BANK OF CANADA

ANNUAL REPORT OF THE GOVERNOR TO THE MINISTER OF FINANCE

AND STATEMENT OF ACCOUNTS

FOR THE YEAR *1968*

BANK OF CANADA Ottawa 4

February 28th, 1969.

The Hon. E. J. Benson, P. C.,
Minister of Finance,
Ottawa, Ontario.

Dear Sir,

In accordance with the provisions of the Bank of Canada Act I am transmitting herewith my report for the year 1968 and a statement of the Bank's accounts for this period which is signed and certified in the manner prescribed in the by-laws of the Bank.

Yours very truly,

L. Rasminsky

Governor

BANK OF CANADA

Report of the Governor — 1968

Some Highlights of the Year

The performance of the Canadian economy last year was satisfactory in many ways, but it was marred by continuing inflation. The period of subdued growth which had lasted from the spring of 1966 to the final months of 1967 gave way to sharply accelerated economic expansion in 1968, led by an abnormally strong demand for Canadian exports. Real output appears to have risen by some 6 per cent in the course of the year, a rate which approached the average of the years of rapid expansion from 1961 to 1966. Employment also grew strongly, and the upward drift in the national unemployment rate which had carried it from a 3½ per cent average in 1966 to nearly 5½ per cent in the summer of 1968 was checked; unemployment declined in the latter part of the year and in January 1969. This occurred notwithstanding a large increase in the labour force and a welcome increase in average output per worker. Although imports grew rapidly in 1968, the increase in exports was substantially greater, especially to the United States where demand pressures were strong, and our deficit on current account was less than it had been for many years.

In 1967 there had been some hopeful signs that price inflation was gradually being brought under control. In 1968, however, little further progress seems to have been made. Indeed, between the fourth quarter of 1967 and the fourth quarter of 1968 the price index of all goods and services, as measured in the Gross National Product, rose by 4 per cent, somewhat more than in 1967. The Consumer Price Index has also continued to rise at the rate of about 4 per cent a year, with no clear evidence of any tendency to slow down.

The stubbornness of the inflation problem in the face of levels of unemployment which have ranged between about 4½ and 5½ per cent during the past year or more is very disappointing. It seems clear that the attitudes of all groups in the community to price and income increases within their influence are affected not only by the levels of unemployment and idle plant capacity but also by expectations about future price trends and by the degree of buoyancy in business conditions and in employment opportunities. It should be pointed out, moreover, that although unemployment rose substantially in the Atlantic Provinces and Quebec in 1968, it was not significantly higher in the rest of the country at the end of the year than it had been at the end of 1967.

A major factor that made it more difficult for Canada to achieve good price performance in 1968 than in the immediately preceding years was the marked intensification of demand pressures from beyond our borders, particularly from the United States. By the end of the year, unemployment in that country had fallen to the lowest level in fifteen years; the rate of price increase in 1968 was the highest since the Korean War. In the course of the year the U.S. consumer price index rose by 4.7 per cent compared to a rise of 4.1 per cent in Canada. This meant that international competition imposed less restraint on price increases in Canada than had been the case in earlier years. There are, however, some signs that we may be moving towards an improved situation insofar as external influences on our prices are concerned. In the United States a 10 per cent surcharge on personal and corporate income tax became effective at mid-year and was accompanied by cuts in planned Government expenditure. The full effect of these measures has not yet been felt, although by the fourth quarter there was a noticeable slowing down of the growth of consumer expenditures. Monetary conditions in the United States, which had eased during the summer, tightened in the latter part of the year and have remained tight in the first months of 1969. While no one can be certain how effective these measures will be, it is encouraging that United States economic policy now appears to be clearly aimed at reducing demand pressures.

It is difficult to form a precise judgment as to the extent to which Canada's current inflationary problem originates outside the country and the extent to which it is due to domestic causes. However, one can hardly avoid the conclusion that even though unemployment averaged about 5 per cent last year the total volume of spending in Canada was at too high a level to be compatible with price performance which, in the prevailing circumstances, would have been acceptable. This conclusion is not a welcome one: we all naturally wish to bring inflation under control with a minimum of unused resources and unemployment in the economy. It is for this reason that I have advocated on earlier occasions that it would be desirable for the Government to make a systematic effort to bring the influence of informed public opinion to bear on decisions regarding increases in prices and incomes.

I welcome the start that has been made in this direction by the Government's decision to try to reinforce the traditional policies of economic stabilization by establishing a Price and Incomes Commission. This decision has introduced a new and potentially constructive factor into the situation. For the first time there will be an official body charged with the responsibility of continuous analysis of price and cost developments, of making policy recommendations, and of educating opinion as to what actions and policies are consistent or inconsistent with reasonable price stability. It is encouraging to know that this Commission will soon be set up and begin to function.

As regards the traditional methods of economic stabilization, that is, fiscal and monetary policies, their stance is now such as to moderate demand pressures. The monetary policy which is being followed is one of restraint; its development over the past year is described in the next section. The Government's budgetary deficit and its cash requirements in 1968 turned out to be much larger than had been planned, but the October budget provided for a balance in the fiscal year ending March 31, 1970 and for a considerable reduction in the Government's cash requirements. What is required now to deal with the problem of inflation is not, therefore, a drastically different setting of policy but rather the determination to persist with the present one—and if necessary to reinforce it from time to time—for as long as this is needed to reduce the domestic pressures that have contributed to the recent rates of price and cost increase.

This determined approach to policy is essential because inflationary expectations have now become very strong. The persistence of rising prices has resulted in a growing tendency on the part of many sections of the public to think of inflation as a normal characteristic of our society. This has developed to the point where firm evidence of progress in checking inflation will be required to break its hold on the economy.

The development of an inflation psychology has had an increasingly serious impact on the availability and cost of long-term debt financing and on the functioning of capital markets in North America. The basic reason why interest rates have risen so high and bond prices fallen so low is the belief of investors and borrowers that the value of money will continue to decline significantly. This belief has made investors increasingly reluctant to commit their funds to long-term bond issues even at progressively higher interest rate levels, and it has made borrowers increasingly resigned to paying these higher rates rather than postpone their spending plans. The shrinkage in the flow of funds into the long-term bond market has been accompanied by an increased flow into liquid, short-term deposits at banks and other institutions and by an intensification of the demand for common stocks and real estate as a hedge against inflation. A growing proportion of the issues of borrowers who have to rely on bond financing to cover their requirements—such as the federal, provincial and municipal governments—has had to be absorbed by the banking system or sold in capital markets outside Canada. Even so, the cost and difficulty of bond financing in Canada has continued to increase. A fundamental reversal of these trends in capital markets will depend on decisive progress being made towards price stability in North America.

It is of crucial importance to all Canadians that the problem of inflation be dealt with successfully, that we bring to an end the excessive price and cost increases which are threatening to undermine our prospects for durable growth in the future. Fortunately, in addition to the possibility of less pressure on price levels from external sources, there is evidence that some developments in the domestic economy are working with us. There was an encouraging improvement in productivity in 1968, though it has to be acknowledged that this was to a large extent a cyclical phenomenon resulting from the rapid increase in production which followed the earlier slow-down from mid-1966 to late 1967. Wage settlements were being negotiated at a somewhat more moderate rate of increase in the closing months of 1968, though at increases that were still substantially above even the enhanced growth in productivity. Broadly speaking, our main public policies seem to be pointed in the right direction—but we shall need a consistency of approach and a deep determination to persevere until we are certain that we have dealt effectively with the problem. The stakes are too great to warrant anything less.

MONETARY POLICY. A detailed chronological account of the Bank's monetary operations is given in the later section of this Report dealing with financial developments. Policy went through three phases which can be briefly summarized here.

For most of the first half of 1968 the Bank gave top priority to the defence of the exchange value of the Canadian dollar. Bank Rate reached a peak of 7½ per cent in mid-March and was maintained at that level to the beginning of July. Market interest rates rose to the highest levels that we had ever experienced in this country up to that time. Bank liquidity declined and the rate of expansion of the banking system slowed markedly. The defence of the Canadian dollar—which involved many important measures in addition to those related to monetary policy—turned out to be completely successful and by early summer Canada's external financial position was again strong.

Once the exchange crisis in Canada had been overcome, a move to lower interest rates was generally expected and considered to be appropriate. Moreover, the view was developing that inflationary pressures were on the wane. Unemployment in Canada ranged between 5 and 5½ per cent in the summer and a marked slowing of economic growth in the United States was widely regarded as imminent. As the Bank of Canada moved to make monetary policy less restrictive and reduced the Bank Rate in three steps from 7½ to 6 per cent, the banks bought Government of Canada securities in large amounts. Market rates of interest declined, though they did not fall back to the levels that had prevailed before the exchange problem developed. As a result of the large purchases of Government securities, there was a sharp increase in bank liquidity and in the total size of the banking system.

By the end of the summer it had become evident that the widely expected change in the economic climate in North America was not yet developing, and the Bank of Canada felt that there should be no further increase in the banks' holdings of more liquid assets. Accordingly, we managed cash reserves in such a way that the chartered banks' holdings of such assets ceased to rise after mid-September, and the rate of expansion of the banking system was slowed. The changing expectations regarding the economic outlook were allowed to have their full impact on market interest rates, which rose gradually at first and more rapidly towards the end of the year. Long-term interest rates reached levels considerably higher even than those which had prevailed earlier in the year when the Canadian dollar was under pressure. Effective December 18 the Bank Rate was increased from 6 to 6½ per cent and the rise in market interest rates continued into 1969. A further increase in Bank Rate to 7 per cent was announced on February 28, 1969.

Over the year 1968, the average yield on long-term Government bonds rose from about 6½ per cent to about 7¼ per cent and other long-term yields also rose to record levels. At the end of 1968 the average yield on outstanding provincial issues was nearly 8 per cent, on municipal bonds about 8⅛ per cent, on corporate bonds more than 8¼ per cent, and the rate on first class conventional mortgages was 9 per cent or higher. It became much more difficult as well as more expensive to raise money in the bond market. The amount of new money raised in Canada by issuers other than the Government of Canada was much less in 1968 than in 1967, while the amount raised outside Canada increased considerably and included for the first time substantial issues in European markets. The Government of Canada, already a substantial borrower in 1967, increased the amount of new money it raised in Canada in 1968, and also borrowed abroad to add to exchange reserves.

The flow of credit through the banking system was large, though the cost of bank credit rose significantly. Total chartered bank assets grew by 14 per cent, the same percentage increase as in 1967. I am aware that the large increase in the size of the banking system has caused some concern, and I too regard it as high. However, in determining how far the central bank should allow the large demand for credit generated by the expansion of the economy and by Government requirements to be accommodated by an increase in the size of the banking system, we had to take into account not only the degree of tightness in the financial system as a whole but also the practical limitations on increases in interest rates that exist at any given time—for example, the additions to the already large cash requirements of the Government that would have resulted from the need to finance reserve accretions produced by any substantial increase in capital inflows. Moreover, the form that the increase in the liabilities of the banking system was taking was also relevant. The rise in currency and demand deposits (a definition of the "money supply" commonly used in the United States) was 6½ per cent in Canada in 1968. The considerably higher rate of increase in total bank deposits was accounted for by large increases in the relatively high-yielding categories of non-chequable savings deposits and time deposit receipts. Deposits of this type are essentially similar to short-term liquid claims outside the banking system which are not included in any definition of the "money supply".

I have referred above to the fact that the Government's domestic borrowing requirements were very high last year. Despite strenuous efforts by the Government to sell a variety of issues carrying high interest rates to non-bank investors, at times with considerable success (particularly in the case of the two issues of Canada Savings Bonds which were sold during the year), there was only a very small net increase in the amount of Government of Canada securities held by domestic non-bank investors over the year. Virtually the whole of the net increase in Government securities outstanding was therefore reflected in an increase in the holdings of the banking system and of foreign investors. The chartered banks added \$943 million to their holdings of Government securities, while the Bank of Canada, to provide for an increase in notes in circulation and an increase in chartered bank cash reserves, increased its holdings by \$135 million. The increase in Government borrowing, while adding to the upward pressures on interest rates, therefore also had the effect of adding to bank liquidity and, of course, increasing the size of the banking system.

There has been no further net increase in the banks' holdings of Government of Canada securities since mid-September; and as bank loans have continued to rise, the ratio of more liquid assets to total assets in the banking system has been reduced. The reduction in the Government's borrowing needs which will result from the measures announced in October is important not only for its economic effect but also for its effect on financial markets. A reduction in the Government's cash requirements will tend to limit the growth of the banks' more liquid assets in the future. This underlines the importance of strict adherence to the programmes announced by the Government to control expenditures and limit borrowing in 1969.

INTERNATIONAL FINANCIAL DEVELOPMENTS. Further progress was made during 1968 towards arrangements to help provide for future world requirements of international liquidity. The outline of the plan for the creation of Special Drawing Rights which was approved at the Annual Meeting of the International Monetary Fund in September 1967 has since been developed by the Executive Directors of the Fund in the form of an amendment to the Articles of Agreement of the Fund. This amendment was approved by the Governors of the Fund in May 1968, and was then referred to all Fund members for acceptance. A bill providing for Canadian participation in the new arrangement is at present before the Parliament of Canada; in the course of committee hearings on the bill the Bank of Canada expressed strong support for the legislation. The machinery proposed is workable and should be effective for its purpose, and I hope that the members of the Fund will proceed with despatch to complete the process of ratification so that the process of activation can be initiated.

During the course of 1968 the international monetary system was buffeted by a series of crises. These resulted from waves of speculation which followed the devaluation of sterling and were generated by doubts about the stability of the exchange rates of some countries. In addition to the continued lack of progress towards a better adjustment of the payments balances of the major countries, there were a number of special factors at work, such as those which contributed to the difficulties of the French franc. The threats to exchange stability called into play existing facilities for co-operative action among monetary authorities and led to several new initiatives in international finance in which Canada participated.

In the latter part of 1967 and the first quarter of 1968 the industrial countries co-operating in the Gold Pool gave up gold to the value of some $3,000 million in an effort to stabilize the price of gold in the free market. On March 17 the Governors of the central banks of the contributing members of the Gold Pool announced that they were stopping such sales and that they had agreed on new arrangements in respect of gold. These arrangements involve two separate markets, an official market among monetary authorities in which the price remains fixed at U.S. $35 an ounce, and a free market in which the price moves in response to the balance of supply and demand. Canada was not a member of the Gold Pool, but it responded affirmatively to an invitation to co-operate in the new arrangements. Canadian producers of gold who do not wish to qualify for assistance under the Emergency Gold Mining Assistance Act remain free to sell their output in the free market at prevailing prices, and those who wish to qualify are still required to sell their output to the Mint at the Canadian dollar equivalent of U.S. $35 an ounce. Instead of transferring gold it purchases to the Exchange Fund Account for inclusion in Canada's official reserves, however, the Mint now sells its gold in the free market, with the Bank of Canada acting as its agent. A request made in December 1967 by the Bank of Canada to banks and other financial intermediaries not to extend credit on gold nor to facilitate forward purchases of gold remains outstanding.

A fresh threat to the stability of the international monetary system arose in 1968 from the possibility that large conversions of sterling holdings by non-residents would cause intense pressure on the pound sterling. The facilities placed at the disposal of Britain to finance temporary reductions in sterling balances in 1966 had been fully drawn upon and repayment over a period of time was arranged in September 1968. At the same time a new initiative was taken to discourage the conversion into other currencies of sterling held by the countries of the sterling area. To assist Britain in working out suitable arrangements, a stand-by facility in her favour for U.S. $2,000 million was provided by the Bank for International Settlements and twelve central banks. The Canadian share is U.S. $100 million, the Bank of Canada acting for Canada as agent of the Minister of Finance.

In November very large flows of funds from France to Germany developed as a consequence of a growing market view that the exchange rates of these countries might be changed. France had received a short-term facility from a group of central banks in the amount of U.S. $1,300 million in July, and following a meeting in Bonn of the Ministers and Governors of the Group of Ten countries in November a new central bank facility in favour of the Bank of France in the amount of U.S. $2,000 million was announced. The Bank of Canada participates in the latter facility to the extent of U.S. $100 million.

The Bank of Canada continues to participate in the network of central bank facilities in favour of the Bank of England that was set up at the time of the devaluation of sterling in November 1967. Our share remains at U.S. $100 million.

The network of reciprocal short-term facilities between the Federal Reserve System and a number of central banks was expanded during 1968, and at the end of the year it totalled $10,500 million. Canada's participation in this arrangement was increased from $750 million to $1,000 million in March.

The group initiatives referred to in the last few paragraphs illustrate at the same time the strains to which the international monetary system was subjected during 1968 and the closeness and effectiveness of international financial co-operation. Many of the initiatives taken in 1968 dealt with the symptoms of strain rather than the causes, and their contribution was therefore in the direction of providing time to find solutions to the underlying problems. Time is frequently essential if such solutions are to be found; it must, of course, be well used if anything of lasting value is to be accomplished.

