

BANK OF CANADA

**ANNUAL REPORT TO
MINISTER OF FINANCE
AND
STATEMENT OF ACCOUNTS**

FEBRUARY 10TH, 1945

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Assistant Deputy Governor

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D. A. SKELTON
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"

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G. A. IVEY

"

BANK OF CANADA

Ottawa, February 10th, 1945.

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 1944, 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.

<u>Calendar Year 1944</u>	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		220.5
Increase in Other Securities		10.0
Increase in Active Note Circulation	145.1	
Increase in Rest Fund	2.0	
Increase in Liabilities Payable in Sterling, U.S.A. and Foreign Gold Currencies	172.3	
Increase in Sterling and U.S.A. Dollars		171.7
Decrease in Other Assets less Other Liabilities	4.8	
	<u>324.2</u>	<u>402.2</u>
Deduct		<u>324.2</u>
Increase in Chartered Banks' Cash Reserves		<u>78.0</u>

BANK OF CANADA

NOTES IN CIRCULATION

The Bank of Canada note issue as at the end of December last was \$1,035,972,607, up \$161,577,295 from the same date a year before. Of the total amount of our notes outstanding, \$896.6 millions were held by the general public, and \$139.4 millions by the chartered banks. The amount of Bank of Canada and chartered bank notes in public hands at the end of each of the last ten years has been as follows:

ACTIVE NOTE CIRCULATION

(As at December 31st in Millions of Dollars)

	<u>1935</u>	<u>1936</u>	<u>1937</u>	<u>1938</u>	<u>1939</u>
Bank of Canada Notes	59.1	87.9	111.4	118.4	162.2
Chartered Bank Notes	111.0	103.2	96.0	88.3	84.6
Total	<u>170.1</u>	<u>191.1</u>	<u>207.4</u>	<u>206.7</u>	<u>246.8</u>
	<u>1940</u>	<u>1941</u>	<u>1942</u>	<u>1943</u>	<u>1944</u>
Bank of Canada Notes	261.6	379.6	572.5	751.5	896.6
Chartered Bank Notes	79.8	70.6	60.3	42.2	33.0
Total	<u>341.4</u>	<u>450.2</u>	<u>632.8</u>	<u>793.7</u>	<u>929.6</u>

In accordance with the provisions of the Bank Act of 1934 the maximum amount of chartered bank notes in circulation was reduced from 100% of their unimpaired paid-up capital, as of the date of establishment of the Bank of Canada, to 25% of this figure as from January 1st, 1945. It is provided under the Bank Act of 1944 that after the latter date no chartered bank shall issue or re-issue its own notes for circulation in Canada, and that after January 1st, 1950, the banks' liability for their notes which then remain outstanding in Canada shall be transferred to the Bank of Canada in return for payment of a like sum to the Bank of Canada.

The main factors accounting for the large increase in total active note circulation in recent years were referred to in my last Annual Report, and need not be repeated here.

RESERVE

The asset account in our statement entitled "Sterling and U.S.A. Dollars" stood at \$172,257,273 on December 30th last. This represented foreign exchange held on deposit for account of foreign clients, and was balanced by a contra item, "Liabilities Payable in Sterling, U.S.A. and Foreign Gold Currencies", of the same amount.

INVESTMENTS

The Bank's holdings of Dominion and Provincial Government securities were \$1,480,825,869 on December 30th last, having increased by \$220,450,616 during the year. Our security purchases in this category were undertaken in order to prevent the chartered banks' cash reserves from declining as a result of the increase in our note circulation, and also in order to bring about some net increase in those cash reserves, for reasons which I shall refer to in a later section of this Report.

Other securities held as at December 30th last amounted to \$10,000,000 and consisted of one hundred thousand shares of the capital stock of the Industrial Development Bank, which we purchased in accordance with the terms of Section 12, Subsection (2) of the Industrial Development Bank Act.

