The Canadian Life Insurance
Officers Association

INFORMAL REMARKS
of Mr. J. E. Coyne, Governor, Bank of Canada to Annual Meeting of The Canadian Life Insurance Officers Association, on May 29, 1956

Mr. Chairman, thank you very much for those kind words. You haven't yet told me, though, what I am to talk about. I have come here, I'm afraid, absolutely unrehearsed and unprepared, unpremeditated, and since the time when Mr. Gill got me out of bed on Sunday morning I really haven't been in a position to do any homework. Any that I did was under the command of an even higher authority than The Canadian Life Insurance Officers Association, namely the Banking and Commerce Committee of the House of Commons.

I have come here with nothing except a small "scripture" without any cover on it, called the Annual Report of the Bank of Canada for the year 1955, which contains our review of major developments in the monetary sphere certainly, the general financial field in Canada last year. It's a very good report, largely written by people other than myself, and I am sure everybody here has read it very carefully, looking between the lines for all those special meanings which at least twelve of us take great care to censor out of it.

There has been of course a fair amount of talk, and that is a good thing, about monetary policy over the past twelve months or more, much more talk, much more study, much more intelligent commentary as well as some of the other kind than we used to have in this country. I think we

have always suffered from a lack of sufficient study and informed opinion and controversy in this field in Canada, unlike the situation to the south where any number of shades of opinion on monetary matters are being expressed on any given day of the week. It makes for a very interesting and lively time for central bankers in the United States.

Of course we are a young central bank, and while the bank itself is twenty-one years old and a few months, the Canadian financial situation in? -- the environment in which the bank must operate -- is fairly young, too, and in some respects has only developed over the past few years, certainly during the post-war period. This has been particularly true of the most technical of all parts of the financial mechanism, the short term money market which was the object of Mr. Towers and the Bank of Canada from the beginning to help in developing. Certainly it was the hope of the bank that it would develop because of the useful part it can play not only in the whole investment process within the community in smoothing out the flow of funds, but in creating a field in which central bank action can be applied or its influence felt in as moderate and smooth and continuously-adjusting a manner as possible. I don't think anybody today would feel that the important part(?) of the central bank's operations is making changes in its discount rate once every two or three years or in times of major changes in the business cycle. To wait that long, if that was your only instrument, you might find that things had gone too far before you dared to use that instrument, and also things would be happening that might have been amenable to the influence to a more moderate

degree by other actions which could be taken.

Certainly we feel that open market operations of the central bank are the proper field of its operations from day to day. We are engaged in operations of that kind. Sometimes (sounds like - I've run out of initiative but buyers) usually respond to market conditions every business day of the year. We did find that by the time the spring of 1955 had come around and the recession of 1954 had begun to run its course, that money market developments, particularly the last step that was taken (I think it was in July of 1954) when the chartered banks began to make everyday loans to certain specified dealers in short term securities, the time had then come when the use of our discount rate should be made perhaps just a little more similar to the use made of it in the United States, and that it should be brought into line with short term interest rates generally, and adjusted as frequently as changes might occur in the short term field so that it would remain in some sort of relationship to short term interest rates.

It cannot be a fixed relationship. We could not say, for instance, that it would always be ¼% or ½% different from the Treasury bill rate but it has to bear some reasonable relationship to it. This is particularly important when other short term rates are rising, because if your central bank discount rate as it is sometimes called remains too low, you will have great demands upon the central bank for money to be supplied at that rate, which could have very inflationary consequences if it were not resisted.

On the other hand, we want the rate itself to be used, we want the means of access to the central bank to be available at a

price, so we want our own interest rate or discount rate to be a little higher than the lowest short term interest rates in the market, and to move up (and at times down) as market conditions change. That putting of the bank rate into commission in February of 1955 was in many ways the beginning of a new era for us. We even went to the length of getting out a public statement at the time explaining the significance of it, and explaining that we expected changes in bank rate to be more frequent from then on. That indeed did happen during 1955. I won't bore you with details of the history of the affair.