The disturbances in foreign exchange markets in 1968 have led some people to urge again that we could best strengthen the international monetary system by providing for more flexibility of exchange rates. Without wishing to maintain that the present arrangements are necessarily the best that could be devised, it seems to me that there are three background considerations that it is important to keep in mind in considering the further evolution of the international monetary system.

The first is that the present Bretton Woods arrangements assign to exchange rate changes an important role in the correction of payments imbalances, but they limit their use to circumstances of "fundamental disequilibrium". Countries are expected to try to maintain external balance by appropriate adjustments in their domestic economic and financial policies, but they are not asked to sacrifice the economic goals of high levels of employment and real income on the one hand or of reasonable price stability on the other.

The second consideration is that by its nature an exchange rate involves more than one country, for it is the price of one currency in terms of other currencies. No country can therefore regard either its own exchange rate or those of others as matters of exclusively domestic concern. The determination of exchange rates is inevitably a proper subject for international consultation and agreement.

There is, finally, the basic question of what kind of an international environment countries want. The Bretton Woods approach attaches weight to the pursuit of stability in international economic relationships in order to encourage the growth of economic and financial transactions between countries. This reflects the view that a stable external environment helps countries to achieve their own economic goals, and that it is therefore in their own interests to try to manage their national affairs in ways that are consistent with that stability. It is a consequence of economic interdependence that each country must rely on its trading partners to manage their affairs in ways that are not disturbing to its cconomic life.

I therefore conclude that it is mainly to good national economic policies around the world that we have to look to make the international economic system work better. It is not easy to manage a modern economy in such a way that it moves towards its economic objectives without causing disturbance to other countries, but all of us must continue to try. There are hopeful indications that the efforts of recent years to encourage countries to examine their economic policies in a sufficiently wide framework are bearing fruit, and that governments and peoples are becoming increasingly prepared to take account of their international economic interdependence.

CANADA - U.S. FINANCIAL ARRANGEMENTS. The agreements between Canada and the United States in respect of their international financial relationships were dealt with twice in the course of 1968 by exchanges of letters between the Secretary of the Treasury of the United States and the Minister of Finance of Canada. The first of these occurred on March 7 and the second on December 17. The full texts of these letters appear in an Appendix to this Report.

The exchange of letters of March 7 exempted Canada from all the United States balance of payments measures affecting capital flows that are administered by the Federal Reserve System and the Department of Commerce. This action was of prime importance in enabling Canada to surmount its serious exchange crisis. It was matched by two steps on the Canadian side to ensure that the United States balance of payments position would not be impaired by the exemption. Canada declared its intention (1) to take any steps necessary to ensure that its exemption from the United States programme did not result in Canada's being used as a "pass-through" by which the purpose of the United States balance of payments programme would be frustrated and (2) to invest its holdings of United States dollars in excess of working balances in United States Government securities which do not constitute a liquid claim on the United States, but with effective safeguards to Canada's position should its reserve levels require.

Steps were subsequently taken to implement the Canadian undertakings. On May 3 the Minister of Finance announced guidelines that had been accepted by the chartered banks following discussions with the Bank of Canada. On July 24 the Minister of Finance asked all other financial institutions operating in Canada to accept a similar guideline. On September 19, guidelines for Canadian incorporated companies other than financial institutions were announced by the Minister of Trade and Commerce. The texts of the statements made on these three dates and of a related statement made by the Minister of Finance on March 16, 1966 appear in an Appendix to this Report.

These various guidelines were designed within the framework of Canadian practices to provide the necessary protection to the United States payments position while at the same time causing a minimum interference with the normal activities of Canadian business. Our financial relations with the United States are so important that it is clearly in the national interest that Canadians should manage their affairs within these guidelines. The Bank of Canada is administering the guidelines which apply to the chartered banks, whose helpful co-operation it has received in this task.

In connection with the second understanding referred to above regarding the investment of Canada's holdings of United States dollars, Canada held at the end of 1968 U.S. $1,250 million of special United States Government securities, an increase of U.S. $1,050 million over the year.

The exchange of letters on December 17 dealt primarily with that part of the understandings between the United States and Canada which has to do with the level of Canada's official reserves. As reserves recovered during the summer and autumn from the low levels reached during the exchange crisis of the first quarter, increasing concern was expressed in Canada that the flexibility of Canadian monetary policy was in danger of being severely limited by the existence of a "target" level for Canadian exchange reserves under our agreements with the United States. In the December exchange of letters it was agreed that the understandings between the two countries do not require that Canada's reserve level be limited to any particular figure, and recognized Canada's need for flexibility with respect to reserve levels in order to accommodate the adaptation of monetary policy to the changing needs of the domestic economy, seasonal factors and other influences of a temporary nature. I welcome this clarification of our basic arrangements with the United States.

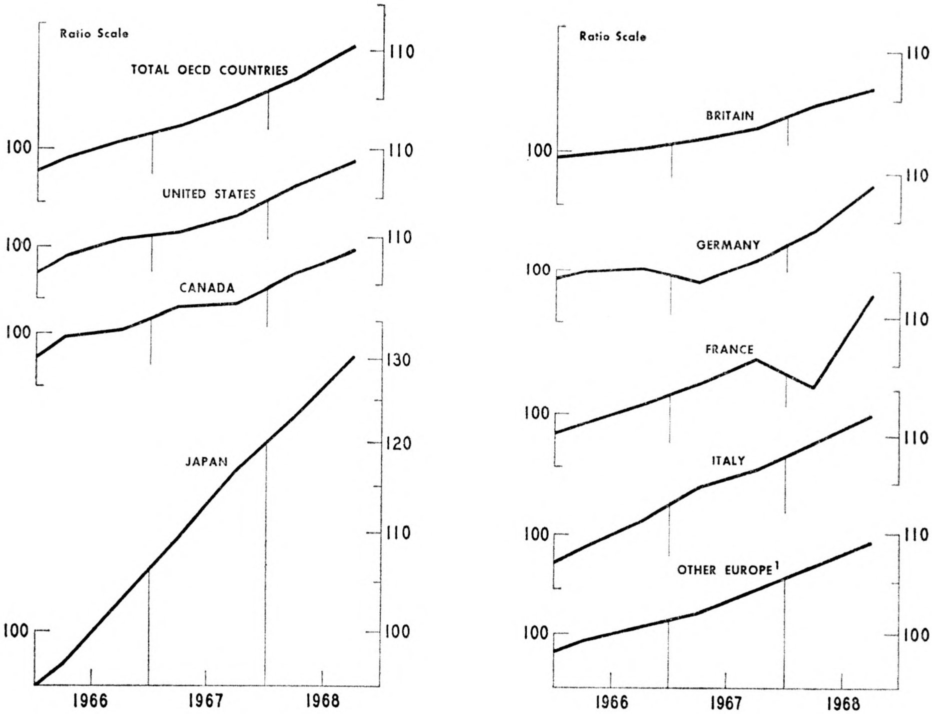
The External Environment

World output and employment expanded strongly in 1968. Total production in the OECD countries rose by more than 5½ per cent compared with 3½ per cent during 1967. In the second half of the year there was some slowing in the expansion in the United States and Britain, a recovery in France and an acceleration in Germany and in most other European countries.

GROSS NATIONAL PRODUCT

Constant Prices

Semi-Annual — Index 1966 = 100



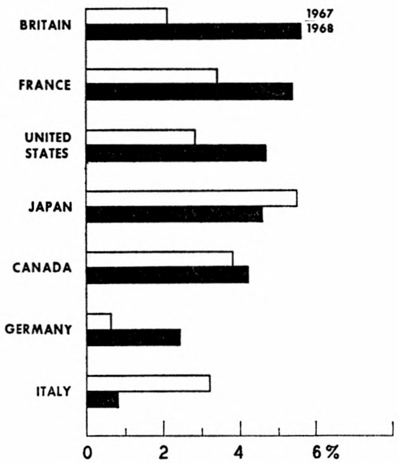
Seasonally adjusted.
1968 preliminary estimates.

1. Austria, Belgium, Denmark, Greece, Iceland, Ireland, Luxembourg, Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and Turkey.

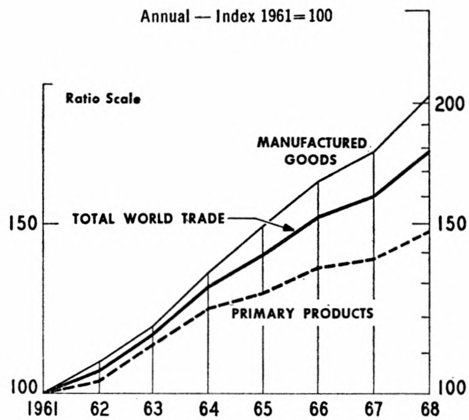
Cost and price pressures increased in most industrial countries. In Britain prices rose sharply, in part as a result of devaluation and higher indirect taxes. In France a large wage settlement in June was followed by a rapid rise in prices. Of most direct significance to Canada was the growth of inflationary pressures in the United States, where the rise in prices was greater than in any year since 1951.

CONSUMER PRICE INDICES

Percentage Increase : Year Ending Fourth Quarter



WORLD TRADE[1]



1968 preliminary.

1. Total exports f.o.b.

The rapid economic expansion in the industrial countries contributed to an increase of about 11 per cent in world trade. Trade in manufactured products continued to be the most dynamic sector, but the exports of many primary producing countries also rose strongly.

Unfortunately the growth in trade did not lead to a better balance in the current account positions of the major countries. In Britain a rising level of domestic demand led to higher imports, and the current account deficit increased from £400 million in 1967 to about £500 million in 1968. Although the current account position improved appreciably during the year it fell considerably short of the official target for the second half of the year. In the United States a rapid growth in imports led to the disappearance of the traditional current account surplus; it had been $1.7 billion in 1967 and the official objective for 1968 had been an improvement of about $1 billion. The high level of import demand in Britain and the United States contributed to a further increase in the already very large current surpluses of Germany and Italy, and to a strengthening of current account positions of many other countries, including Canada.

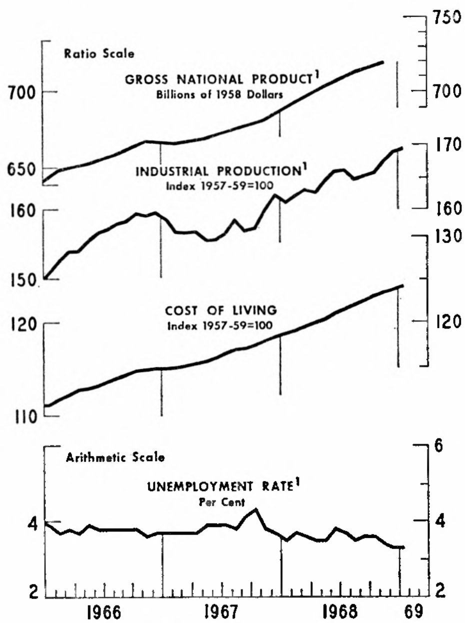
Restrictions on capital outflows by the reserve currency countries and the encouragement of capital outflows by the surplus countries contributed to a further increase in the activity of European capital markets in 1968. The Euro-bond market, an international market for new issues of long-term securities, handled issues totalling more than $3.5 billion in 1968, the major part being the obligations of overseas subsidiaries of United States corporations. In addition, a large volume of new security issues denominated in deutsche marks was sold in the German capital market during the year by foreigners, including the Government of Canada and a number of other Canadian borrowers.

The international flows of capital through these and other channels during 1968 were unusually large, and except for brief periods, they were helpful in moderating the impact on official reserves of movements in countries' current account positions. Nevertheless, doubts regarding the ability of some countries to cope with their payments imbalances without exchange rate changes contributed to large disequilibrating capital flows at certain times in the year, and these required substantial recourse to both existing and new international credit facilities.

Some of the highlights in economic developments during the year in the United States and, more briefly, in Britain, Germany, Italy, France and Japan are noted below.

In the *United States* the Gross National Product increased by 9½ per cent in value and 5½ per cent in volume during 1968, well above the increases of 5½ and 2¼ per cent respectively during 1967. The growth in real output of goods and services, which was at an annual rate of about 6 per cent in the first half of the year, moderated a little in the third and fourth quarters following enactment of the 10 per cent surcharge on personal and corporate income tax liabilities in June, but remained greater than had generally been expected. Consumer expenditures rose strongly in the third quarter, as the rate of personal saving declined simultaneously with the impact of the tax surcharge. In the fourth quarter consumer expenditures registered the smallest

UNITED STATES
SELECTED ECONOMIC INDICATORS

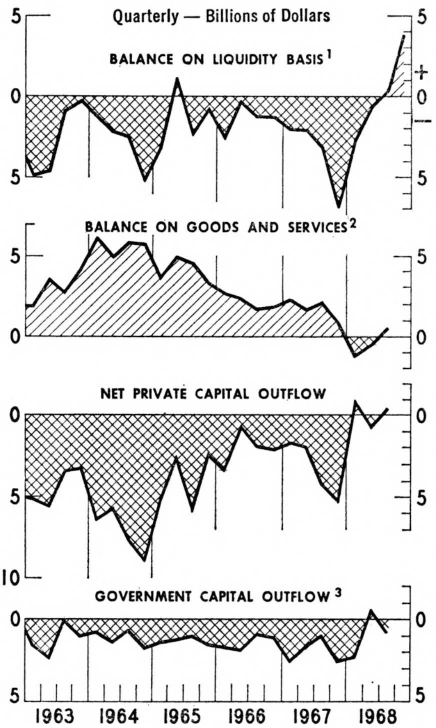


1. Seasonally adjusted (GNP at annual rates).

increase in more than a year, but private fixed investment showed unexpected strength and inventories were accumulated at a higher rate. The official United States forecast calls for an easing both in the rate of real growth and in the increase in prices in 1969.

The increase in employment fully absorbed the relatively small growth in the United States labour force in 1968. The seasonally adjusted unemployment rate averaged 3.6 per cent in each of the first three quarters, a little less than the 3.8 per cent average in 1967. Late in the year employment pressed even more strongly on the available labour supply and the unemployment rate dropped to 3.4 per cent in November and to a 15-year low of 3.3 per cent in December and January. The 5½ per cent increase in real output during 1968 was considerably larger than the 1¾ per cent rise in total employment, reflecting a signifieant improvement in output per worker. Increases in wages and fringe benefits resulting from labour contract negotiations in 1968 were larger than in the preceding year, and despite the improvement in productivity there was a further substantial rise in labour costs per unit of output. A 3.9 per cent increase in the GNP price deflator during the year compares with a 3.2 per cent increase during 1967; the Consumer Price Index rose by 4.7 per cent as against 3.1 per cent a year earlier.

UNITED STATES
BALANCE OF PAYMENTS



Seasonally adjusted at annual rates.
1. As measured by changes in U.S. official reserve assets and in liquid liabilities to all foreigners.
2. Includes unilateral transfers.
3. Includes special government transactions.

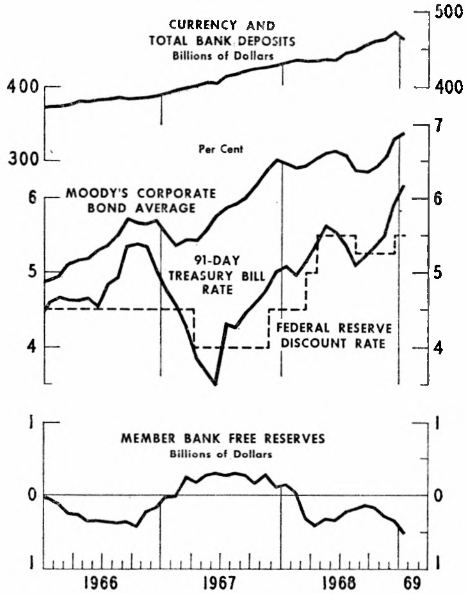
Strong economic growth in 1968 generated an exceptionally large increase in United States imports; they were also affected by actual or threatened strikes in the copper, aluminum and steel industries and by longshoremen. The growth in exports was not nearly so great and the United States trade surplus, which had amounted to $3.5 billion in 1967, virtually disappeared. This was offset in part by an improvement in the balance on service account, and the current account, including government grants and unilateral transfers, was apparently about in balance, compared with a $1.7 billion surplus in 1967.

As the result of a very large swing in the capital account the over-all international payments position of the

United States was roughly in balance on a liquidity basis in 1968, in contrast to a deficit of $3.6 billion in 1967. Mandatory controls on foreign direct investment announced at the beginning of 1968 greatly stimulated efforts of American firms to finance their foreign investment by borrowing abroad, particularly in the Euro-bond market. Foreign purchases of equities in the United States market also rose substantially, encouraged in part by political developments in France and Czechoslovakia, and there was a significantly larger inflow of funds from special financial transactions by United States and foreign official agencies.