On the basis of the Wednesday figures published in our weekly statement, the Bank's total investments averaged \$275 millions more in 1944 than in 1943.

PROFIT AND LOSS

The net profit from our operations in 1944, after providing for contingencies and reserves, was \$20,312,659.68. Payment of a dividend of \$225,000 on capital stock held by

the Minister of Finance left \$20,087,659.68 available as compared with \$15,686,478.79 in 1943, and \$1,638,725.20 in 1939.

Under Section 31(b) of the Bank of Canada Act one-tenth of the surplus available from operations of the Bank during 1944 was added to our Rest Fund and the residue of \$18,078,893.71 was paid to the Government.

The addition to our Rest Fund for the year 1944 brings this Fund to an amount more than twice our paid-up capital. Consequently the distribution of profits in 1945 will be governed by the terms of Section 31(c) of the Bank of Canada Act, which provides that the whole of the surplus available from the operations of the Bank shall be paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund.

The large increase in the Bank's profits during the war years has been due to the great expansion in our security portfolio. In part this was undertaken as an offset to the increase in circulation of Bank of Canada notes, but the growth in our security portfolio, and resultant profits, also arose in part out of measures designed to expand the chartered banks' cash reserves, referred to elsewhere in this Report.

BANK RATE

The reduction in our Bank Rate from 2½ to 1½ per cent on February 8th, 1944, was referred to in my last Annual Report. During 1944, as in previous years, banks have had little need to borrow from us.

STAFF

Notwithstanding an increase in the volume of work, the staff on December 30th, 1944, numbered 1,125, as compared with 1,169 at the end of 1943, a reduction of 44.

That a decrease in staff is possible despite the continuing addition of work is due in large measure to the cheerful assumption of greater responsibilities by the senior officers and older employees, combined with increased efficiency of those, including many young women, who have been added to the staff during the war years. It is with pleasure that I record my appreciation of the co-operation and loyalty of all members of the staff.

SECURITY MARKETS

Medium and long-term government bond prices increased perceptibly in the United States and the United Kingdom, as well as in Canada, during 1944, and the interest rates on such securities showed a commensurate decline.

As in previous Reports, I have appended a table showing our estimate of net new bond issues and retirements during the year. Net new federal public issues, at about \$2.6 billions, were only slightly greater than in the previous year. The net reduction in the amount of provincial bonds outstanding which has been taking place since 1940 was on a greater scale in 1944 than in previous years, while net municipal and corporate retirements were somewhat smaller. In these latter categories, however, an unusually large volume of issues were called for redemption and refunded at lower interest rates.

The Sixth and Seventh Victory Loans were, of course, the major developments of the year in the Canadian market. As the table below shows, there was an appreciable increase in the amount subscribed by individuals of moderate means, i.e. excluding individuals of larger means who are covered in the Special Names Canvass. The table also indicates a continued improvement in distribution, as measured by the increase in the total number of applications.

	Total Number of Applications	Amount of Cash Applications by Individuals* (ex Special Names)
1st War Loan—Jan. 1940_____	178,000	\$132 millions
2nd " " —Sept. " _____	151,000	113 "
1st Victory Loan—June 1941_____	968,000	280 "
2nd " " —Feb. 1942_____	1,681,000	336 "
3rd " " —Oct. " _____	2,032,000	375 "
4th " " —Apr. 1943_____	2,668,000	530 "
5th " " —Oct. " _____	3,033,000	600 "
6th " " —Apr. 1944_____	3,077,000	642 "
7th " " —Oct. " _____	3,327,000	766 "

CANADIAN BANKING DURING THE WAR

In past Annual Reports I have had occasion to refer to banking developments during the year under review. In view of the magnitude of the changes which have taken place during the war, it may be of some interest for me to give a brief summary of banking events over the past five years.