During 1955, too, there was an amazing recovery really from the recession -- a very fast recovery, certainly, after the end of the year. This manifested itself first in interest rates, as one would expect. Indeed interest rates began to rise . . .   Treasury Board rates three days before we took the bank rate down from 2% to 1½% in order to get closer to the market, and other interest rates began to rise shortly thereafter and increased rather more rapidly in the second half of the year. Adjustments to this changing situation were fairly smooth but we found two difficulties from the point of view of the central bank in the response of the chartered banks and the markets generally to such actions as the central bank felt it could take in the circumstances.

Those of you who arefamiliar with the . . . know that a very large amount of term loans were overtaken by the chartered banks which took large companies out of the securities markets and relieved the securities

markets of the impact of the rising demand for money to a large extent, and similarly that the chartered banks, perhaps some of them not realizing that this expansion of the demand for non-control to a large extent was fluid, allowed their liquid assets to run down (?) towards the latter part of the year and subsequently at our suggestion agreed to adopt the standard practice of adapting . . . to gain.

But for those two developments, which ended up with agreement of the banks and the Bank of Canada, there would not have been too much trouble in the year 1955, and we at no time suggested that we were faced with imminent inflation. We did say, however, and I suppose everybody agrees, that the remarkable case of recovery made it evident at the end of the year that there were inflationary pressures present, that there were gathering strikes, and that after one reached a condition of full employment this growing demand for money would continue to mount to be fully satisfied without actually giving rise to inflation.

When the developments in 1955 were reinforced by statistical summaries of intentions with regard to capital investment in 1956, the picture became even clearer. You will recall that in the United States the McGraw-Hill Forecast of investment intentions for 1956 was first issued in October of last year and forecast a rise of 13% which was quite substantial. Later the Department of Commerce forecast a rise of 22%, and just the other day McGraw-Hill came out with their revised figure now showing the increase in capital investment, private business

capital investment, in the United States would be 30% over last year. At the time the Department of Commerce estimate of 22% was made, similar figures could be drawn from our official figures here, comparative figures. Our official figures forecast an increase of 21% for all types of capital investment, not just private business. The private business element of that were intending to increase capital investment by 35%, substantially more than in the United States. Of course we have been doing more by the way of capital investment. Our needs for development and expansion have been greater than in the United States for some years.

I think in those circumstances it was clear that if capital investment was indeed going to take place on that scale, something else would have to give way, saving would have to increase, or in the competition for the available supply of physical ~~goods~~ materials later there was going to be price inflation or, if the central banks in the United States and Canada did their jobs there was going to be competition for the available supply of money and that was going to cause a rise in interest rates.

A little of everything seems to have happened since. There have been some price increases. There certainly has been a rise in interest rates. There has been some giving way in the field of consumer expenditures, an example of which in the United States is automobiles, and there has in consequence been some rise in consumer savings. I imagine — I am pretty sure — that there has been also some increase in corporation savings growing out of the high-level profits. In Canada we are very much aware of the

influence of our big neighbor to the south which, in this respect, can be a safety valve. It could of course be a great danger to us if there were inflation in the United States; it would certainly spread to Canada and we would have a very serious problem on our hands fighting against it. But if the demand for development is greater in Canada than in the United States, it tends to spill over from the smaller economy into the larger, and we have a large import of physical goods that we cannot produce in the quantity needed. We also, fortunately perhaps, are able to import an equivalent amount of money by borrowing or in other ways, to pay for the physical goods. That in a sense is a signal or a symptom of the situation we have had in Canada, these last two years perhaps, where the volume of imports is rising faster than the volume of our exports -- the value is certainly rising faster. The deficit in our balance of payments going out was $400 millions two years ago, $660 millions last year, and certainly will be more than that this year. The importation of capital is also rising more or less in line with the deficit in our . . . payments.

There is just one point I think I should emphasize before laying myself at the mercy of the audience, Mr. Chairman, in respect of questions, and that is I want to talk to you about shortage of money, "tight" money, credit restrictions. I shouldn't have to tell life insurance men that there isn't any shortage of money in the sense of there being less money available this year than last year. You've got more money to invest this year than last year. So have the banks. So have practically every kind of financial institution and ... persons and

corporations. It seemed probable for a time — and perhaps it is still probable, I don't know — that the increase in the amount available was somewhat less than the increase in the demands being exerted to get money for investment. There have been credit restrictions in the sense that a man with a good bargain, with a good project, could not always get the money he wanted, just because there were too many good bargains, too many good projects, in this country. There is in consequence competition for money, rising interest rates.