During the first five months of 1968, in the absence of Congressional approval of the tax increase proposed by the Administration, monetary policy in the United States became progressively more restrictive in an effort to moderate inflationary pressures. Loans and investments of commercial banks increased at an annual rate of 7½ per cent after seasonal adjustment, compared with 12½ per cent during the second half of 1967 and there was a sharp swing from net free to net borrowed reserves at member banks. After a short period of easing at the beginning of the year, there was a renewed upward trend in interest rates. The Federal Reserve discount rate was raised to 5½ per cent in two half-point increases in March and April, and by mid-May most short-term rates had risen above the peak levels reached during the period of monetary restraint in 1966. Long-term rates also tended to move upward during this period and generally rose above the previous year's highs.

UNITED STATES MONETARY INDICATORS



The legislation enacted in June providing for the 10 per cent surcharge on income taxes included a limitation on government expenditures. It is officially estimated that the budget will swing from the $25 billion deficit in the fiscal year ended June 30, 1968 to a surplus of $2.4 billion in fiscal 1969 and $3.4 billion in fiscal 1970. As prospects for fiscal restraint improved late in May interest rates began to move down again and by August they had returned to roughly the levels prevailing at the beginning of the year. Monetary policy became less restrictive during this period and the discount rate was reduced to 5¼ per cent in August. Beginning late in the summer, however, when the slowdown in business activity failed to develop to the extent anticipated, monetary policy began to tighten again. Investor expectations changed and in the face of heavy credit demands the downward movement in interest rates was reversed. In December the discount rate was restored to 5½ per cent and by year-end most market rates exceeded their historical highs established earlier in the year.

In *Britain* domestic demand continued through 1968 at a higher level than was expected or desired. In the period between devaluation and the restrictive March budget, consumer expenditure rose sharply. The budget provided for both a substantial increase in revenues and a limited increase in government expenditures. The sharp rise in indirect taxes was designed to reduce personal consumption and provide scope for an expansion of exports and fixed investment within the context of a 3 per cent annual increase in total real output. Following the budget consumer expenditure fell but there was a substantial restocking of inventories. As the year progressed consumer demand reappeared as an expansionary element, stimulated by a larger increase in incomes than was envisaged in the budget. In November 1968, average weekly earnings in manufacturing were 7½ per cent higher than a year earlier. At the time of the budget the Bank Rate was lowered one-half point from the 8 per cent level fixed at the time of devaluation and it was reduced again by one-half point in September. On the other hand, credit to the private sector was curtailed throughout the period by ceilings imposed on bank lending. Short-term interest rates trended downward from the high levels reached in November 1967 while long-term rates were moving upward during the year.

The high level of domestic demand retarded the pace of external adjustment. In the favourable external environment, Britain's exports rose more than was expected but imports remained at the high level to which they had risen in the months following devaluation and the improvement in the trade balance was relatively small. The current account deficit totalled about £500 million in 1968 of which much the greater part was incurred in the first half of the year. Britain drew $1,400 million in June from the International Monetary Fund and had recourse to other credit facilities at various times during the year.

In November the authorities tightened hire-purchase terms, increased indirect taxes, imposed tighter credit restrictions, and introduced a system of prior deposits on imports. Bank Rate was raised by one point to 8 per cent on February 27, 1969.

The cyclical recovery of the *German* economy which had begun in 1967 picked up momentum during 1968. Total real output rose by about 7½ per cent with an even faster rate of growth in the second half of the year. The buoyant state of the economy was reflected in a firming of the labour market and income per employee, which had shown virtually no change during 1967, began to rise rapidly. However, productivity also rose strongly with the cyclical growth in output, and prices were relatively stable until late in the year.

Exports rose even more than imports and there was a substantial increase in the trade surplus. The current account surplus rose to $2.9 billion from $2.4 billion in 1967. Monetary policy continued to be relatively easy in 1968 and the prevailing credit conditions in Germany facilitated an export of private long-term capital of almost the same magnitude as the current account surplus. Although net new issues of fixed interest securities rose sharply during the course of the year, long-term interest rates continued to drift downward. The strong position of the deutsche mark and uncertainties regarding the French franc led to a short-term capital inflow of about $2.5 billion into Germany in the first three weeks of November. The Government announced a temporary subsidy on imports and tax on exports, in each case of 4 percentage points, and 100 per cent cash reserve requirements on any increase in credit institutions' liabilities to non-residents over the level of November 15, 1968. All of the November inflow of foreign exchange had been reversed by the first months of 1969.

In *Italy* there was a slight slowing in the pace of economic activity, and unemployment began to rise in 1968. Foreign demand was strong throughout the year but consumer demand eased markedly and inventories fell in the first half. Expansionary changes in fiscal policy introduced later in the year led to a more rapid growth in domestic demand and a strong recovery in imports. Despite some decline in the second half the current account surplus was about $2.5 billion for the year as a whole. However, capital outflows more than doubled in 1968 and official reserves fell slightly.

In *France* the course of economic activity was distorted by the May strikes. The pace of expansion accelerated rapidly after the settlement, stimulated by expansionary fiscal and monetary policies and higher incomes resulting from the large increase in wages. Imports increased and the balance of payments position deteriorated. A run on the French franc in November led to the imposition of tight exchange controls, the introduction of tax measures to stimulate exports and import substitution and a substantial cutback in the 1969 budget. Monetary policy was also tightened. For the year as a whole a substantial deficit in the balance of payments on current account and massive outflows of capital caused large losses of gold and foreign exchange; official reserves declined by $2.8 billion.

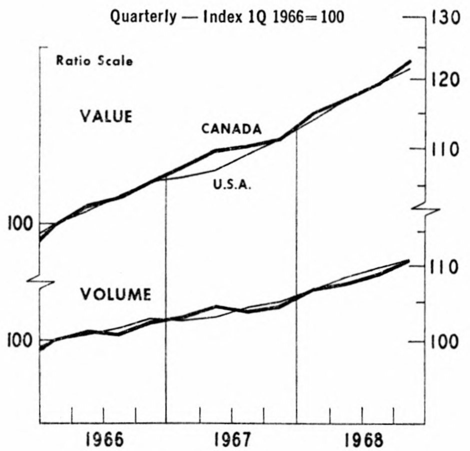
In *Japan* economic activity continued to grow rapidly and there were further substantial increases in costs and prices. Strong external demand resulted in a rapid acceleration in exports while the restrictive measures applied late in 1967 to correct a widening current account deficit resulted in a slowing down of imports and a decline in inventories. The current account position swung from a substantial deficit at the end of 1967 to a surplus which increased during the course of 1968. The outflow of long-term capital, which had been a feature of the Japanese economy in recent years, fell sharply in 1968 and official reserves rose by $860 million.

Economic Developments in Canada

Following a period of adjustment and slow growth which began in the spring of 1966 the Canadian economy resumed a strong rate of expansion towards the end of 1967. The recovery was spurred by a large increase in merchandise exports late in 1967 and early in 1968 which resulted from the strong resurgence of demand in the United States. In the course of 1968 additional momentum was provided by a record level of housing starts, by an acceleration in consumer spending on durable goods, by some recovery in business outlays on plant and equipment, and by the completion of the adjustment in business inventories. Employment responded to the revival in demand, but the labour force rose even more rapidly and productivity, which had failed to show any improvement over the period of slow growth in the economy, also picked up. As a result, the average level of unemployment was somewhat higher in 1968 than in 1967. At the same time increases in wages, salaries and profits outpaced even the faster growth in output in 1968 and prices continued to rise at about the same rate as in the two previous years.

GROSS NATIONAL PRODUCT
CANADA — U.S.A.

Quarterly — Index 1Q 1966=100



Seasonally adjusted.
Fourth quarter 1968 for Canada is estimated.

TOTAL OUTPUT. As the pace of economic expansion was moderating in the course of 1967 and accelerating in 1968, a conventional comparison of data for the two calendar years understates the extent of the growth during 1968. Between the fourth quarter of 1967 and the fourth quarter of 1968, seasonally adjusted GNP appears to have increased by about 10 per cent in money terms, of which about 6 per cent is accounted for by volume and some 4 per cent by price increase. The rate of real economic growth was thus almost as rapid as it was over the five-year period ending in the second quarter of 1966 and three times as fast as it was during the adjustment period that followed. A comparison of the annual rates of increase in the major economic aggregates during these three periods is given in the following table.

ANNUAL PERCENTAGE RATES OF GROWTH
MAJOR ECONOMIC AGGREGATES
SELECTED PERIODS 1961-1968

	2Q 1961 to 2Q 1966	2Q 1966 to 4Q 1967	4Q 1967 to 4Q 1968
Gross National Product:			
Value	9.2	5.8	10e
Volume	6.5	2.1	6e
Price	2.5	3.7	4e
Real output per employee	3.1	−0.3	2½e
Employment(1)	3.3	2.4	3.3
Labour force(1)	2.4	3.2	3.7

e: Estimate.
(1) Includes Armed Forces.

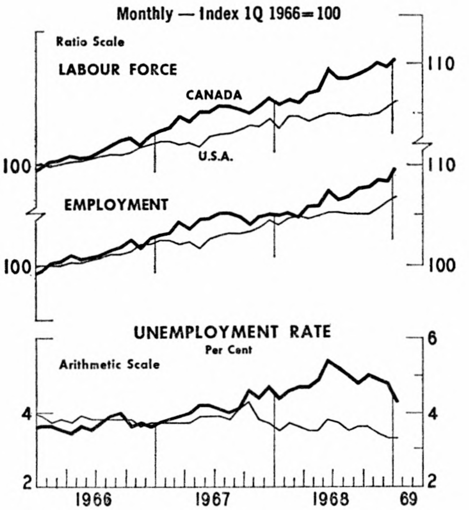
Manufacturing output rose even more strikingly than total output. In the fourth quarter of 1968 it was 7 per cent higher than in the fourth quarter of 1967; this compares with an annual rate of increase of slightly more than one per cent over the previous year and a half. Particularly notable gains were recorded in steel, automobiles and lumber. Virtually all the evidence suggests that output was continuing to rise strongly as 1969 began.

Agriculture also appears to have experienced a significant increase in the volume of output in 1968, but an unusually difficult situation has confronted western grain producers. While the crop harvested in 1968 was somewhat larger, adverse harvesting weather seriously lowered its quality. In addition, there have been marketing difficulties associated with the less ebullient demand for Canadian wheat in the past two years and aggravated by a variety of problems resulting from the damp condition of the 1968 crop, bottlenecks in transportation, and the congestion in storage facilities.

PRODUCTIVITY AND EMPLOYMENT. As shown in the above table the rapid expansion of the economy since the end of 1967 has been accompanied by renewed growth in productivity. In manufacturing, where productivity began to recover in the course of 1967, output per man-hour appears to have been at least 4 per cent higher in the fourth quarter of 1968 than a year earlier. These encouraging developments in productivity are, however, subject to an important qualification. They undoubtedly contain elements of a short-run nature associated with the normal cyclical factors which affect productivity measures during a period of slowdown and subsequent re-acceleration in output. Over the whole period from the second quarter of 1966 to the fourth quarter of 1968 the productivity performance of the economy remains disappointing, as productivity appears to have risen by less than one per cent per annum.

Because of the improvement in average productivity in 1968, the recovery in employment was less pronounced than in output. At the same time the labour force was increasing more rapidly. As a result of these developments, the gradual rise in unemployment persisted until the middle of 1968 with the unemployment rate reaching a seasonally adjusted peak of 5.4 per cent in June when an unusually large number of students were seeking summer jobs. However, the unemployment rate fell somewhat in the second half of the year; in the fourth quarter it averaged just under 5 per cent, only slightly higher than in the same period a year earlier, and declined further in January 1969. For 1968 as a whole the unemployment rate averaged 4.8 per cent compared with 4.1 per cent in 1967. The civilian labour force was 3¾ per cent higher in the last quarter of 1968 than a year before, compared with an annual rate of increase of 3 per cent during the period of slower growth in output and employment. Net immigration was less in 1968 than in 1967 and there was little change in the rate of growth of the labour force attributable to demographic factors; the principal explanation for the faster rise in labour force was a higher rate of participation, especially by married women.

LABOUR FORCE AND EMPLOYMENT
CANADA — U.S.A.



Seasonally adjusted.

COSTS AND PRICES. The size of wage and salary increases in the collective bargaining sector showed some signs of moderating in 1968. There were again numerous instances of very large increases, but the weighted average of annual increases in base-rates in contracts negotiated during the year fell to 8.1 per cent compared to 8.7 per cent in 1967 contracts and 8.3 per cent in 1966 contracts; the average increase in the fourth quarter of 1968 was 7.5 per cent. The 1968 average remained somewhat higher in Canada than in the United States, though the increases negotiated under collective bargaining in the United States were slightly larger than in 1967.

The most comprehensive figures available on average wage and salary earnings relate to employees in larger industrial establishments; they exclude government employees and cover only slightly more than half the number of paid workers indicated by the labour force survey. They cover a considerably larger proportion of the work force than that covered by collective bargaining arrangements and, because they include salaried workers, are more representative than figures pertaining to hourly-rated employees only.

AVERAGE WEEKLY WAGES AND SALARIES YEAR-OVER-YEAR PERCENTAGE INCREASE

(three months ending November)

	1966	1967	1968
Manufacturing	6.1	6.4	8.1
Mining	7.1	8.0	8.3
Forestry	8.2	10.5	4.6
Construction	12.0	6.5	6.3
Transportation and utilities	6.0	7.9	8.3
Trade	4.8	5.8	8.0[e]
Finance, insurance and real estate	5.1	5.8	9.1
Other commercial services	6.3	7.1	5.1
Total of above	6.3	6.2	7.4

e: Estimate.

On the basis of these figures, it would appear that in the business sector of the economy, at least, average earnings rose significantly more in 1968 than in the two previous years.

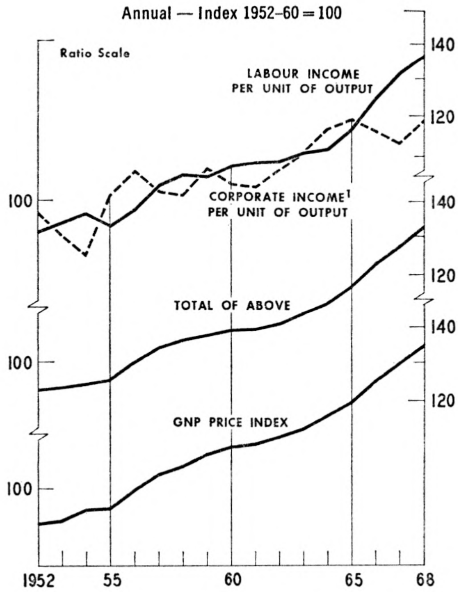
The total of wages, salaries and supplementary labour income (including military pay) in the non-farm economy is estimated to have increased by more than 9½ per cent between the fourth quarter of 1967 and the fourth quarter of 1968, compared to an increase of 7½ per cent in the previous year. Real GNP excluding agriculture is estimated to have increased by almost 6 per cent during 1968 compared to less than 3 per cent during 1967. Thus, labour costs per unit of output in the non-farm economy are estimated to have risen by about 3½ per cent in 1968, compared with about 4½ per cent in 1967 and more than 7 per cent in 1966. While the increase in 1968 was still appreciably greater than the 2 per cent average increase over the period from 1952 to 1965, it appears to have been slightly less than that which occurred in the United States where unit labour costs in the non-farm economy rose by an estimated 4 per cent in 1968.

It is particularly useful to compare output, costs and productivity in the manufacturing sector of the Canadian and United States economies, because it is the sector of most direct relevance to the relative competitive position of the two countries. The results are summarized in a series of charts on page 27. These comparisons suggest that, in manufacturing, output per employee increased more in Canada than in the United States in 1968 while income per employee rose less rapidly. As a result, unit labour costs in Canadian manufacturing increased by some 2 per cent between the fourth quarter of 1967 and the fourth quarter of 1968 while they rose by about 4 per cent in the United States. The increase in Canada was less than half the high rate of increase over the previous two years whereas unit labour costs in United States manufacturing rose somewhat more rapidly than in the earlier period. Consequently, the deterioration in the competitive position of Canadian manufacturing which occurred in 1966 and 1967 appears to have been recouped over the course of 1968.

While non-farm unit labour costs increased more slowly in 1968 than in the two previous years, profits per unit of non-farm output, which had declined in 1966 and 1967, reversed this decline in 1968. In the non-farm economy, as may be seen in the accompanying chart, corporate income (before taxes and depreciation) per unit of output in 1968 just about returned to its 1965 level. As a result, the combined total of corporate and labour income per unit of output rose by about the same percentage in 1968 as in 1967, and by about the same percentage as the GNP price index.