The volume of Canadian bank deposits and active note circulation increased from \$2,775 millions at August 31st, 1939, to \$6,075 millions at December 30th, 1944, i.e. by \$3,300 millions. Of this expansion about \$700 millions was accounted for by unspent balances of Dominion and provincial governments at December 30th, 1944 and \$2,600 millions represented an increase in general public deposits and active note circulation. I estimate that something of the order of 60 per cent of the expansion in the amount of money held by the general public is owned by individuals, and on the basis of available statistics the increase held by individuals appears to have been quite widely distributed.

The increase in chartered banks' Canadian deposit liabilities has been approximately equal to the increase in their cash, Government securities, and amounts temporarily

*Including applications by small commercial and small non-profit organizations, which are not segregated in the statistics of General Canvass. The amount involved is only a minor part of the total.

advanced to finance Victory Bond purchases by the public; other loans and investments taken together have not risen on balance.

Canadian loans of the chartered banks were \$1,006 millions at August 31st, 1939 and \$1,303 millions at December 30th, 1944, the latter figure including temporary loans in connection with Victory Bond issues. Loans to provincial and municipal governments have shown a sharp decline during the war, as the budget positions of these governments improved. Loans to finance the grain carryover rose quite appreciably during the first two war years due to large crops in 1939 and 1940 but since 1942 there has been a decline in such advances as grain stocks have fallen, chiefly because of the sharp increase in domestic and foreign utilization. Apart from temporary advances made at the time of Victory Loans to enable subscribers to buy on a deferred payment plan, loans for the purpose of financing the purchase of securities have declined somewhat during the past five years. General industrial and commercial loans rose fairly sharply in the first two war years when the war programme was in the construction stage and when inventories were being accumulated for future needs; since 1941, however, there has been a steady decline in commercial and industrial loans and present figures indicate about the same level as in 1939. Increased borrowings of those engaged in war activities have, of course, been offset by a reduction in other types of advances.

Chartered bank holdings of Dominion and provincial government direct and guaranteed securities (excluding Victory Loan bonds held temporarily in connection with Official Instalment Plan purchases) increased by \$1,956 millions between August 31st, 1939 and December 30th, 1944. Most of this expansion occurred as the result of direct purchases from the Dominion Government of certain special short term issues. At December 30th, 1944 there

were outstanding in such issues \$1,000 millions in Deposit Certificates issued for a term of six months at an annual interest rate of $\frac{3}{4}$ per cent and \$450 millions of $1\frac{1}{2}$ per cent notes issued for a term of two years; the average interest rate on these two types of security is approximately 1 per cent per annum. In addition to the direct acquisition of government securities, the banks made net market purchases of such securities amounting to some \$500 millions between August 31st, 1939 and December 30th, 1944. For the most part these market purchases have consisted of bonds the maturity of which has come into the short or middle term category.

Of the Bank of Canada's purchases of Government securities during the war, \$775 millions have been for the purpose of offsetting the decline in chartered banks' cash reserves which would otherwise have resulted from the increase in active circulation of Bank of Canada notes. Of this increase in Bank of Canada note circulation \$55 millions may be attributed to the decline in chartered bank notes outstanding, but most of the expansion has been due to the public holding more currency than ever before.

In addition to increasing its security portfolio as an offset to increased active note circulation, the Bank of Canada bought Government securities in order to expand by \$282 millions the cash reserves of the chartered banks, whose Canadian deposit liabilities have risen by \$2,580 millions between August 31st, 1939 and December 30th, 1944. This expansion in banks' cash reserves has been somewhat more than enough to maintain the pre-war ratio of cash to deposit liabilities; a higher average cash ratio is appropriate in view of large temporary swings in the cash position of individual banks arising from a greatly increased volume of turnover in their customers' accounts.

