BANK OF CANADA

ANNUAL REPORT TO
MINISTER OF FINANCE
AND
STATEMENT OF ACCOUNTS

FEBRUARY 10TH, 1944

BANK OF CANADA

Ottawa, February 10th, 1944

The Hon. J. L. Ilsley,
Minister of Finance,
Ottawa.

Dear Sir,

In accordance with the provisions of the Bank of Canada Act Amendment Act, I am enclosing herewith in duplicate a statement of the Bank's accounts for the fiscal year 1943, signed by the Governor and the Chief Accountant, and certified by the Auditors in the form prescribed by the by-laws of the Bank.

The major changes which took place in our various asset and liability accounts during the course of the year are indicated in the following table, which shows the effect of these changes on the cash reserves of the chartered banks.

Calendar Year 1943	Changes producing a decrease in chartered banks' cash	Changes producing an increase in chartered banks' cash
	(Millions of Dollars)	
Increase in Dominion and Provincial Government Securities		244.0
Increase in Rest Fund	1.6	
Increase in Active Note Circulation	179.0	
Decrease in Dominion Government Deposits		25.0
Decrease in Other Assets less Other Liabilities	6.4	
	187.0	269.0
Deduct		187.0
Increase in Chartered Banks' Cash Reserves		82.0

NOTES IN CIRCULATION

The Bank of Canada note issue was \$874,395,312 on December 31st last, \$180,777,381 higher than on the same date a year before. The general public held \$751.5 millions of the total amount of our notes outstanding and the chartered banks the remaining \$122.9 millions. The amount of Bank of Canada and chartered bank notes in public hands at the end of each of the last five years has been as follows:

(Millions of Dollars)

December 31st	1939	1940	1941	1942	1943
Bank of Canada Notes	162.2	261.6	379.6	572.5	751.5
Chartered Bank Notes	84.6	79.8	70.6	60.3	42.2
	246.8	341.4	450.2	632.8	793.7

The expansion shown over the period as a whole has undoubtedly been due chiefly to the increase in incomes arising out of employment in war industry, the large rise in farm income and the growth of the armed services. Other factors, as well, have tended to bring about an increase in the publicly-held note circulation. Many persons have been working at times and in places which made it inconvenient to use branch banking facilities and therefore have carried more currency than usual. Some people receiving higher incomes during recent years were not previously bank depositors and often have kept their savings in the form of bank notes. In addition, there may be some who prefer to accumulate cash rather than put their savings into bank deposits or securities.

Over the past year the increase in active note circulation has been somewhat less than in 1942 on both an absolute and a percentage comparison. This was to be expected in view of the fact that the rate of increase in incomes slowed

down as we approached a position of virtually full employment.

INVESTMENTS

The Bank's holdings of Dominion and Provincial Government securities were \$1,260,375,252 on December 31st last, having risen by \$243,974,530 during 1943. Our security purchases during the year were undertaken in order to offset the effect upon the chartered banks' cash reserves of the increase in active note circulation, and also to bring about some increase in those cash reserves, for reasons which I shall refer to in a later section of this Report.

On the basis of the Wednesday figures published in our weekly statement, the Bank's total investments averaged \$365 millions more in 1943 than in 1942.

PROFIT AND LOSS

The net profit from our operations in 1943, after providing for contingencies and reserves, was \$15,911,478.79. Payment of a dividend of \$225,000 on capital stock held by the Minister of Finance left \$15,686,478.79 available as compared with \$8,872,478.25 in 1942. The increase was mainly attributable to the rise in security holdings mentioned above.

Section 31(b) of the Bank of Canada Act provides that one-tenth of the surplus available from operations of the Bank shall be allocated to the Rest Fund and the residue paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund. In accordance with these provisions \$1,568,647.88 of the profits available for distribution was added to our Rest Fund and the remaining \$14,117,830.91 was paid to the Government.

STAFF

The staff of the Bank, not including those who are on leave of absence while serving with the armed forces, numbered 1,169 as at December 31st, 1943, a reduction on the year of 11. The male staff is now only 12.6% of the total.