LABOUR COST AND PROFITS IN THE NON-FARM ECONOMY AND PRICES

Annual — Index 1952-60 = 100



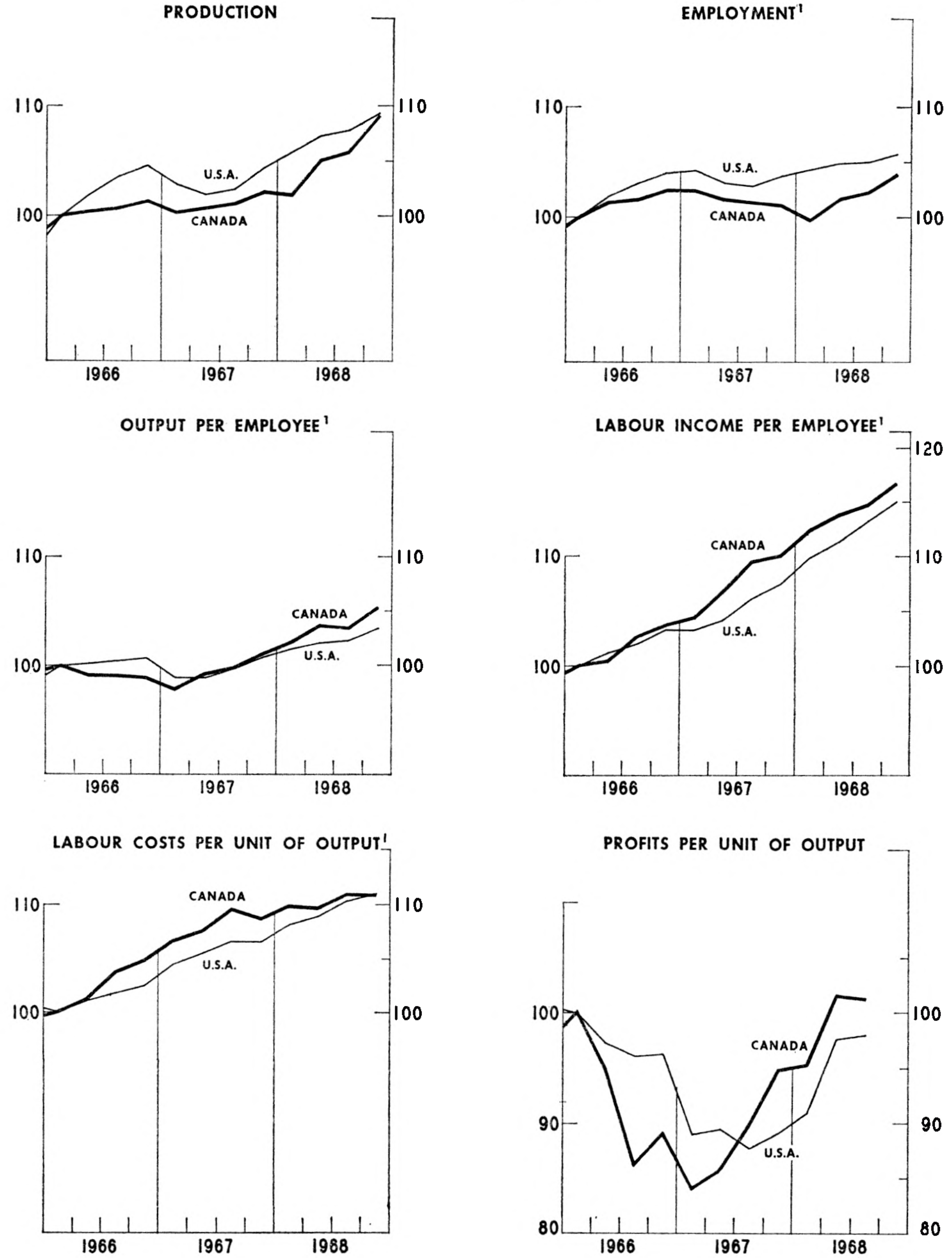
1968 estimated on basis of first 9 months.

1. Corporation profits before taxes and capital cost allowances.

Both the GNP price deflator and the Consumer Price Index rose by about 4 per cent between the fourth quarter of 1967 and the fourth quarter of 1968. In both cases this was a somewhat larger increase than occurred during the preceding twelve-month period. In fact, in the case of the Consumer Price Index the increase of 4.2 per cent over this period was the largest during any year since 1951. Food prices, which increased by 3½ per cent during 1968 compared to about 2 per cent during 1967, were a factor in the acceleration of the total index last year; but the index of all other items combined again registered a large increase of almost 4½ per cent as it had during 1967.

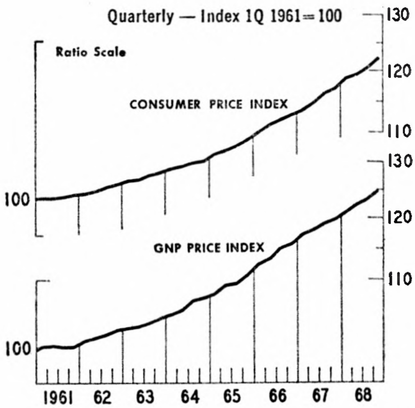
INCOME AND PRODUCTIVITY IN MANUFACTURING
CANADA - U.S.A.

Quarterly — Index 1Q 1966=100

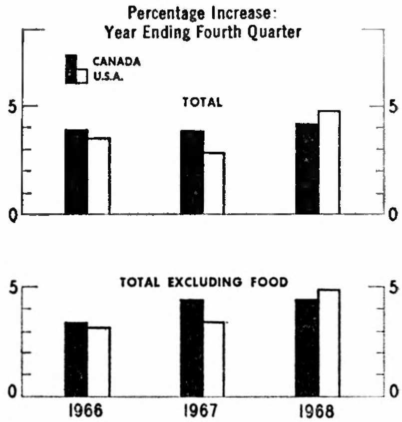


Seasonally adjusted.

1. Fourth quarter 1968 for Canada is estimated.



Seasonally adjusted: CPI adjusted by Bank of Canada.
Fourth quarter 1968 GNP Price Index is estimated.



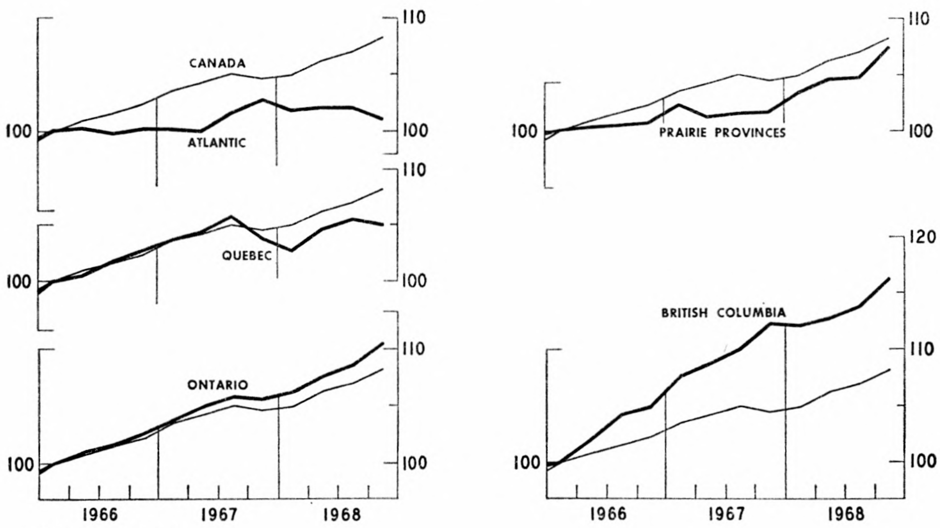
In 1968 for the first time in several years price increases in Canada were no larger than in the United States. Indeed, the increase in consumer prices was greater in the United States—4.7 per cent between December 1967 and December 1968, as against 4.1 per cent in Canada. For both countries the GNP price deflator rose by about 4 per cent during the course of the year.

REGIONAL DEVELOPMENTS. Although regional comparisons differ considerably on the basis of the various statistical series available, the resumption of faster growth in the national economy in 1968 had, on the whole, less impact on Quebec and the Atlantic region than on the rest of the country. Ontario appears to have led the recovery, reflecting its predominant industrial position especially in such buoyant areas as steel and automobiles; British Columbia also benefitted markedly from the stronger demand for the products of forest-based industries, particularly lumber. Most indicators for Quebec suggest that expansion may have been less vigorous in 1968 than in the previous year when Quebec's performance significantly exceeded the national average as a result in part of activity in the Montreal region related to Expo '67. In the Atlantic Provinces, tourist expenditures recovered strongly following some loss of business to Expo in 1967, and the major goods-producing industries in this region also appear to have grown somewhat more rapidly than in the previous year though perhaps less than the national average.

All regions shared in the substantial increase in residential construction last year. Business investment which, on the basis of a calendar year comparison, was little changed in most parts of the country continued to rise strongly in Newfoundland and appears to have been significantly higher in the Prairie Provinces in 1968 than in 1967. On the other hand, farm cash income, which increased slightly elsewhere, declined fairly sharply in the Prairies as a result of the difficulties already mentioned relating to the 1968 grain crop; despite the strength in many non-farm sectors of the Prairie economy, retail trade in that region showed the smallest gain of any except Quebec.

REGIONAL EMPLOYMENT

Quarterly — Index 1Q 1966=100



Seasonally adjusted.

During the adjustment period of 1966-67, employment in most parts of the country grew more slowly than in the years of rapid expansion and unemployment rates increased in all regions. In Quebec the growth in employment remained strong through the summer of 1967 due to Expo-related activity in the Montreal region, then fell off towards the end of the year. Considerable differences among the major regions are evident in the period of rapid growth in the national totals of output and employment since the latter part of 1967. On the one hand, there has been a strong demand for labour in Ontario and the West and the rise in unemployment in those regions has been checked. In Quebec and the Atlantic region, on the other hand, the demand for labour has shown little change and unemployment continued to rise during 1968. These labour market developments are summarized in the table on page 30.

REGIONAL LABOUR MARKETS

	Labour force		Employment		Unemployment rate		
	Annual rates of change(1)				Seasonally adjusted		
	2Q 1966 to 4Q 1967	4Q 1967 to 4Q 1968	2Q 1966 to 4Q 1967	4Q 1967 to 4Q 1968	2Q 1966	4Q 1967	4Q 1968
Atlantic Provinces	2.5	−0.6	1.7	−1.7	5.8	6.8	7.8
Quebec..........	2.9	2.7	2.1	1.4	4.8	5.8	7.0
Ontario..........	3.7	4.8	2.9	4.9	2.3	3.5	3.4
Prairie Provinces.	1.3	5.9	0.8	5.7	1.9	2.7	2.8
British Columbia.	7.7	3.6	6.6	3.8	4.5	5.9	5.7
Canada..........	3.3	3.8	2.5	3.4	3.5	4.5	4.9

(1) Derived from seasonally adjusted data.

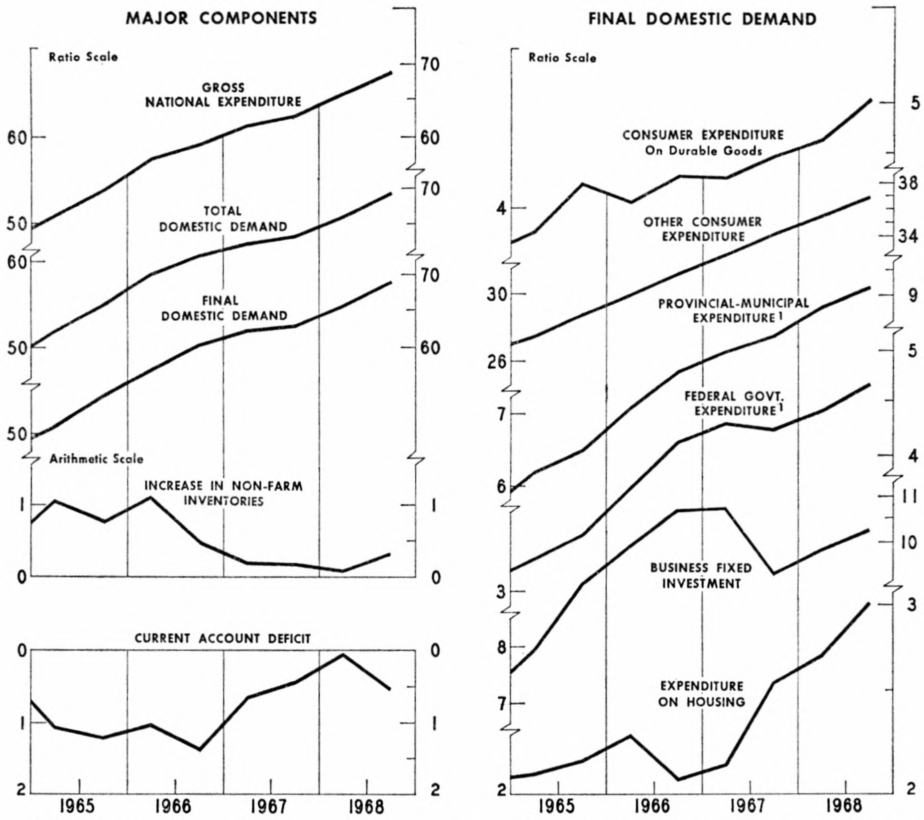
DOMESTIC DEMAND. Although the initial stimulus leading to the recovery of economic activity during 1968 appears to have been external demand, most components of domestic demand were advancing strongly by the end of the year. The rate of growth of GNP apparently moderated slightly in the second half of the year but domestic demand, which had increased at an annual rate of 8½ per cent between the second half of 1967 and the first half of 1968, rose at an estimated rate of about 10½ per cent from the first half to the second half.

Consumer expenditure, which had continued to increase quite strongly during the adjustment period, showed persistent strength in 1968 and in the second half of the year it was running some 8½ per cent above the corresponding period of 1967. In the aggregate, the increase in consumer spending was not much larger than in the preceding year, but there was a marked increase in the demand for durables (notably for new automobiles) which rose by 13 per cent between the second half of 1967 and the second half of 1968, compared to an increase of 4 per cent over the preceding year. The growth in total consumer outlays fell somewhat short of the estimated increase of about 10 per cent in total personal income. However, when allowance is made for an increase of some 20 per cent in personal direct tax payments, the rise in consumer expenditure during the past year has exceeded the rise in personal disposable income, and the rate of personal saving has fallen slightly.

The recovery in residential construction had preceded the resumption of more rapid growth in the economy and various measures adopted to increase the supply of mortgage funds facilitated a sharp expansion in housing activity in 1968. Starts totalled almost 197,000 dwelling units, far exceeding the previous peak of 167,000 in 1965 and the 1967 total of 164,000. Of more immediate importance, in view of the relative scarcity of housing accommodation which had developed after the 1966 squeeze on mortgage markets, completions recovered

COMPONENTS OF DEMAND

Semi-Annual — Billions of Dollars



Seasonally adjusted at annual rates.
Last half 1968 includes an estimate for fourth quarter.

1. On goods and services only; does not include transfer payments.

sharply from their relatively low level of 150,000 units in 1967, to a new record of about 170,000 units. In the second half of 1968 total outlays on house building were running almost 20 per cent above the level a year before, although as much as a third of this increase reflected the continued sharp increase in costs. The high level of activity at year-end is illustrated by the fact that 127,000 units were under construction compared with 103,000 a year earlier.

Outlays for new plant and equipment, after declining through 1967, have been rising again since the beginning of 1968. While the available estimates in this area are still subject to sizeable revision, outlays are estimated to have been some 5 to 10 per cent higher in the second half of 1968 than in the corresponding period of 1967. The strength of export demand which developed towards the end of 1967 and the accompanying strong recovery of profits undoubtedly provided incentive for, and facilitated the financing of, the revival in investment.

Investment in inventories did not increase significantly until the third quarter of 1968. This may reflect some difficulty encountered by producers in expanding output quickly enough to meet the sharp increase in final demand and to provide desired increases in stocks consistent with a higher level of activity. Following some reduction of non-farm business stocks in the fourth quarter of 1967, there was little net accumulation in the first half of 1968 and such rebuilding of stocks as may have occurred in the last half of the year seems to have been of modest proportions. While the book value of manufacturers' inventories increased more rapidly after mid-year, the strength of shipments in the second half of the year prevented any rise from occurring in stock-sales ratios.

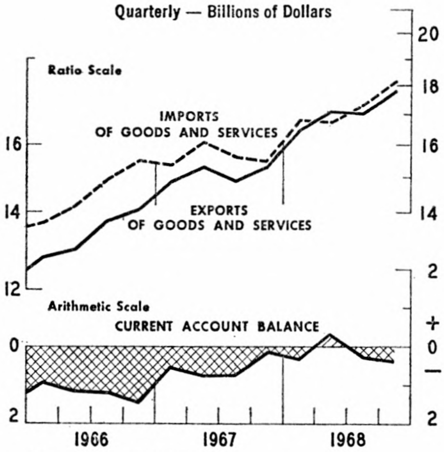
After allowing for quarterly irregularities, expenditures on goods and services by all levels of government combined appear to have increased at a rate of about 10 per cent during 1968, somewhat more than during the preceding year but appreciably less than in 1966. Wages and salaries of government employees and capital outlays in such areas as education have been major elements in the continued increase. The stability in defence expenditure in 1968 was a moderating element at the federal level.