There has been a policy on the part of the central bank of not increasing the money supply as far as the demand has grown, but we have not yet actually decreased it and I certainly hope that we never find ourselves in the position in which the central bank x has to actually contract the money supply except in a purely seasonal way. Our money supply has grown certainly throughout 1955, and it has grown a bit since then but certainly not at a very fast pace and, as I say, the supply of investable funds, the supply of true savings, has certainly increased in 1956 over 1955.

There have been no directives to anybody to restrict credit, and there have been no exemptions from any such non-existent directives. There may well be a situation, there must be a situation, if such a demand continues, in which some buyers will be dissatisfied, some projects will be postponed -- I don't say abandoned altogether because I think they will be revived. In fields such as houses and consumer durables, we have seen some falling-away in the past three months. I have no idea whether this will continue in the future or not.

There's still going to be lots of money to lend and to invest in lots of good projects, and I am sure that the financial community in Canada is going to see to it that this money is invested to the best possible result, that the adjustments are made as smoothly and easily as possible, that responsible investment policies are carried on, because the only serious concern of the central authorities I think will arise if it is thought that serious distortions are developing in the investment picture. There is no need for any drastic adjustments to be made just because interest rates may be a bit lower in one field than in another. In my opinion the way to look after investment funds is certainly a matter for every individual and every institution throughout the country, and we don't want you to feel that any direction as to the particular field you invest in should be given by the central authorities. As a matter of fact, we want to avoid that kind of situation.

As to the result, I am satisfied that no serious distortions will appear, and I am sure that you with your high sense of responsibility know as well as I do that in time the community could get exasperated if it thought there were serious distortions, serious gaps opening up in any particular, necessary field of allocation of resources to necessary projects. But certainly the object of money policy, financial policy in Canada as I understand it, has been to avoid restrictions, to avoid directives, to avoid getting into the kind of situation we got into in 1951, when of course the situation and circumstances were entirely different and we did not have a situation nearly as amenable to ordinary monetary operations either in the

United States or in Canada as we have right now.

I hope I have not said anything that I haven't said several months ago, Mr. Chairman, and if there is anything I can do to answer your questions or elucidate anything I have left very un-clear, I shall do my best.

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Question 1:

To what extent can a capital investment program in Canada of $7½ billion for 1956 be contemplated without inflationary consequences?

Mr. Coyne:

I don't absolutely know, and I doubt if anybody does. We cannot expect to have a gross national product increasing by 56% in 1956 and if one element increases by 21% and some other element by ? % ... $7½ billion is an awful lot and I think the fact that there has been such competition for various kinds of investment opportunities, both governmental and private, shows that this amount could be accommodated unless some other things gave way.

Question 2:

Does the movement of investment funds into Canada from abroad -- principally from the U.S. -- increase the problems of the Bank of Canada in making effective its tight money policy? Do you consider that such investment from abroad adds to inflationary pressures in Canada?

Mr. Coyne:

I don't know in point of pure theory whether the import of funds on a larger and larger scale is inflationary. It might be that in that way

money would come into the hands of people with projects to develop who otherwise would not have had access to any and would not have been in the picture. Of course it is awfully difficult to dissociate the import of money from the import of goods. To a large extent they have to be in balance. An American can only pay money over into Canada if he can find someone in Canada who wants to buy. The money is used to buy goods. If on the other hand all you had was Americans and others investing in Canada, and Canadians investing their money as quickly abroad, there would be a saw-off without much effect one way or the other. I am inclined to think that a good part of the import of money comes about because of the goods that are going to be imported. It is going to pay for required capital equipment imported from abroad and which either they or someone else decided would be a good idea to finance from abroad to some extent.

On the other hand, some Canadian foreign funds that are brought back are influenced by the kind of interest rates we have in Canada as compared with other countries. I don't think you could give any hard and fast answer even to an erudite colleague as to whether the import of money has an inflationary bearing.

Question 3:

How will it be possible to maintain a stable price level in the light of recurrent wage boosts; and is full employment compatible with stable currency?