Improvements in operating methods in the War Savings Section, which became possible following the transfer late in 1942 to the new premises on King Edward Avenue, were largely responsible for a reduction of 112 in the staff of that Section. This reduction, however, was almost wholly offset by net increases of 70 in the Public Debt Division, 15 in the Agencies and 16 in other departments of the Bank. Most of these increases were due to further heavy additions of work arising out of the larger public holdings of the Government debt.

The growing activities of the Bank continue to impose heavy burdens on the staff, many of whom are young and inexperienced. I wish to place on record my appreciation for the enthusiasm they have displayed and my thanks to the senior officers for their loyalty and readiness to assist in the training of new employees while at the same time carrying out their own increased responsibilities.

BANK RATE

Bank Rate remained unchanged throughout 1943 at 2½ per cent. Following the issue of the Fourth and Fifth Victory Loans small credit facilities were required for only brief periods.

At a meeting of the Board of Directors on February 7th, 1944, it was decided to reduce the Bank Rate to 1½ per cent, effective February 8th, from the 2½ per cent level which had been maintained since the Bank's establishment in 1935. During the intervening period, there had been a considerable reduction in interest rates on short-term securities, and the Bank Rate was somewhat out of line with the current market. However, this was not a matter of great

importance because the lending facilities of the Bank have been required on few occasions and for rather small amounts.

The change to a 1½ per cent rate does not mean that the Bank expects its credit facilities to be needed on a much greater scale in the future than in the past. Nor does it mean that under existing war conditions there is any less need for people to save. The utmost effort to maintain and increase our saving is still necessary, and the first and foremost concern of financial policy must be with winning the war. The stage has now come, however, when many are also having to give thought to the economic problems which will arise after the war.

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 raising interest rates.

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. There can be little doubt that the easy money policy which has been pursued since 1935 assisted in promoting recovery from the depression and facilitated the adjustments which have been required during the war period. Indication that the Bank intends to continue this easy money policy should be helpful in making plans for the future.

CREDIT EXPANSION

During 1943, the Canadian deposit liabilities of the chartered banks increased by $748 millions. In addition, total active note circulation (including Bank of Canada notes) rose by $161 millions, making the total expansion in the volume of money, therefore, $909 millions during the year.

Dominion and Provincial Government securities held by chartered banks rose by $626 millions during the year. Most of this increase was accounted for by special short-term issues which were sold to the banks by the Dominion Government. The outstanding amount of six-months Deposit Certificates bearing interest at three-quarters of one per cent per annum rose by $275 millions during 1943, and on September 1st the banks bought $200 millions of one and one-half per cent notes maturing July 2nd, 1945. In addition, a major part of the $60 millions net increase in Dominion Treasury Bills outstanding went into chartered bank portfolios.

Cash reserves of the chartered banks rose $82 millions during the year, as shown in the table on page 1. Most of the expansion was necessary in order to maintain the cash ratio position of the chartered banks in view of the $748 millions increase in their Canadian deposit liabilities referred to above. In the latter part of the year the Bank of Canada also took steps to increase bank cash by a moderate further amount. This leeway in regard to the over-all cash position

was needed in order to prevent large temporary swings in the cash position of individual banks, which are caused by the unprecedented scale of the Government's financial operations, from having an undesirable effect.

In last year's Annual Report I mentioned that monetary expansion had not been necessary or desirable for some time except to meet wartime fiscal requirements. Again in 1943, credit expansion was entirely due to Government financing and attendant operations. Total Canadian loans and investments of the chartered banks, excluding Government securities and loans made to finance instalment purchases of Victory Bonds, declined by $84 millions during the year.

SECURITY MARKETS

Medium and long-term Dominion Government bond prices rose moderately during 1943, and at the end of the year were about the same as comparable averages for the first half of 1939. Although gilt-edged prices in London receded several points from the peak reached in January 1943, they rose slightly in the last half of the year, and remain appreciably above the pre-war level.