On a calendar year basis, the total of all governments' expenditure including all transfer payments but excluding loans and similar financial transactions increased by about 11 per cent in 1968 compared with 13 per cent in 1967 and 15 per cent in 1966. With increased rates of personal and corporation income tax and of indirect taxes, total government revenues rose by about 12 per cent, slightly more than in the previous two years. Additional increases in taxation introduced in the federal budget on October 22, 1968 take effect in 1969.

With government revenues rising more rapidly than expenditures, the net deficit of all governments combined was reduced by about $100 million in 1968. In addition, the total of net loans and advances by all governments to their own enterprises and to the private sector decreased moderately in 1968.

CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS. The sharp acceleration in the demand for Canadian exports from late 1967 to mid-1968 emanated primarily from the United States where a strong general demand for imports was augmented by strikes or threatened strikes in the copper, aluminum and steel industries. It came at a time when imports into Canada were rising more moderately, as investment in machinery and equipment had eased and an adjustment was occurring in business inventories. The resulting sharp improvements in the current account balance on goods and services directly accounted for about one quarter of the total growth in Canadian production from the third quarter of 1967 to the second quarter of 1968. With the removal of strike-related import demand in the United States, our exports increased less rapidly in the second half of the year, while imports rose more quickly as investment in machinery and inventories picked up. The consequent weakening of the current account balance moderated the impact on Canadian resources of the resurgence of domestic demand in the second half of the year.

CURRENT ACCOUNT OF THE BALANCE OF PAYMEN S

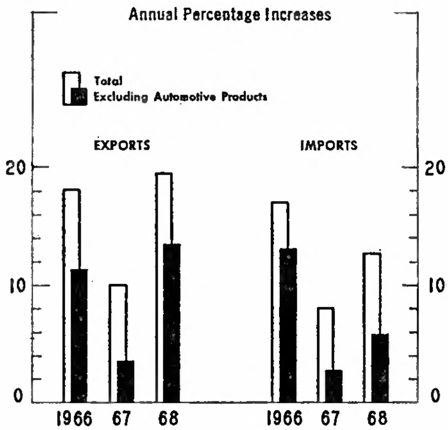


Balance of payments basis.

Analysis of Canada's balance of payments for 1967 and 1968 is rendered difficult by a large discrepancy in the official statistics between the direct estimates of the current and capital accounts, which leave a substantial residual of unidentified net payments to non-residents. In the statistics, the balancing item is attributed to the capital account but part of it may in fact reflect an underestimation of current payments or an overestimation of current receipts. The published estimates show the current account deficit declining from $1,162 million in 1966 to $543 million in 1967 and to $181 million in 1968, with all of the reduction in the two years being in transactions with the United States.

The merchandise trade surplus rose sharply in 1968; the recorded statistics show an increase from $481 million in 1967 to $1,295 million in 1968. Rapidly rising exports and imports of automotive products contributed substantially to the growth in merchandise trade last year, as they have each year since the signing of the Canada - United States automotive agreement in 1965. Our statistics show an increase in exports of automotive products to all countries of more than 50 per cent in 1968. The rise in our imports of these products was almost 40 per cent and the import balance, which had declined sharply in 1966 and 1967, fell only slightly in 1968.

GROWTH IN MERCHANDISE TRADE



Excluding automotive products, exports rose by 13½ per cent in 1968 following a 3½ per cent increase in 1967, while imports rose by nearly 6 per cent compared with a 2½ per cent increase in 1967. Both exports and imports were facilitated in 1968 by the first stage of reductions in customs tariffs under the Kennedy Round. Higher prices contributed a little more to the increases in the value of exports and imports in 1968 than in 1967.

Exports to the United States of commodities other than automotive products showed an increase of 17½ per cent in 1968 compared with 6 per cent in 1967. This increase in Canadian shipments in 1968, though very large, fell short of the steep rise in the total of United States non-automotive imports from all countries. This may reflect the fact that Canada is not a major exporter of the many sophisticated manufactured goods which have been imported in increasing quantities into the United States in the past few years. While Canadian exports of copper, aluminum, iron and steel benefitted from special situations in United States markets late in 1967 and the first half of 1968, there does not appear to have been a major impact on our total exports for the calendar year. Excluding these categories as well as automotive products, the increase in our exports to the United States in 1968 was 15½ per cent.

Exports of wheat and flour, often a cause of major fluctuations in our exports to overseas countries, had declined sharply in the second half of 1967, largely as a result of reduced shipments to the Soviet Union and Mainland China. For the year 1968 they were slightly lower than in 1967; shipments to China rose sharply again but exports to most Western and Eastern European countries and to other Asian countries fell.

Canadian overseas exports of commodities other than wheat increased by nearly 12 per cent in 1968, about the same rate as in 1967. Shipments of automotive products rose sharply and exports of copper benefitted from the world shortage created by the strike in the United States. Shipments to Britain increased slightly less than in 1967, but sales to Germany, Belgium, Norway and South America rose more rapidly. Excluding wheat, exports of commodities to Japan, which had recorded an exceptional increase of 60 per cent in 1967, increased by 10 per cent in 1968.

Merchandise imports of commodities other than automotive products, as noted above, were only 6 per cent higher in the calendar year 1968 than in 1967. However, the value of such imports rose by nearly 11 per cent from the second half of 1967 to the second half of 1968, an increase more in line with the accelerating pace of domestic demand over the past year.

The statistics of Canada's international non-merchandise transactions show an increase in the deficit of about $450 million to $1,476 million in 1968. The larger deficit was due mainly to the loss on travel account of the benefits arising from Expo '67 and other Centennial attractions. Also, there was a further increase in net interest and dividend payments abroad which rose by $75 million to $971 million in 1968. On the other hand, larger transfers of funds to Canada by immigrants and smaller outright grants under official foreign aid programmes tended to limit the increase in the non-merchandise deficit.

Financial Developments in Canada

This section begins with a chronological account of the Bank of Canada's operations during the year, and goes on to describe financing activity and conditions in financial markets in Canada during 1968. The main forces shaping the course of financial events and central bank policy in Canada were the strong underlying demand for funds generated by public sector borrowing requirements and by vigorous economic expansion, the spread of inflationary expectations, and unsettled conditions in foreign exchange markets.

BANK OF CANADA OPERATIONS. During the early months of 1968 the dominant influence on monetary policy was the need to combat the sharp run on Canada's foreign exchange reserves. After the devaluation of sterling in November 1967, nervousness in exchange markets began to be reflected in speculative activity against several currencies, including the Canadian dollar; the value of the Canadian dollar declined from its upper limit to about its official par value during the latter part of the month. When central bank discount rates were raised in Britain and the United States in November 1967 the Bank of Canada raised Bank Rate from 5 per cent to 6 per cent, and through its cash reserve management in the latter part of 1967 it encouraged the rise in market rates of interest that was occurring. Overseas, there were heavy purchases of gold by speculators and in December, as a measure of international co-operation, the Bank of Canada requested Canadian banks and other financial intermediaries not to extend credit on gold nor to facilitate forward purchases of gold.

The announcement of the new United States balance of payments programme on January 1, 1968 brought greatly intensified pressure on the Canadian dollar. Although in designing the United States programme an effort had been made to minimize difficulties for Canada, doubts were raised about the basic viability of the Canadian balance of payments position in a situation where the country from which we drew the bulk of our external capital was restricting capital exports. The Canadian dollar weakened in both the spot and forward exchange markets as hedging of Canadian dollar positions by subsidiaries of foreign companies and others developed on an unusual scale. Following discussions between Canadian and United States authorities the United States Treasury Department released a statement on January 21 making it clear that the new United States programme was not intended to produce abnormal transfers of funds from Canada to the United States by Canadian subsidiaries of American corporations and that it left room for large flows of capital to Canada. On the same date, the Bank of Canada announced that following discussions with the chartered banks it had been agreed that the banks would discourage the use of bank credit to facilitate abnormal transfers of funds abroad by Canadian subsidiaries of foreign companies and would also discourage the use of bank credit by such companies to meet financial requirements in Canada which had in the past normally been met by parent companies. It was announced that, effective January 22, Bank Rate was raised from 6 per cent to 7 per cent. At the end of January the Bank of Canada drew U.S. $250 million under its U.S. $750 million reciprocal currency facility with the Federal Reserve System.

Pressure on the Canadian dollar continued through February and into March as uncertainty arose concerning Canada's fiscal position and as concern about the international financial system again gave rise to extremely large purchases of gold in free markets around the world. At the end of February Canada drew U.S. $426 million from the International Monetary Fund. Of this amount U.S. $241 million represented Canada's creditor position with the Fund; the remaining U.S. $185 million, the equivalent of Canada's contribution of gold to the Fund, involved a repayment obligation. Early in March when Euro-dollar interest rates began to rise again the Bank asked the chartered banks and other financial intermediaries not to facilitate swapped* deposit transactions in foreign currencies, and the Minister of Finance asked Canadian investors not to enter into or renew swapped deposits through any intermediary, Canadian or non-Canadian. In the exchange market the forward discount on the Canadian dollar deepened further; this made speculative and hedging transactions more expensive.

It was clear, however, that the situation was unlikely to improve decisively unless a fundamental change could be secured in the conditions governing access by Canadians to foreign capital. On March 7, following discussions between Canadian and United States authorities, it was announced that the United States had undertaken to exempt Canada completely from all United States balance of payments measures affecting capital flows that were being administered by the Department of Commerce and the Federal Reserve System. On the same day, additional standby credits to supplement Canada's foreign exchange reserves

* Funds converted into a foreign currency, usually U.S. dollars, which have been placed on term deposit with a bank and which the bank has undertaken through a forward contract to convert back into Canadian dollars at maturity.

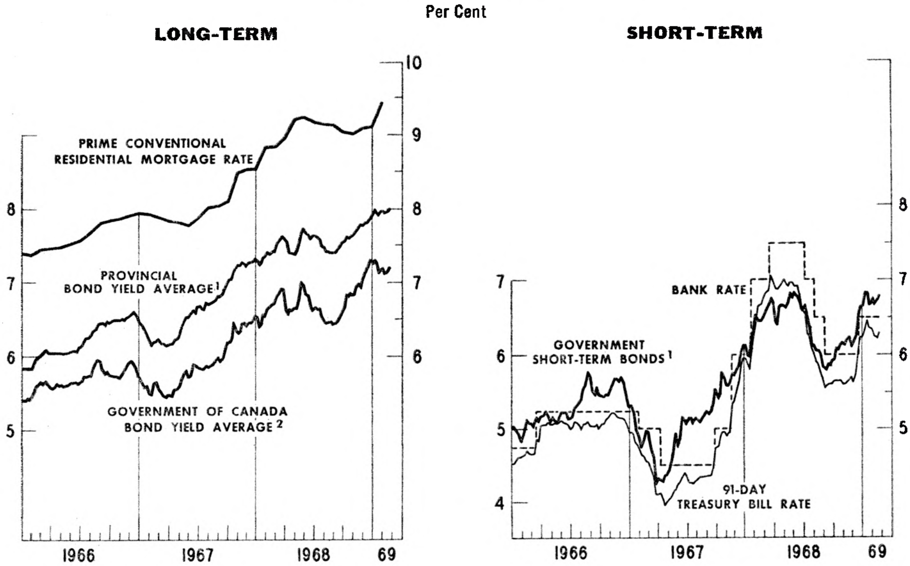
were arranged by the Bank of Canada for U.S. $100 million with the Bank for International Settlements, and for the equivalent of U.S. $150 million with the Deutsche Bundesbank and U.S. $150 million with the Banca d'Italia through the BIS. The Export-Import Bank of the United States opened a standby credit for the Government of Canada in the amount of U.S. $500 million. These standby credits represented an addition to the U.S. $500 million still available to the Bank of Canada under the reciprocal arrangement with the Federal Reserve System and the large credits totalling U.S. $740 million that would still be available to Canada by arranging further drawings from the International Monetary Fund.

Following the March 7 announcement the drain on Canada's foreign exchange reserves slowed down. It stopped completely after March 17, when confidence in the stability of the whole international monetary system was bolstered by the announcement that the participating Gold Pool countries had taken steps to halt the drain on their gold reserves caused by their sales in free markets. The Bank of Canada and the Department of Finance announced immediately their intention to co-operate in the new arrangements in respect of gold. On the same day the Bank's reciprocal credit facility with the Federal Reserve System was raised by U.S. $250 million to U.S. $1,000 million. Bank Rate had been raised by ½ per cent to 7½ per cent effective March 15, at the time of a similar increase in the rediscount rates of most of the Federal Reserve Banks.

The exchange losses suffered in the first eleven weeks of the year were very heavy. The official reserve figures (excluding the funds obtained through the drawings from the International Monetary Fund and the Federal Reserve System) show a decline of U.S. $707 million during the first quarter but the decline to the middle of March was greater: in the latter part of that month reserves began to increase and the rising trend continued strongly through the rest of the year.

Market rates of interest in Canada rose steadily in the first quarter of the year, with yields on treasury bills and Government of Canada bonds reaching the 7 per cent range and mortgage rates rising above 9 per cent. When the Federal Reserve Banks raised their rediscount rates in mid-April, however, the situation in Canada had improved to the point where it was not felt necessary to increase our own Bank Rate. To hasten the rebuilding of reserves the Government negotiated bond issues in Germany, Italy and the United States in May and June. The equivalent of U.S. $100 million in Government notes payable in lire was placed with the Italian Exchange Office, the equivalent of U.S. $62 million in Government notes payable in deutsche marks was offered through a German bank to European investors and U.S. $100 million in Government bonds was sold through a public offering to United States investors.

INTEREST RATES



1. Average weekly yield on the 10 provincial bonds included in the monthly series published by McLeod, Young, Weir and Co. Ltd.
2. Average weekly yield on Government of Canada bonds with a maturity of 10 years or over.

1. Average weekly yield on Government of Canada bonds with a maturity between 3 months and 3 years.

Of the last offering, U.S. $72 million was delivered in June, U.S. $13 million in October and U.S. $15 million in January 1969.

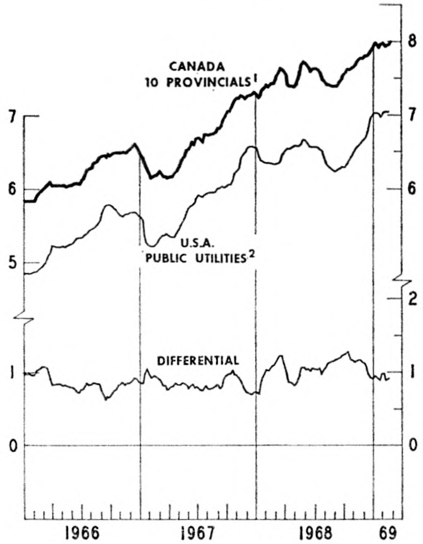
By mid-year the exchange crisis was clearly over and it was felt that the unusually tight credit conditions that had been necessary to help overcome it could be relaxcd to some extent. Moreover, the long-discussed programme of fiscal restraint in the United States had finally been enacted and it appeared that the forces of economic expansion in North America would become less buoyant. The cash reserve position of the banking system was eased in June and with the market anticipating a sharp reduction in interest yields the banks became aggressive buyers of Government securities. The special guideline on foreign currency swapped deposits issued in March was withdrawn in mid-June. Also in June the Bank of Canada repaid U.S. $125 million of its drawing from the Federal Reserve System and reduced the standby credits with the Bank for International Settlements and the central banks of Germany and Italy from a total of U.S. $400 million to U.S. $250 million.

Bank Rate was reduced to 7 per cent on July 2, and to 6½ per cent on July 29. The Bank of Canada repaid the remaining U.S. $125 million of its drawing from the Federal Reserve System and terminated the standby credit

BOND YIELD COMPARISONS
CANADA - U.S.A.

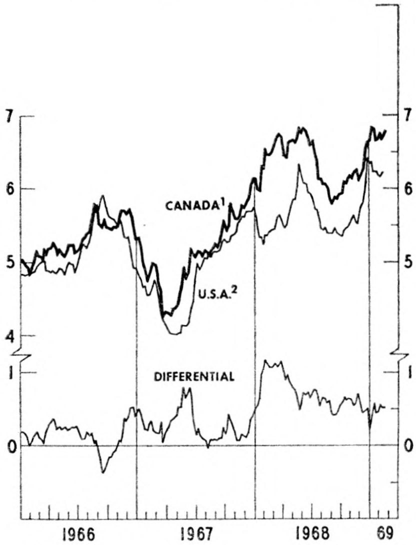
Weekly — Per Cent

LONG-TERM



1. Average weekly yield on the 10 provincials included in the monthly series published by McLeod, Young, Weir and Co. Ltd.
2. Moody's Investors Service Inc. average yield on public utility bonds.

