purposes.

A moderation of the growth of the banking system can be achieved while still leaving ample scope for rates of credit and monetary growth fully adequate to sustain the economic expansion. There is, I find, a common tendency to try to describe monetary policy with a vocabulary of only two words -- "tight" and "easy". This is not very illuminating. What we want to bring about is a moderation of the recent extraordinary rates of bank credit expansion. We want to do this in order to lessen the risk that excessive demand pressures will develop in the months ahead.

The underlying objective is to increase the prospect of maintaining the high levels of employment and output that now seem to be within our grasp.