A table of new Canadian bond issues of all categories, less retirements, is appended to this Report. Net new domestic issues taken up by the public during 1943, totalling $2,563 millions, greatly exceeded the corresponding figure for any previous year. The major items were, of course, the Fourth Victory Loan in April and the Fifth Victory Loan in October, which produced cash applications for $1,309 millions and $1,383 millions respectively. The table below shows the progressive increase which has taken place in the total number of applications, and in the volume of war bonds sold to individuals of moderate means (as distinct from individuals of larger means included in the Special Names Canvass).

	Total Number of Applications	Amount of Cash Applications by Individuals (ex Special Names)
1st War Loan—Jan. 1940	178,000	$132 millions
2nd " " —Sept. 1940	151,000	113 "
1st Victory Loan—June 1941	968,000	280 "
2nd " " —Feb. 1942	1,681,000	336 "
3rd " " —Oct. 1942	2,032,000	375 "
4th " " —Apr. 1943	2,668,000	530 "
5th " " —Oct. 1943	3,033,000	604 "

These results are in part attributable to rising national income but are also a measure of the strenuous efforts which have been made to achieve the widest possible distribution of the Government's war borrowing. This is the most effective kind of borrowing for purposes of combating inflation, and it is also highly desirable for broad social reasons that as many people as possible should have some reserve against emergencies.

For many individuals, Victory Bonds and War Savings Certificates purchased during the war period represent the first significant backlog of saving they have ever been able to build up, and it is apparent that some high-pressure promoters of dubious or worthless securities are attempting to exploit these savings. Security regulation is a provincial responsibility, and it is obviously not easy by means of legislation to prevent activities of a criminal character, without at the same time hampering the desirable flow of capital into legitimate risk enterprise. A satisfactory solution of this problem, where it exists, will require whole-hearted and vigilant co-operation from responsible members of the financial community, as well as government administration of a high order.

Prices of provincial government bonds (particularly those of the Prairie Provinces) rose markedly during 1943. With provincial revenues up by one-third from the

pre-war level and protected by the Dominion-Provincial Tax Agreements, and with capital expenditures restricted by material and labour shortages, the provinces have been able to reduce their debt in each of the last three years. Municipalities and corporations have continued to pay off debt on a considerable scale, as will be seen from the appended table.

FEDERAL DEBT

Net Federal Government borrowing in Canada since August 1939 has amounted to $7,654 millions, or about half of the Government's total cash requirements during the war to date. This represents a quadrupling of the Government's domestic debt over the period in question, but taken by itself it gives an exaggerated impression of the extent to which the over-all Federal debt burden has increased, because there are several important offsetting factors.

For example, a considerable amount of the Federal Government's domestic borrowing was used to redeem its own bonds payable in sterling, or was advanced to the Canadian National Railway Company to enable it to redeem obligations outstanding in London. These operations, which were initiated in November 1939 and largely completed by April 1942, were designed to assist the United Kingdom Government to finance its war purchases in Canada. A further portion of the domestic borrowing was used to redeem certain Government issues payable in U.S. dollars, and to enable the C.N.R. to pay off non-sterling obligations which matured during this period. The effect of these offsets is shown in the table of total Federal and C.N.R. debt which is given below.

Another offsetting factor is the substantial reduction which has taken place in the rate of interest payable on the combined Federal and C.N.R. debt. As the table below shows, the average coupon rate has fallen by more than onequarter during the war period. This was not caused by any significant reduction in market rates of interest, which have shown little net change since the middle of 1936. It has resulted mainly from more complete conversion of the debt to current rates through the continuing process of maturities, refunding and new issues.