SHORT-TERM GOVERNMENT



1. Average weekly yield on Government of Canada bonds with a maturity between 3 months and 3 years.
2. Average yield on United States Government bonds with a maturity between 9 months and 12 months.

facilities with the Bank for International Settlements and the central banks of Germany and Italy. By August the Bank of Canada's January request to the banks regarding loans to subsidiaries of foreign companies had become redundant because of the decline in demand for such loans in the preceding months and it was withdrawn.

Bank Rate was reduced to 6 per cent on September 3, following a reduction by the Federal Reserve Banks in the United States of their rediscount rates to 5¼ per cent in the latter part of August. By this time the Canadian treasury bill rate had declined by 1½ per cent from the peak level reached during the exchange crisis and long-term bond yields had fallen by ½ per cent. On September 13 the Government announced that it had discharged in full its repayment obligation to the International Monetary Fund and that the standby credit from the Export-Import Bank had been terminated. The Canadian dollar had been trading at or near its upper limit for about two months and the forward discount on the Canadian dollar had been substantially reduced. The combined total of official holdings of gold and U.S. dollars and Canada's net creditor position with the International Monetary Fund had been rebuilt to about the level prevailing before the pressures on the Canadian dollar first appeared the previous November.

Towards the end of the summer a marked shift occurred in the immediate outlook for economic activity and credit conditions in North America. This shift was based on growing evidence that the United States economy was responding much more slowly than had been anticipated to the programme of fiscal restraint adopted in June. In Canada the gradual slowing of the rate of inflation which had seemed to be emerging around the end of 1967 and which had been expected to continue through 1968 appeared to have come to a halt. A high rate of monetary expansion had accompanied the decline in interest rates over the summer months and bank liquidity had been considerably increased through heavy bank buying of Government of Canada securities. A substantial upward revision of Government spending estimates was announced in September. In November renewed speculative activity in international currency markets provided an additional source of concern.

In these changing circumstances it seemed desirable to bring to an end the increase in chartered bank liquidity which had been occurring during the summer. The growth in the total assets of the banking system slowed during the remaining months of 1968 and January 1969, even though bank loans were rising at an accelerated pace. In late February 1969, the banking system's holdings of more liquid assets were about $150 million lower than they had been in mid-September 1968; as a proportion of total chartered bank assets they had declined from 32.6 per cent in September to 30.6 per cent in February.

Interest rates in Canada moved sharply upward again during this period, as they did in the United States. Effective December 18 the Bank Rate was raised by ½ per cent to 6½ per cent following an increase of ¼ per cent in the rediscount rate of the Federal Reserve Banks. By the end of the year long-term bond yields in Canada had risen appreciably above the previous peak levels reached during the exchange crisis.

As the cost of financing rose to new highs in 1968 some areas of the capital market experienced greater problems of availability of funds than others. The most difficult area in which to raise money was undoubtedly the domestic long-term bond market. The high interest costs and difficulty of floating new bond issues in the Canadian market induced borrowers to turn to the United States and then to European capital markets, to chartered bank credit, to the short-term money market and to the stock market. On the other hand, the supply of mortgage funds increased appreciably in 1968, and there was a sharp increase in consumer credit outstanding.

Operations by the Bank of Canada in Government of Canada securities during each month of 1968 are summarized in Appendix Table I. Market transactions resulted in a decline of $283 million in the Bank's portfolio over the year but other transactions resulted in an increase of $418 million so that there was a net increase of $135 million. Market purchases or sales of Government of Canada securities were made by the Bank on about 90 business days in 1968; continuous contact was maintained with securities markets and the Bank participated, as usual, in the weekly treasury bill auctions. On occasion the Bank entered into temporary swaps of foreign currency assets with the Exchange Fund Account in order to adjust the level of Government cash balances at the chartered banks for cash reserve management purposes. Changes in the main balance sheet items of the Bank are shown in Appendix Table II.

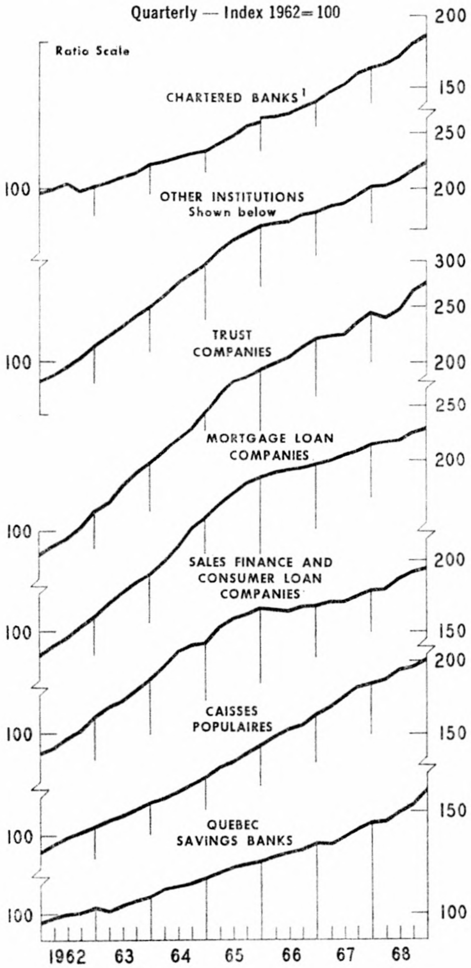
Bank of Canada advances to banks were outstanding on 14 business days in 1968 compared with 24 days in 1967. The daily averages for 1968 and 1967 were $0.2 million and $1.1 million respectively. The Bank held securities under purchase and resale agreements with money market dealers on 35 business days during the year compared with 72 days in 1967 and the daily averages for these years were $4.3 million and $7.6 million respectively.

On October 25, 1968 the Bank gave formal notice that under Section 72(3) of the Bank Act the chartered banks would be required to maintain their statutory cash requirements on a half-monthly rather than a monthly basis beginning in January 1969. The object of this change is to increase the speed and predictability of response of the banking system to changes in the supply of cash reserves brought about by the central bank.

Coincident with the requirement that the chartered banks meet minimum requirements twice monthly for their average cash reserves, revised arrangements became effective governing their access to central bank credit. The changes took two forms. First, there was an increase in the normal line of credit for each of the chartered banks which reflected, in a general way, the growth in the banking system. Second, there was a reduction in the minimum period for which an advance could be taken. Formerly, advances were for a minimum of seven days and chartered banks were obliged to pay interest for the full period; under the revised arrangement, at the option of the chartered bank, an advance can be taken for a period of either 2 or 3 juridical days. As well, a bank may take an advance for one day on the last day of any averaging period, provided that on the preceding day its cumulative average cash reserve ratio was equal to or higher than its legal minimum ratio. While the central bank is conscious of its responsibility as a lender of last resort, it expects that each bank will be able in the ordinary course of events to adjust its cash position through the money market, that advances will be relatively infrequent, and that more than one advance to a bank in the same period will be rare. The first advance taken in an averaging period bears interest at Bank Rate; if a second or subsequent advance is required the rate in principle will be higher and will be negotiated.

To help money market dealers meet the increased demands which may be made on them as a result of twice-monthly cash reserve averaging, revisions were also made in the conditions of their access to purchase and resale facilities at the central bank. The aggregate of their lines of credit was increased, and in order to modify the potentially destabilizing effect of access to a greater amount of central bank credit, the rate of interest applicable on usage beyond two thirds of a dealer's line was made subject to negotiation. In principle this rate will be higher than the Money Market Rate, which is applicable on the first two thirds of a dealer's line of credit. The Money Market Rate continues to be the lower of Bank Rate or of the latest average tender rate on three-month treasury bills plus one quarter of one per cent.

MAJOR CANADIAN ASSETS OF SELECTED FINANCIAL INSTITUTIONS



Seasonally adjusted.

1. Break in series reflects revised treatment of general reserves held against losses on loans and other assets.

CHARTERED BANKS AND OTHER FINANCIAL INSTITUTIONS. 1968 was the first full year in which the chartered banks operated under the terms of the revised Bank Act, the last remaining restrictions on bank lending rates having been removed at the end of 1967. The banks made vigorous use of their new freedom to compete on a price basis with other lenders and borrowers, seeking out profitable loan business and bidding strongly for savings and fixed-term deposit funds from the public which might otherwise have been invested in market securities or savings bonds. For the second year in a row the assets of the chartered banks grew at the unusually rapid rate of 14 per cent while those of competing institutions grew on average at an annual rate of close to 10 per cent; thus the size of the banking system in relation to other financial institutions, which had been declining for many years prior to the mid-sixties, continued to increase in 1968 as it had in 1967.

In the course of 1968 further changes occurred in the structure and operations of non-bank financial institutions directed towards improv-

MAJOR CANADIAN ASSETS OF SELECTED FINANCIAL INSTITUTIONS(1)

	Millions of dollars Dec. 1968	Percentage Increase			
		Average 1962-1965	1966	1967	1968
Chartered banks(2)	26,150	7.3	6.5	14.2	14.2
Other financial institutions					
Quebec savings banks	551	6.3	7.2	8.9	12.9
Trust companies	4,763e	21.3	13.4	10.9	13.2e
Mortgage loan companies	2,630e	19.7	5.5	8.0	6.9e
Sales finance and consumer loan companies	4,569e	15.8	1.0	6.6	9.6e
Caisses Populaires Desjardins de Québec	1,618	11.3	12.5	13.6	9.4
Sub-total	14,131e	17.1	7.1	9.1	10.4e
Life insurance companies (assets in Canada)	13,650e	7.4	6.2	6.5	5.7e
Trusteed pension funds	8,995e	12.6	10.8	11.3	11.5e
Mutual funds (assets valued at cost)	2,610e	24.7	21.6	14.5	19.1e
Sub-total	25,255e	10.1	9.0	8.8	9.0e
Total	65,536e	10.3	7.6	10.9	11.3e

e: Estimate.

(1) Excludes, insofar as available data make this feasible, fixed assets, foreign currency assets and investments in related companies.

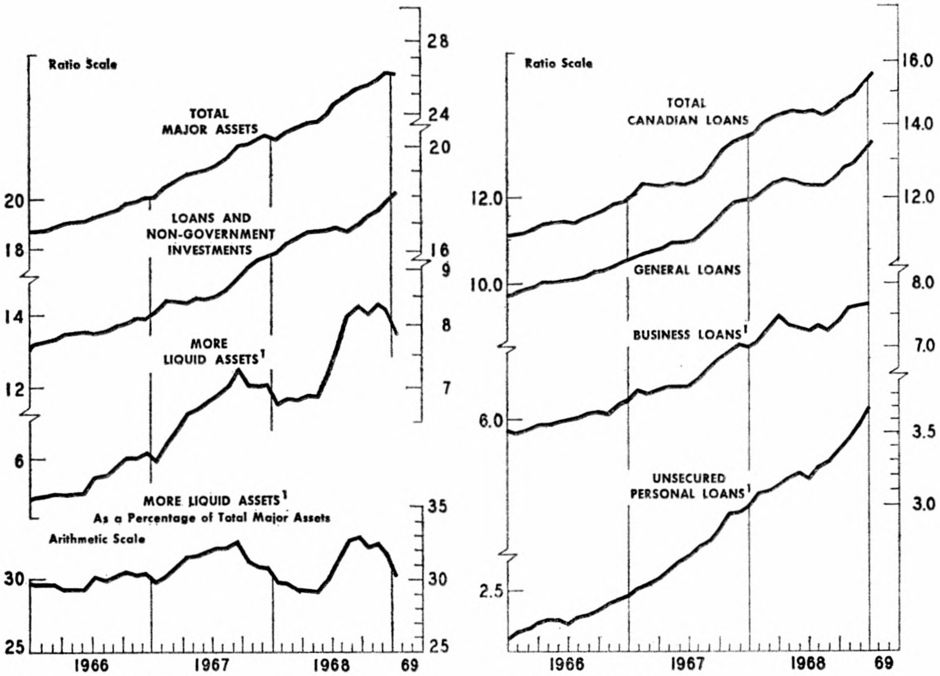
(2) Foreign currency assets of the banks are included net of their foreign currency liabilities.

ing their competitive position. In the trust and mortgage loan industry a number of mergers occurred. A bill is currently before Parliament to convert a savings bank in Quebec into a chartered bank. Sales finance companies, faced with increased competition in the financing of consumer durables, have directed more of their lending into areas such as residential and commercial mortgage lending and vehicle and equipment leasing. Some life insurance companies are now offering variable income annuities as well as equity funds in which dividends left on deposit can be invested.

While the cost of bank loans rose in 1968, they continued to be readily available to a wide range of borrowers. The banks' prime lending rates rose

CHARTERED BANK ASSETS

Average of Wednesdays — Billions of Dollars



Seasonally adjusted.
1. Includes net foreign assets.

Seasonally adjusted.
1. Month-end.

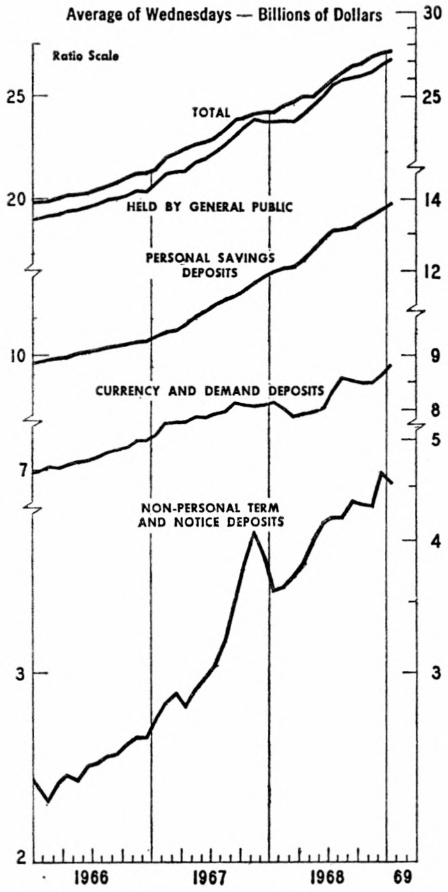
from around 6½ per cent at the beginning of the year to a peak of 7¼ per cent in the early spring, eased to 6¾ per cent over the summer months and then rose again to 7 per cent in January 1969. The Canadian dollar loans of the banks rose by more than 12 per cent during the year. The increase was particularly sharp for personal loans, loans to municipal governments and mortgage loans (about 20 per cent in each case) and in loans to grain dealers (about 50 per cent). Business loans at the chartered banks increased by 9 per cent in 1968, with a temporary bulge at the time of the exchange crisis and a temporary decline for a few months thereafter. As borrowing conditions in the bond market became more difficult again in the fall of 1968 and the early months of 1969, bank loans to business resumed their expansion.

The banks' holdings of Government of Canada treasury bills and bonds increased by $943 million, or 20 per cent, during 1968. The whole of this growth in the banks' holdings of these liquid assets occurred during the summer months: for an extended period prior to the summer bank liquidity had been declining, and since the end of the summer a downward trend has again been in evidence. In late February 1969 the banks' ratio of more liquid assets* to total assets, at 30.6 per cent, was virtually the same as it had been at the beginning of 1968.

In the process of financing such a large increase in assets during 1968 the chartered banks bid very aggressively for savings and time deposits. Early in 1969 they were paying 6¾ per cent for large blocks of short-term funds and 5¼ per cent on non-chequable personal notice deposits, compared with 5¾ per cent and 5 per cent respectively at the beginning of 1968. The banks also competed strongly for the fixed-term deposits of persons: in late February 1969 they were typically offering yields of up to 7¼ per cent on large deposits for terms of over two years.

In total, the public's holdings of bank deposits and other liquid claims grew somewhat more slowly in 1968 than in 1967. Detailed figures are shown in the table on page 46. Currency and chartered bank demand deposits—the narrowest definition of private money holdings —increased by 6.6 per cent during 1968, compared with 8.1 per cent in 1967. Much the larger part of the increase in the public's holdings of currency and chartered bank deposits, which amounted to 13.3 per cent in 1968, consisted of high-yielding savings and fixed-term deposits; in 1967 the increase had been 16 per cent. There were also substantial increases in holdings of foreign currency deposits, short-term paper and trust company investment certificates. By contrast, resident non-bank holdings of Government of Canada market securities showed virtually no change during 1968, as will be seen from the table on page 47, and the increase in holdings of Canada Savings Bonds was quite small.

CURRENCY AND CHARTERED BANK CANADIAN DOLLAR DEPOSITS



Seasonally adjusted.

* Includes till money, deposits at the Bank of Canada, treasury bills, day-to-day loans, call loans, Government securities and net foreign assets.