In the early months of the war it was thought desirable that Dominion Government financing should take a form which would involve some credit expansion, and accord-

ingly, as mentioned in my Annual Report dated February 1940, some government borrowing from banks was deliberately undertaken. Subsequently, the increasing tempo of the war and the emergence of shortages have made deliberate stimulus through credit expansion unnecessary and undesirable. In this situation, the Government's policy has been to cover its financial requirements to the maximum possible extent first by taxation and secondly by borrowing the savings of the public.

Although Dominion Government disbursements between August 31st, 1939 and December 30th, 1944 have been nearly \$20 billions, about one-half of this total has been covered by taxes and other revenues. Moreover, through Victory Loan and other campaigns specifically directed toward the second objective, it has been possible to cover two-thirds of the Government's over-all borrowing by means of bonds sold to and retained by non-banking investors.

The remaining one-sixth of the Government's total requirements has been financed to a considerable extent by the chartered banks, which has involved a substantial increase in their holdings of Government securities, and consequently in the volume of savings and demand deposits of the public with the banks. This increase in deposit liabilities has in turn given rise to a need on the part of the chartered banks for larger cash reserves. The policy of the Bank of Canada—implemented through its purchase of Government securities in the market—has been to keep pace with these necessities, without trying to bring about expansion of credit for purposes unrelated to war needs.

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	Municipalities**	Private Corporations	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	— 22	+ 473
1941	+ 730	—	—32	— 33	+ 665
1942	+1,833	+ 7	—42	— 12	+1,786
1943	+2,606	+15	—36	— 27	+2,558
1944	+2,702	—31	—17	— 14	+2,640
PAYABLE ABROAD, ONLY OR OPTIONALLY					
1936	— 39	—27	—14	—141	—221
1937	— 14	—24	—16	— 87	—141
1938	— 21	—11	—21	— 42	— 95
1939	— 96	+29	—15	—129	—211
1940	—144	—15	—16	— 35	—210
1941	—193	—18	—14	— 31	—256
1942	—296	—41	—14	— 64	—415
1943	—148	—25	—11	— 30	—214
1944	— 67	—27	— 9	— 17	—120
TOTAL					
1936	+ 86	+39	—27	+41	+ 139
1937	+ 11	+58	—25	—12	+ 32
1938	+ 70	+48	—30	—11	+ 77
1939	— 22	+80	—39	—33	— 14
1940	+ 290	+60	—30	—57	+ 263
1941	+ 537	—18	—46	—64	+ 409
1942	+1,537	—34	—56	—76	+1,371
1943	+2,458	—10	—47	—57	+2,344
1944	+2,635	—58	—26	—31	+2,520

*Includes War Savings Certificates, but excludes Treasury Bills, Deposit Certificates and special short-term issues sold to chartered banks and the Bank of Canada of which the amount outstanding increased by 57, nil, 5, 200, 325, 290, 633, 535 and 248 in the calendar years 1936 to 1944 respectively.

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

BANK OF CANADA

PROFIT AND LOSS ACCOUNT

For the Year Ended 30th December, 1944

PROFIT FOR THE YEAR ENDED 30TH DECEMBER 1944, after making provision for contingencies and reserves		\$20,312,659.68
APPROPRIATED AS FOLLOWS:		
Dividends for the year ended 30th December 1944 at the rate of 4½% per annum—		
No. 20 paid 5th July 1944	\$ 112,500.00	
No. 21 payable 2nd January 1945	112,500.00	225,000.00
BALANCE		20,087,659.68
TRANSFERRED TO REST FUND - -	2,008,765.97	
TRANSFERRED TO THE RECEIVER GENERAL OF CANADA FOR CREDIT TO THE CONSOLIDATED REVENUE FUND	18,078,893.71	\$20,087,659.68

REST FUND

BALANCE AS AT 31ST DECEMBER 1943		\$ 8,041,600.85
AMOUNT TRANSFERRED FROM PROFIT AND LOSS ACCOUNT AT 30TH DECEMBER 1944		2,008,765.97
BALANCE AS AT 30TH DECEMBER 1944		\$10,050,366.82