BONDED DEBT
(including Treasury Bills and Deposit Certificates)

	Amount Outstanding at Aug. 31, 1939	Amount Outstanding at Dec. 31, 1943	Increase or Decrease
Federal Government:			
Payable in Canada only	$2,558 millions	$10,212 millions	+$7,654 millions
Payable in London	406 "	12 "	− 394 "
Payable in New York	469 "	333 "	− 136 "
Canadian National Railways:			
Payable in London	395 "	26 "	− 369 "
Other	865 "	719 "	− 146 "
Total Federal and C.N.R.	$4,693 millions	$11,302 millions	+$6,609 millions
Average Coupon Rate	3.61%	2.69%	—
Total Annual Interest Payable	$169 millions	$304 millions	+$135 millions

In calculating the *net* interest burden, adjustment must be made for:

(1) C.N.R. interest which the Railway is able to pay out of its own net earnings,* and

(2) cash revenue received by the Federal Government on its investment in or advances to other organizations such as the Bank of Canada, the Foreign Exchange Control Board and the National Harbours Board.

*The calculation takes no account of the C.N.R. surplus (over and above debt charges) which is now accruing to the Federal Government.

These offsets amounted to approximately $24 millions and $84 millions in 1939 and 1943 respectively. Net interest charges are therefore now running at about $220 millions a year, as compared with about $145 millions a year at the outbreak of war, which represents an increase of 52%.

The real burden of public debt charges depends, of course, on the taxable capacity of the economy. National income has approximately doubled since before the war, and taxable capacity has increased a good deal more, because *surplus* income over and above basic food, shelter and clothing requirements has increased proportionately more than *total* income. In relation to taxable capacity, therefore, the burden of Federal and C.N.R. debt charges has declined substantially during the war period. It is also less now, in relation to national income, than it was 20 years ago, when net interest charges were about $135 millions a year and national income was less than half its present level.

In making these comments I do not wish to suggest that public debt could be increased at the present rate for an indefinite period without placing intolerable strain on our economy. I do feel, however, that the war debt, and the increases which will inevitably take place for a time after the war ends, can be handled without serious embarrassment. The key to this problem, as to many others, lies chiefly in the maintenance of a high level of employment and income.

GENERAL

The magnitude of the adjustments which Canada will face in maintaining high employment after the war can be indicated in simple terms. In 1939 about 4,000,000 Canadians were gainfully occupied and at least 300,000 who were available for work were not employed. By the end of 1943 the gainfully occupied population had risen to approximately 5,100,000 but about 1,900,000 of these were engaged in the armed forces, in supplying the weapons of war, or in producing the food required for special wartime exports. The number available to meet civilian needs had therefore fallen to about 3,200,000, but at the same time the average standard of living had risen materially and was probably higher than it had ever been. This increased output of consumption goods by a smaller working force can be accounted for in part by longer hours of work, favourable crop conditions and the abnormally small number now employed in private capital development and maintenance work. Another important factor, however, has been the improvement in production techniques worked out under the stress of war.

After the war, some of those who are now employed will voluntarily withdraw from the working force, and the armed services may be maintained at a level considerably above their pre-war strength. It seems likely, however, that at least 4,700,000 workers will be available for employment in civilian jobs, or at least 1,500,000 more than the number employed in that sector of the economy at the present time. A working force of this size, at present rates of efficiency, will be able to produce a vastly greater volume of civilian goods and services than Canada has ever known before. By the same token, a vastly increased volume of consumption and capital development will be necessary if this output is going to be fully absorbed and high employment maintained. The adjustments required will clearly be of unprecedented magnitude, and bold planning on the part of labour, farm and business organizations, as well as governments, is urgently needed.

One of the many difficult problems to be faced in this connection concerns the probable future of international trade. Should this country count on maintaining or expanding production in specialized lines where she has a competitive advantage, with a view to increasing her exports above the pre-war level? This will only be possible in the long run if

Canada and other countries are willing to import more in lines where they are relatively less efficient. Or should Canada orient her economy further towards self-sufficiency, deliberately building up high-cost industries which depend for their existence on some form of subsidy from the community at large?

I believe this country has a greater interest than almost any other in following the first course if it is in fact open to her. Internal adjustments will be required under either alternative but they would undoubtedly be less fundamental and painful under the first. Moreover, the specialized character of Canada's resources, and her relatively small internal market severely restrict the standard of living which she can achieve without the benefit of a large export and import trade. Her choice will, however, necessarily depend on whether other countries, too, are willing to give international trade a chance.