GENERAL PUBLIC HOLDINGS OF CERTAIN FINANCIAL ASSETS

	Millions of dollars Dec. 1968	Percentage increase 1967	1968
Currency	2,991	9.8	9.3
Chartered bank demand deposits	5,869	7.2	5.3
Quebec savings banks' deposits	518	8.3	13.6
Caisses Populaires Desjardins de Québec deposits	1,399	12.7	8.2
Trust and mortgage loan company demand certificates and deposits	1,668e	5.2	7.1e
Sub-total	12,445e	8.2	7.1e
Chartered banks			
— personal savings deposits	13,461	14.7	15.8
— non-personal term and notice deposits	4,395	47.3	20.3
— foreign currency deposits of residents			
— swapped	845	12.2	−5.5
— other	1,193e	27.5	13.0e
Finance company short-term paper(1)	1,108	6.2	66.4
Other commercial paper(1)	317	34.4	28.9
Provincial and municipal short-term(1)	425e	16.0e	27.6e
Bankers' acceptances	116	−13.6	−20.5
Canada Savings Bonds	6,359	3.8	0.6
Trust company investment certificates	3,182e	12.9	16.2e
Mortgage loan company debentures	1,747e	11.2	5.7e
Sub-total	33,148e	15.0	13.0e
Total	45,593e	13.0	11.3e

e: Estimate.
(1) Resident holdings only.

SECURITIES MARKET FINANCING. Although the yield on bonds rose substantially in 1968—indeed to unprecedented levels—the flow of funds from non-bank sources to this area of the domestic capital market fell off sharply during the year. Funds available for investment from non-bank sources seem to have been directed in an increasing degree towards short-term instruments of fixed capital value, towards mortgages and towards equities and real estate.

Borrowers who in the past relied on long-term bond issues as their major source of financing have found themselves confronted with serious problems of availability and cost in raising new funds in the Canadian market. The problem has been most acute for governments and their agencies, which for many years have depended heavily on this type of financing in the Canadian market; they found themselves under growing pressure to cut back on the rising trend of their

NET NEW ISSUES OF SECURITIES

(millions of Canadian dollars)

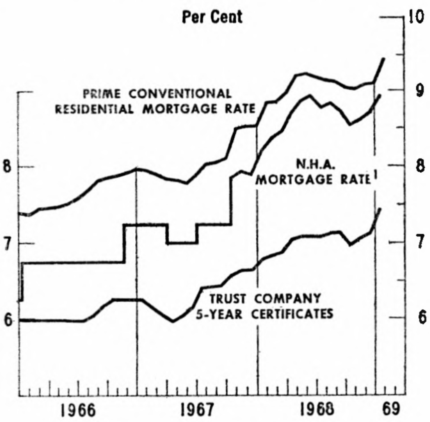
	1966	1967	1968
Funds raised through new issues of:			
Government of Canada bonds and treasury bills....	139	934	1,375
Provincial and municipal bonds and short-term paper........................	2,064	2,711	2,374
Corporate bonds and short-term paper...........	1,236	963	1,139
Sub-total........................	3,439	4,608	4,888
Corporate stocks............................	594	505	522
Total funds raised.................	4,033	5,113	5,410
Funds supplied by increase in holdings of:			
Resident non-bank investors			
— Canada Savings Bonds....................	223	229	40
— Government of Canada market issues.......	11	– 256	– 4
— Provincial and municipal bonds...........	1,028	936	510
— Corporate bonds.........................	466	738	324
Sub-total........................	1,728	1,646	870
— Corporate stocks........................	677	448	339
— Short-term paper........................	190	124	576
Total non-bank residents...........	2,595	2,218	1,785
Canada and Quebec Pension Plans...............	601	814	880[e]
Bank of Canada			
— Government of Canada market issues.......	1	334	135
Chartered banks			
— Government of Canada market issues.......	167	740	943
— Provincial and municipal bonds...........	– 69	83	50
— Corporate securities.....................	31	45	107
Total chartered banks..............	129	868	1,100
Non-resident investors			
— Government of Canada issues.............	– 263	– 112	261
— Provincial and municipal bonds...........	454	808	854
— Corporate bonds.........................	603	169	358
Sub-total........................	794	865	1,473
— Corporate stocks........................	– 83	57	183
— Short-term paper........................	– 4	– 43	– 146
Total purchases of Canadian securities by non-residents........	707	879	1,510
Total funds supplied...............	4,033	5.113	5,410

e: Estimate.

expenditures or to raise more revenue. In part their response was to borrow more where they could, by selling foreign currency issues in the United States and in European capital markets where funds were somewhat more readily available and interest costs somewhat lower than in Canada, although in some cases they accepted a relatively short term to maturity. Borrowers also had increased recourse to the chartered banks. Some corporate borrowers shortened the term of their obligations or attached conversion options or stock warrants to bond issues to improve their access to funds and lower their cost.

The table on page 47 summarizes the main trends in the supply and in the holdings of Canadian-debtor bonds, stocks and short-term paper during the past three years. The total amount of net new issue financing in 1968 was $5,410 million, moderately larger than in 1967 despite some reduction in the amount of new provincial and municipal issues. Of this amount, however, only 16 per cent was obtained from net sales of bonds to resident non-bank investors, compared with 32 per cent in 1967 and 43 per cent in 1966. Government of Canada issues were again relatively large in total; apart from foreign currency issues sold in the United States, Italy and Germany in order to bolster official foreign exchange reserves they were absorbed mainly by the banking system. Provinces and corporations increased their flotations of new bond issues in external capital markets considerably in 1968 and also their use of the short-term paper market. Over one quarter of the $1,510 million of net new issues sold to non-residents during the year was sold in overseas capital markets.

MORTGAGE MARKET INTEREST RATES



1. Previous to October 1967 N.H.A. loans were made at the maximum rates set by orders in council but since then actual rates hava been below the maximum. From October 1967 the series is a monthly weighted everaga of the rates chargad by approved lenders on home ownership loans.

MORTGAGE MARKET FINANCING. The cost of mortgage borrowing rose to record levels in 1968, with typical interest rates on new mortgages in the vicinity of 9 per cent. Demand for mortgage credit remained strong and the supply of mortgage funds from private institutional lenders continued to expand vigorously. As may be seen from the table on the facing page, all of the increase in mortgage lending appears to have been in the form of residential loans; non-residential mortgage lending is estimated to have declined slightly.

The volume of residential mortgage loans approved by private financial institutions increased by about $600 million in 1968. As in 1967, the chartered banks (including mortgage lending subsidiaries) played an important part in this growth of mortgage lending; their approvals amounted to about $430 million in 1968, approximately double the 1967 figure. The relatively large increase in National Housing Act loans was associated with a narrowing in the interest rate differential between conventional and NHA mortgages which followed the change in the method of determining the NHA maximum rate in October of 1967. A change in NHA regulations in February 1968 made it permissible for approved lenders to earn current mortgage yields for a term of up to 25 years on NHA loans to corporate builders of multiple-dwelling projects. The decline of $220 million in direct lending by the Central Mortgage and Housing Corporation mainly affected the volume of lending to builders and individuals for the construction of single-family dwellings. Loans by CMHC for low-income housing remained close to their high 1967 level.

GROSS MORTGAGE LOAN APPROVALS

(millions of dollars)

	Residential mortgage loans approved							
	Private financial institutions[1]							
	Conventional							
	New	Existing	NHA	Total	CMHC	Total	Non-residential	Total
1966	574	471	191	1,236	593	1,829	382	2,211
1967	745	655	356	1,756	727	2,483	369	2,852
1968[e]	962	572	831	2,365	503	2,868	335	3,203

e: Estimate.
(1) Includes: life insurance companies, chartered banks, trust and mortgage loan companies, Quebec savings banks, fraternal and mutual benefit societies.

BUSINESS FINANCE. On the basis of such information as is currently available it seems unlikely that business capital expenditures and business inventory accumulation increased substantially in 1968, but there does appear to have been a substantial increase in the cash flow generated internally by business enterprises in the form of profits and depreciation allowances. Consequently, the amount of external funds required by business to finance capital spending in 1968 would appear to have been considerably smaller than in 1967. However, the total amount of the main types of external borrowing by private business enterprises in 1968, insofar as such borrowing can be identified, seems to have been only slightly smaller than in 1967, as shown in the table on page 50. The explanation may be that businesses continued to rebuild holdings of liquid assets which they had depleted during the investment boom of 1966; it is also possible that they were borrowing in anticipation of higher investment spending in 1969.

MAJOR SOURCES OF BORROWING BY NON-FINANCIAL BUSINESS

(millions of dollars)

	1966	1967	1968
Net new issues of:			
Commercial paper and bankers' acceptances.......	60	29	29[e]
Bonds......................................	913	762	655
Stocks.....................................	538	376	458
Sub-total................................	1,511	1,167	1,142[e]
Increases in:			
Chartered bank loans(1).........................	582	719	643
Sales finance company loans.....................	– 213	64	187[e]
Industrial Development Bank loans...............	44	34	42
Sub-total................................	413	817	872[e]
Net direct investment from abroad.................	705	530	415
Total....................................	2,629	2,514	2,429[e]

e: Estimate.
(1) Total business loans excluding provincially-guaranteed loans to utilities, plus loans to farmers and all foreign currency loans to residents.

CONSUMER CREDIT. The net amount of consumer credit extended in 1968 was $1,176 million; this represented an increase of 14 per cent in total consumer credit outstanding. There was again a substantial increase in unsecured personal lending by the chartered banks, who were also active in introducing new cheque guarantee and credit card plans. Consumer credit extended by sales finance companies, which had declined in 1967, increased again in 1968.

MAJOR SOURCES OF CREDIT EXTENDED TO CONSUMERS

(millions of dollars)

	1966	1967	1968
Net increase in consumer credit(1) extended by:			
Chartered banks (unsecured personal loans).......	217	519	688
Consumer loan companies.......................	120	140	161
Credit unions and Caisses Populaires..............	124	109	134[e]
Sales finance companies........................	53	– 79	68
Retail dealers(2)................................	60	43	65
Life insurance companies (policy loans)...........	39	36	56[e]
Quebec savings banks..........................	–	1	4
Total....................................	613	769	1,176[e]

e: Estimate.
(1) New extensions of credit less repayments.
(2) Includes credit extended by department stores, furniture and appliance dealers, motor vehicle dealers, other retail dealers and oil company credit cards.

GOVERNMENT FINANCING. As in the previous year, the government sector had recourse to financial markets for large amounts of borrowed funds in 1968. The major sources of government borrowing are summarized in the table below.

The outstanding amount of Canadian dollar securities of the Government of Canada (excluding securities held by Government accounts) rose by $1,109 million in 1968. Virtually the whole of this increase was in market issues of bonds and treasury bills, and was taken up by the chartered banks and the Bank of Canada. As shown earlier in the table on page 47 public holdings of Canada Savings Bonds increased by $40 million; holdings of market issues by resident investors other than banks were virtually unchanged over the year as a whole.

SELECTED SOURCES OF BORROWING: FEDERAL, PROVINCIAL AND MUNICIPAL GOVERNMENTS AND THEIR ENTERPRISES(1)

(millions of dollars)

	1966	1967	1968
Government of Canada			
Increase in securities outside Gov't accounts:			
— treasury bills	10	295	360
— Canadian-pay market bonds	70	454	709
— Canada Savings Bonds	223	229	40
Total Gov't of Can. domestic issues(2)	303	978	1,109
Provincial and Municipal Governments			
Increase in outstanding Canadian-pay bonds:			
— purchased by Canada and Quebec Pension Plan funds	601	814	880e
— other Canadian dollar issues	989	1,027	495
Increase in loans from:			
— chartered banks	139	124	− 4
— Government of Canada (including CMHC and MDLF)	205	175	276
Increase in short-term paper outstanding	50e	70e	80e
Increase in outstanding foreign currency issues	424	800	919
Total provincial-municipal borrowing(3)	2,408	3,010	2,646

e: Estimate.

(1) To obtain a total of combined federal, provincial and municipal financing without double counting, loans from the Federal Government to the provinces and municipalities would have to be eliminated, as well as changes in provincial-municipal holdings of Government of Canada securities.

(2) Changes in outstanding foreign currency issues of the Government of Canada during 1966, 1967 and 1968 respectively, in millions of dollars, were −164, −45, and +266. The increase in 1968 reflected new issues sold in the United States, Italy and Germany, the proceeds of which were used to bolster official foreign exchange reserves.

(3) To the extent that provincial government accounts purchase provincial or municipal securities the total of provincial-municipal financing is overstated.

In 1967, in order to finance total net cash requirements of $1,276 million, the Government had supplemented its net new issues of securities in the Canadian market by drawing heavily on its cash balances. In 1968, although the Government's net new Canadian issues were somewhat higher than in 1967, part of the proceeds were used to rebuild cash balances; total financing requirements for all other purposes amounted to $1,049 million. (See Appendix Table III) There was a substantial reduction in Government lending to the Central Mortgage and Housing Corporation and in the amount of Canadian funds required to finance the Government's net acquisition of foreign currency assets. On the other hand, the budgetary deficit was somewhat larger in 1968, and repayment began at mid-year of the refundable corporation tax, which had been a source of funds to the Government in 1967.

The combined borrowing requirements of provincial and municipal governments and their business enterprises in 1968 are estimated at $2,646 million, appreciably below the estimated figure of $3,010 million for 1967. The reduction in provincial-municipal borrowing was due in part to a further narrowing of the shortfall of their revenue below their expenditure and provincial lending to the private sector for industrial development, farm credit and residential construction slowed markedly during 1968. There appears to have been little change in the scale of capital outlays by provincial and municipal enterprises compared with the previous year.

Net new issues of provincial and municipal bonds sold in the domestic market in 1968 were approximately $530 million less than the amount sold in 1967. Net borrowing in the United States market was also down by about $170 million, but foreign currency borrowing in Europe, which had been negligible in past years, amounted in total to about $300 million in 1968.

PUBLIC DEBT MANAGEMENT OPERATIONS. The Government of Canada was again very active in the capital market in 1968. There were six offerings of marketable bonds in the domestic market; foreign currency issues were placed in Italy, Germany and the United States; there were two Canada Savings Bond issues; three offerings of special treasury bills were made, and the amount of the weekly bill offerings varied considerably during the year. The factors which gave rise to financing activity on this scale included the substantial domestic requirements of the Government arising out of its budgetary and non-budgetary transactions, and the abnormal extent of the decline in the amount of Canada Savings Bonds outstanding during much of the year when yields available on such bonds were exceeded by rates offered on competing deposit and investment instruments. The timing of new issues was affected by the unanticipated increase and subsequent decline in domestic cash balances as the Government first

SUMMARY OF DIRECT NEW ISSUES AND RETIREMENTS
GOVERNMENT OF CANADA MARKET BONDS

Date	Issues offered	Amount delivered (millions of dollars par value)	Years to maturity	Yield to maturity	Amount retired (millions of dollars par value)
		(Payable in Canadian dollars)			
1968					
Jan. 15	6% Feb. 15, '70	250	2 yrs. 1 mo.	6.20	
	6% Dec. 15, '71	200	3 yrs. 11 mos.	6.44	
		450			400
Apr. 1	5½% Apr. 1, '69	60	1 yr.	7.03	
	7% Apr. 1, '73	215	5 yrs.	7.30	
		275			275
Apr. 3					9(1)
June 15	6¾% July 1, '69	75	1 yr. ½ mo.	7.00	
	7% Oct. 1, '70	275	2 yrs. 3½ mos.	7.11	
	7% June 15, '74	250	6 yrs.	7.26	
		600			495
Aug. 1	6½% Dec. 15, '69	35	1 yr. 4½ mos.	6.65	
	6¾% Oct. 1, '70	105	2 yrs. 2 mos.	6.75	
	7% Apr. 1, '73	260	4 yrs. 8 mos.	7.00	
		400			
Sept. 13					100(2)
Oct. 1	6% Feb. 15, '70	35	1 yr. 4½ mos.	6.11	
	6¼% Oct. 1, '71	200	3 yrs.	6.25	
	6½% Apr. 1, '75	200	6 yrs. 6 mos.	6.60	
	6½% Oct. 1, '95	100	27 yrs.	6.60	
		535			260
Dec. 15	6¼% May 1, '70	50	1 yr. 4½ mos.	6.28	
	6¼% Apr. 1, '71	200	2 yrs. 3½ mos.	6.36	
		250			100
		(Payable in foreign currencies)			
Apr. 15					1(3)
May 15	5¾% May 15, '70 (lire)	35	2 yrs.	5.75	
	5⅞% May 15, '71 (lire)	36	3 yrs.	5.875	
	6% May 15, '72 (lire)	37	4 yrs.	6.00	
		108			
June 1	6¾% June 1, '73 (DM)(4)	68	5 yrs.	6.87	
	6⅞% June 1, '88 ($US)(5)	108	20 yrs.	6.90	
		176			
Oct. 15					1(3)

(1) Cancellation of 5½% Aug. 1, 1980 securities held by Government Securities Investment Account and/or Purchase Fund.
(2) Cancellation of Government Securities Investment Account holdings of 5% Oct. 1, 1968 securities.
(3) Partial redemption at par of $U.S. pay 5% Oct. 15, 1987 for the sinking fund.
(4) Net proceeds of deutsche mark issue credited to Government by underwriter on May 24, 1968.
(5) U.S. $100 million issue, of which U.S. $72 million delivered June 11, 1968; U.S. $13 million delivered Oct. 15, 1968, and U.S. $15 million delivered Jan. 15, 1969.

lost foreign exchange reserves when the Canadian dollar came under pressure and then recouped them later in the year.