Mr. Coyne:

I suppose the big debate on monetary policy is behind your question. Everyone agrees with the broader statement of monetary policy these days

that as far as it has an influence it should be directed towards maintaining full employment — more or less full employment with more or less stable standards of living. I suppose you might have full employment without any rise in the standard of living or the productivity. We assume that productivity increases from year to year and therefore full employment means declining hours of work or rising standards of living, including higher wages.

Economic growth is probably well burned into our conscious and unconscious thinking these days and that is a good thing. We don't think of stability as stability at the same level, but orderly growth throughout the whole economy, sparked by whichever elements are able to give the lead. I rather doubt if wages have over any sizable period of time gone up faster than productivity, or would do so. . . but there would be a very serious rigidity and distortion if they did.

Question 4:

There seems to be a tendency to regard with complacency a condition of creeping inflation. Do you not feel that this is basically dangerous to the whole highly developed savings mechanism — without which a country's capital development is impossible?

Mr. Coyne:

It would be dangerous if everyone believed it or a large majority thought that creeping inflation was going to be the order of the day, and those who thought so acted on it and turned it into a galloping inflation, unless the central monetary authorities were prepared to take pretty strong action. I don't think it is necessary. You might find after a few years, looking

back, that there had been creeping inflation. I don't think you could say you were going to have it. I think the idea is an impossible one. You couldn't have creeping inflation knowingly. Some people would not be satisfied and it would gallop.

I don't think there is any serious danger of inflation short of war and war consequences, and national disasters, and commodity speculations and things of that sort. I would think the central authorities in the United States were strong enough to prevent that. There has been another rumor going around ever since President Eisenhower's heart attack . . . for political reasons or so on, the government would not permit the central reserve system in the United States to follow a stiff enough line. I think it was an extremely dangerous idea and I hope it has been hit over the head when the interest rate was raised again. I don't say that has caused the let-down that has occurred in the United States in the meantime, but I think it did kill a serious idea that might have permeated the whole economy.

Question 5:

> The general credit restraint currently in force is one with which we all agree. While the volume of capital is thereby generally controlled, its direction becomes a matter of the aggregate of many investors' individual decisions -- in other words the individual's choice in the market place — with which we heartily agree. Do central banks envisage conditions whereby in addition they may direct the flow of capital into specific channels?

Mr. Coyne:

I started my informal remarks without any idea what I was going to say and I think I finished up without any clear idea as to what I had said. I did say something on that point, I know. There are no legal powers to direct investment in this country. The legislation we had controlling

consumer credit and providing foreign exchange control, no longer exists. The Bank of Canada has no powers. I don't think anyone wants those powers. I hope I was careful of what I said but I think you will all agree we live in a democracy but one that decides every so often what it wants and goes after it. If there was a widespread feeling that some phase of economic life was suffering, I don't know what could be done about it. I think that is the sort of consideration that responsible people everywhere concerned with the good functioning of the private enterprise system carry in their thoughts all the time . There is the short-sighted attitude as to how you carry on your business, and the longer-run view with the advantage it has to your business as a whole if broad public policies or broad objectives of public desire are being reasonably well met. I think it is a great triumph of the private enterprise on this continent that this has been so since the war.

Question 6 (in effect):

> It is my recollection that about a year ago you had occasion to refer to the part being played by financial institutions in channelling savings, and mildly suggested that perhaps the institutions in Canada were paying too little attention to savings in the form of equity capital as against debt capital. One inference that could be drawn from those remarks was that as time goes on and we continue to import a significant but minor part of our capital from outside the country, we run the risk of having too little of that in the form of equity capital and too little of our domestic savings in that form. Might we ask you to repeat some of your remarks of a year ago?

Mr. Coyne:

The great development in this country since the war that has been

financed by foreign capital has been a very valuable thing for us and very welcome, and I am sure that as time goes on we will be concerned that their large enterprises and small enterprises should be in Canadian hands. As a very extreme case, we would not be happy as consumers if all the insurance companies in Canada were foreign-owned. . . . The only way short of coercion to prevent that happening is that individual Canadians and investment pools should take an interest in owning Canadian enterprises themselves.

It is not newsworthy, I hope, for me to say simply that I think that would be a good thing to come about.