One indication of the prospects in this regard will no doubt be found in the extent and character of the international monetary arrangements which can be worked out by the United Nations. Three plans have been put forward by British, American and Canadian experts respectively, which are genuinely international in their approach. Though differences exist between these plans and need to be reconciled, the broad objective is the same in each case, viz:—that countries should get together and provide credit on a collective basis, within certain limits, in order to achieve a reasonable degree of exchange stability and promote the exchange of goods.

No doubt these plans represent something less than perfection, and criticism should be welcomed. In the last analysis, however, they must be assessed against the practical alternatives which are either:

(a) no plans for the provision of external credit at all, or

(b) plans for the extension of trade credit directly between individual countries on a bilateral basis.

It would be unrealistic to assume that bilateral credit would not sooner or later be accompanied by trade discrimination in favour of the countries extending credit. In the long run this would hamper world trade almost as much as the absence of international credit, and would be even more likely to promote economic imperialism and international discord.

The central provision of the international monetary proposals is the arrangement for the extension of credit. It is important to realize, however, that the necessity for credit does not arise out of these specific proposals but out of the fact that countries' exports of goods and services are not necessarily equal to their imports at any particular time. The countries whose exports exceed their imports should recognize that (except insofar as other countries have a stock of gold or acceptable foreign exchange which they are willing to deplete) a creditor country must in all circumstances finance its export surplus. If it prefers to do so, it can make long-term loans abroad rather than extend credit through an international institution as proposed in the monetary plans. But if it is unwilling to extend credit in any form, it has no alternative but to eliminate its export surplus by increasing its imports or curtailing its exports.

An international monetary agreement would, of course, be no more than a good start towards expanding world trade and laying the economic foundations of a durable peace. Measures designed to reduce tariff barriers, increase international investment and stabilize primary commodity prices are also needed; and the extent of such economic collaboration

will no doubt largely depend upon how far confidence in international political security can be established.

If sensible international arrangements cannot be worked out, Canada, like most other countries, will presumably have no choice but to adopt increasingly nationalistic economic policies. Growing economic and political friction between countries would inevitably result, and it is hard to believe that any nation would deliberately choose such a course if all its implications were clear. On the other hand, it would be foolish to expect that any given country will make and fulfil international commitments unless it sees an interest in doing so. Self-interest is indeed the only practical basis for durable international agreements. What we badly need, therefore, is a hard-headed appraisal by each country of what that self-interest really is in the long run, and what is necessary to achieve it.

I am,

Dear Sir,

Yours faithfully,

G. F. TOWERS,

Governor.

ESTIMATED
NET NEW BOND ISSUES (+) OR RETIREMENTS (–)

(Par Values in Millions of Canadian Dollars)

Calendar Year	Dominion and C.N.R. ★	Provinces	Muni-cipalities ★★	Private Corpora-tions	Total
PAYABLE IN CANADA ONLY					
1936	+ 125	+66	–13	+182	+ 360
1937	+ 25	+82	– 9	+ 75	+ 173
1938	+ 91	+59	– 9	+ 31	+ 172
1939	+ 74	+51	–24	+ 96	+ 197
1940	+ 434	+75	–14	– 21	+ 474
1941	+ 731	–	–32	– 33	+ 666
1942	+1,833	+ 9	–42	– 11	+1,789
1943	+2,606	+12	–30	– 25	+2,563
PAYABLE ABROAD, ONLY OR OPTIONALLY					
1936	– 39	–27	–14	–139	–219
1937	– 14	–24	–16	– 87	–141
1938	– 21	–11	–21	– 45	– 98
1939	– 96	+29	–15	–127	–209
1940	–144	–15	–16	– 34	–209
1941	–195	–18	–14	– 29	–256
1942	–296	–41	–13	– 62	–412
1943	–148	–26	–11	– 26	–211
TOTAL					
1936	+ 86	+39	–27	+43	+ 141
1937	+ 11	+58	–25	–12	+ 32
1938	+ 70	+48	–30	–14	+ 74
1939	– 22	+80	–39	–31	– 12
1940	+ 290	+60	–30	–55	+ 265
1941	+ 536	–18	–46	–62	+ 410
1942	+1,537	–32	–55	–73	+1,377
1943	+2,458	–14	–41	–51	+2,352

★Includes War Savings Certificates, but excludes Treasury Bills, Deposit Certificates and special short-term issues sold to banks, of which the amount outstanding increased by 57, nil, 5, 200, 325, 290, 633 and 535 in the calendar years 1936 to 1943 respectively.

★★The division of net municipal retirements between the domestic and the foreign category is a rough approximation only.

PROFIT AND LOSS ACCOUNT

For the Year Ended 31st December, 1943

PROFIT FOR THE YEAR ENDED 31ST DECEMBER, 1943, after making provision for Contingencies and Reserves		$15,911,478.79
APPROPRIATED AS FOLLOWS:		
Dividends for the year ended 31st December, 1943 at the rate of 4½% per annum:		
No. 18 paid 2nd July, 1943 .	$ 112,500.00	
No. 19 payable 3rd January, 1944	112,500.00	225,000.00
BALANCE		$15,686,478.79
TRANSFERRED TO REST FUND . . .	1,568,647.88	
TRANSFERRED TO THE RECEIVER GENERAL OF CANADA FOR CREDIT TO THE CONSOLIDATED REVENUE FUND	14,117,830.91	$15,686,478.79

REST FUND

BALANCE AS AT 31ST DECEMBER, 1942	$ 6,472,952.97
AMOUNT TRANSFERRED FROM PROFIT AND LOSS ACCOUNT AT 31ST DECEMBER, 1943	1,568,647.88
BALANCE AS AT 31ST DECEMBER, 1943	$ 8,041,600.85

BAN ADA

STATEMENT OF A LIABILITIES

as ber, 1943

LIABILITIES

CAPITAL:		
Authorized—100,000 shares, par value $50.00 each . .	$ 5,000,000.00	
Issued and Paid Up . . .		$ 5,000,000.00
REST FUND		8,041,600.85
NOTES IN CIRCULATION . . .		874,395,312.37
DEPOSITS:		
Dominion Government . .	34,594,239.96	
Chartered Banks	340,195,799.88	
Other	17,765,520.87	392,555,560.71
DIVIDEND DECLARED:		
Payable 3rd January, 1944 .		112,500.00
ALL OTHER LIABILITIES . . .		28,149,704.04
		$1,308,254,677.97

AUDITORS' REPORT

We have examined the above statement of assets and liabilities of the Bank of Canada as at 31st December 1943 and have received all the information and explanations we have required. We report that, in our opinion, it is properly drawn up so as to exhibit a true and correct view of the state of the Bank's affairs as at that date, according to the best of our information, the explanations given to us and as shown by the books of the Bank.

FRANK E. H. GATES, C.A.
of the firm of P. S. Ross & Sons

JEAN VALIQUETTE, C.A., L.I.A.
of the firm of Anderson & Valiquette

Ottawa, Canada, 28th January 1944.

ASSETS

RESERVE:		
Sterling and U.S.A. dollars, at market value		$ 558,336.23
SUBSIDIARY COIN		134,046.37
INVESTMENTS—at values not exceeding market:		
Dominion, Dominion guaranteed and Provincial Government short term securities	$787,578,136.19	
Other Dominion, Dominion guaranteed and Provincial Government securities . .	472,797,116.42	1,260,375,252.61
BANK PREMISES:		
Land, Buildings and Equipment—at cost less amounts written off		1,968,499.14
ALL OTHER ASSETS		45,218,543.62
		$1,308,254,677.97

G. F. TOWERS,
Governor.

H. R. EXTENCE,
Chief Accountant.