The Government's borrowing was conducted in an environment of considerable uncertainty in the capital market and generally high and rising interest rates. For the most part, it continued to issue securities of relatively short term to maturity as is indicated in the table on page 53. An exception was the October 1 issue when $100 million of 27-year bonds were included in the offering.

As a means of offering investors a wider choice of maturities in connection with many of the 1968 debt operations, the Bank concurrently offered a variety of switch programmes. These programmes were of two types. One type represented an advance refunding operation, under which the Bank agreed to take a stated amount of a new issue from the Government in exchange for short-dated securities, and at the same time offered the market an opportunity to effect the same exchange with the Bank. Under the second type, the market was given an opportunity to purchase certain outstanding issues from the portfolio of the Bank in exchange for the newly-offered maturities. A feature common to both types of switching offer was that the market lengthened the average term to maturity of its holdings in the process. Most of these offers were taken up virtually to the full extent of their pre-announced limits.

The amount of treasury bills outstanding was increased by $370 million over the course of 1968; chartered bank holdings of bills increased by $403 million during the year. Apart from weekly changes in the tender, $150 million of one-year bills were sold in June, while a $100 million 11-day series in November provided the Government with temporary financing during the period of heavy redemptions of outstanding Canada Savings Bonds just prior to receipt of the proceeds of sale of the new Canada Savings Bonds in the autumn campaign. In addition $75 million of one-year bills were auctioned at the end of November to refund part of the $125 million of maturing one-year bills.

The first Canada Savings Bond issue in 1968 was the Special Replacement Series offered in March in advance refunding of the unusually large maturity of the 1959 Series due November 1; the refunding issue yielded 6.88 per cent if held to maturity in 1978. This campaign lasted until May 15 by which time $538 million of the 1959 Series bonds had been exchanged for the new issue. A further $312 million of the Special Replacement Series bonds were sold in a limited cash offering which followed the refunding campaign and terminated on May 23. The usual autumn Canada Savings Bond campaign took place against a background of great uncertainty as to the direction of interest rates. On this issue the yield was 6.75 per cent if held to maturity in 1982; if the interest coupons were held uncashed to maturity $250 would be received at that date for each $100 bond presented, as a result of the compounding of interest earned. The campaign was successful in netting almost $900 million during the October-November period.

FINANCIAL TRANSACTIONS OF CANADIANS WITH NON-RESIDENTS. As mentioned earlier (page 33), the increasingly large errors and omissions in the Canadian balance of payments statistics in 1967 and 1968 make interpretation of both the current and capital account flows difficult. In the official estimates, which attribute all of the balancing item to the short-term capital account, the net use of non-resident savings by Canadians is shown as declining from $543 million in 1967 to $181 million in 1968; net capital inflows in 1968 are shown at $534 million, slightly less than the $561 million inflow in 1967. Official reserves, which had risen by $18 million in 1967, increased by a further $353 million in 1968, of which $266 million was attributable to new foreign currency bond issues sold by the Government of Canada.

The recorded statistics indicate that net sales of securities to non-residents in 1968 were very much larger than in 1967. The table on page 47 shows that Government of Canada new bond issues and treasury bills sold abroad in 1968 exceeded by $261 million the small retirements of maturing Government bonds and Canadian purchases of outstanding Government bonds from non-residents. This was in contrast with the preceding two years when the Government repatriated considerable amounts of its foreign debt. Net sales of provincial and municipal bonds to non-residents rose slightly in total in 1968; sales of corporate bonds and stocks rose appreciably. From 1962 to mid-1967 non-residents had been reducing their holdings of Canadian stocks but for the past year and a half they have been adding to their holdings. The large inflows of capital from

NET SALES OF SECURITIES TO NON-RESIDENTS

(millions of Canadian dollars)

	1966	1967	1968
Canadian securities:			
Bonds — gross new issues	1,408	1,255	1,889
— retirements	– 495	– 338	– 394
— trade in outstandings	– 104	– 56	– 70
Total	809	861	1,425
Treasury bills and short-term paper	– 19	– 39	– 98
Corporate stocks	– 83	57	183
Total Canadian securities	707	879	1,510
Foreign securities:			
IBRD bonds — transactions by Government of Canada	– 25	– 20	45
Other foreign securities transactions	– 376	– 398	– 509
Total foreign securities	– 401	– 418	– 464
Total	306	461	1,046

sales of Canadian securities to non-residents have been offset in part by Canadian purchases of foreign securities, mainly United States corporate stocks; these rose again in 1968.

Almost all of the increase in 1968 in net sales of securities to non-residents resulted from sharply increased sales of new issues of Canadian bonds. Deliveries rose from $1,255 million in 1967 to $1,889 million in 1968. Of the total increase, $266 million arose from Government of Canada borrowings in Europe and the United States. At the close of 1967 Canadian borrowers were beginning to tap the developing European market by selling U.S. dollar bonds in the Euro-bond market, and in 1968 sales of such issues amounted to over $100 million. Following the sale of bonds in the German market by the Government of Canada in May, other Canadian borrowers placed issues in that market and by year-end they had sold the equivalent of about $220 million in bonds denominated in deutsche marks. As the table below shows, there was only a small increase in the total of funds raised by borrowers other than the Government of Canada in the United States market; such deliveries totalled $1,257 million in 1968 compared with $1,196 million in 1967.

Foreign direct investment in Canada is estimated to have amounted to $585 million in 1968 compared with $620 million in 1967. All of the reduction occurred in the first quarter when such investment dropped to almost nothing; it rose sharply in the second quarter and remained high in the second half of the year. Canadian direct investment abroad also varied with the swings in sentiment about the Canadian dollar in the first half of the year; for the year as a whole it was $170 million as compared with $90 million in 1967.

GROSS NEW ISSUES OF CANADIAN BONDS SOLD TO NON-RESIDENTS(1)

(millions of Canadian dollars)

	To United States residents			To other non-residents			Total
	Gov't of Canada	Other borrowers	Total	Gov't of Canada	Other borrowers	Total	
1967 — 1Q..........	–	295	295	3	8	11	306
2Q..........	1	273	274	3	6	9	283
3Q..........	–	259	259	4	4	8	267
4Q..........	3	369	372	6	21	27	399
Total...............	4	1,196	1,200	16	39	55	1,255
1968 — 1Q..........	–	340	340	4	63	67	407
2Q..........	76	356	432	179	91	270	702
3Q..........	–	279	279	4	177	181	460
4Q..........	16	282	298	9	13	22	320
Total...............	92	1,257	1,349	196	344	540	1,889

(1) Includes small amounts of bonds payable in Canadian dollars sold to non-residents.

Capital outflows from recorded short-term capital transactions rose in 1968. Canadian holdings of bank balances and other short-term funds abroad increased again, producing a substantial capital outflow. There was a sharp reduction in non-resident holdings of Canadian finance company paper and an offsetting rise in their holdings of Canadian dollar bank deposits and treasury bills. The balancing item in the statistics of the international balance of payments, which is included in the residual short-term capital account but which may represent unidentified net current payments as well as unidentified capital outflows, was large in the fourth quarter of 1967 and in 1968.

The foreign currency transactions of the chartered banks produced a net outflow of $375 million in 1968, almost the same as the outflow in 1967. In 1968 the banks channelled $438 million to the United States, with $63 million

CANADIAN CHARTERED BANKS
HEAD OFFICES AND BRANCHES IN CANADA
NET CHANGES IN FOREIGN CURRENCY ASSETS AND LIABILITIES[1]

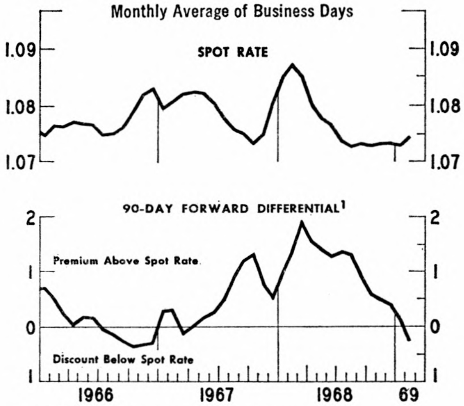
(millions of Canadian dollars)

	1966	1967	1968	Feb. to Dec. 1968
With non-residents				
United States residents				
Assets	229	264	137	317
Liabilities	−302	75	−302	−186
Net	532	189	438	503
Other non-residents				
Assets	2	330	624	492
Liabilities	63	153	687	685
Net	− 61	177	− 63	−193
Total				
Assets	232	594	761	809
Liabilities	−239	228	385	498
Net claims on non-residents	471	366	375	311
With Canadian residents				
Assets	91	−112	− 54	− 78
Liabilities	413	332	85	32
Net	−322	−444	−139	−109
Chartered banks' own net position	149	− 78	236	202

(1) Does not include assets or liabilities in gold.

being raised in other countries and the remainder arising from transactions with Canadian residents and from increases in the banks' own foreign currency positions. In the spring of 1968 the banks agreed to observe three guidelines in the conduct of their foreign currency operations that would ensure that Canada was not used as a "pass-through" by which the purpose of the United States balance of payments programme would be frustrated. The text of these guidelines appears in the Appendix. On balance, the banks were net borrowers of funds from residents of overseas countries between the reference date for the guidelines of Feburary 29 and the end of the year. By the end of December their claims in overseas countries were $492 million higher than at the end of February but their liabilities were $685 million higher, so that their net liabilities in overseas countries rose by $193 million. In connection with the third guideline, from February to December they reduced their deposit liabilities to United States residents by $186 million.

U.S. DOLLAR IN CANADIAN FUNDS



1. Expressed as a per cent per annum.

The spot rate for the United States dollar in the Canadian foreign exchange market fluctuated close to the top of the permitted range from January to mid-March. It then declined steadily to late July when it reached the bottom of the permitted range, and it has subsequently fluctuated close to that level. The forward exchange rate for the U.S. dollar in Canada was at a large premium during most of the first half of 1968, declined gradually during the second half of the year, and moved to a discount in the opening months of 1969.

At the end of 1968 Canada's reserves were U.S. $2,848 million compared with U.S. $2,516 million a year earlier. Official holdings of gold and U.S. dollars rose by U.S. $559 million in 1968, while Canada's net creditor position with the International Monetary Fund declined by U.S. $227 million.

OFFICIAL HOLDINGS OF GOLD AND U.S. DOLLARS AND NET CREDITOR POSITION WITH THE INTERNATIONAL MONETARY FUND

(month-ends — millions of U.S. dollars)

	Dec. 1967	Mar. 1968	June 1968	Sept. 1968	Dec. 1968
Official holdings of gold and U.S. dollars	2,268	2,244	2,574	2,534	2,827
Net creditor position with IMF	248	–	–	1	21
Total	2,516	2,244	2,574	2,535	2,848
of which:					
Repayable to IMF	–	185	64	–	–
Repayable to Federal Reserve System	–	250	125	–	–
Other	2,516	1,809	2,385	2,535	2,848

APPENDIX TABLE I

BANK OF CANADA NET TRANSACTIONS IN GOVERNMENT OF CANADA SECURITIES IN 1968

(delivered basis — par value in millions of dollars)

	Net purchases from (+) or net sales to (−) investment dealers and banks						
		Bonds(1)					
	Treasury bills	3 years & under	3 years to 5	5 years to 10	Over 10 years	Sub-total bills and bonds	Securities under PRA
Jan.	−190	+ 45	− 4	− 45	− 11	−205	−
Feb.	− 51	−	−	−	−	− 51	−
Mar.	− 60	+ 2	−	−	−	− 58	−
Apr.	− 15	+133	−143	−	+ 2	− 23	−
May	−	+ 2	− 2	−	−	−	−
June	− 40	+ 82	−	−126	−	− 84	−
July	− 15	−	−	−	−	− 15	−
Aug.	−107	+121	− 71	− 26	− 24	−107	−
Sept.	+123	−	−	−	−	+123	−
Oct.	+ 17	− 1	−	− 13	+ 27	+ 30	−
Nov.	+ 36	−	−	−	+ 11	+ 47	−
Dec.	+ 60	−	−	−	−	+ 59	−
Total	−242	+384	−219	−211	+ 5	−283	−

(1) Classified by years to maturity at time of transaction.

Net transactions with Government and other client accounts						Net change in holdings of Government of Canada securities		
Purchases (+) of new issues less matured holdings		Net purchases from (+) or net sales to (−)						
		Securities Investment acct.		Other Government and client accounts				
bills	bonds	bills	bonds	bills	bonds	bills	bonds	total
− 21	+ 57	−	− 50	− 49	−276	−260	−284	−544
+ 3	−	−	− 70	− 43	− 1	− 91	− 71	−162
+158	−	−	+120	− 84	− 4	+ 13	+118	+132
+ 21	+109	−	−100	+ 18	− 9	+ 24	− 7	+ 16
+ 67	− 20	−	−	− 29	− 3	+ 38	− 23	+ 15
+ 57	+132	−	−	− 46	+ 57	− 29	+145	+117
+ 11	−	−	−	− 31	+133	− 35	+133	+ 98
+ 69	+190	−	−100	− 41	+ 3	− 79	+ 93	+ 14
+104	−	−	−	− 45	− 2	+182	− 2	+180
− 12	+ 92	−	−	− 23	− 2	− 18	+103	+ 85
+ 42	−	−	−	− 53	− 1	+ 25	+ 10	+ 35
+143	+108	−	−100	− 59	− 3	+145	+ 5	+149
+643	+669	−	−300	−486	−108	−85	+220	+135

APPENDIX TABLE II

BANK OF CANADA ASSETS AND LIABILITIES

(monthly changes – millions of dollars)

	Government of Canada securities at book value	Net foreign currency assets	Investment in IDB	All other assets, net	Note circulation	Canadian dollar deposit liabilities		
						Chartered banks	Government of Canada	Other
1968								
Jan.	−542	+270	+ 2	+ 51	−186	−121	+ 92	−4
Feb.	−160	− 1	+ 2	− 15	− 30	− 43	−105	+4
Mar.	+130	+ 8	+ 1	− 38	+ 9	+ 38	+ 53	+1
Apr.	+ 16	+ 56	+13	+ 82	+ 59	+ 50	+ 63	−5
May	+ 15	+ 53	+ 1	− 55	+ 24	− 13	− 3	+6
June	+115	− 64	+ 2	+121	+106	− 43	+112	−1
July	+100	−184	+ 3	− 29	+ 73	+ 52	−233	−3
Aug.	+ 17	–	+ 1	− 8	− 44	− 42	+ 95	–
Sept.	+179	−129	–	+ 31	− 23	+151	− 50	+4
Oct.	+ 85	–	+ 8	−135	+ 20	− 96	+ 39	−6
Nov.	+ 34	–	+ 2	− 62	+ 37	+ 9	− 75	+2
Dec.	+148	+ 3	+ 4	+179	+204	+111	+ 17	+2
Total	+137	+ 12	+39	+121	+250	+ 52	+ 5	–

APPENDIX TABLE III

GOVERNMENT OF CANADA FINANCIAL ACCOUNTS

(millions of dollars)

	Calendar 1966	Calendar 1967	Calendar 1968
1. Budgetary deficit	428	678	733
Adjustments to national accounts basis:			
Amount financed by increase (—) in liabilities to:			
Public service superannuation accounts	—412	—432	—510e
Unemployment insurance and old age security funds	—289	—119	— 95e
All other adjustments to national accounts basis	109	129	157e
2. Deficit or surplus (—) on national accounts basis	—164	256	285e
3. Increase in major loans and advances to:			
Central Mortgage and Housing Corporation	456	678	394
Farm Credit Corporation	167	168	131
CNR (incl. Air Canada, excl. debt refunding)	17	124	130
Export Credits Insurance Corporation	38	28	42
Municipal Development and Loan Fund	122	66	7
Veterans' Land Act Fund	51	60	51
1967 World Exhibition	115	68	— 9
National governments	7	— 13	61
Provincial governments (excl. 1967 World Exhibition)	24	10	61
Other	58	46	46
Sub-total	1,055	1,235	914
4. Canadian dollars required to finance increase in Government's foreign currency assets (or reduction in liabilities):			
Advances to the Exchange Fund	—633	147	529
Holdings of IBRD and Columbia River Treaty bonds	— 7	— 12	— 78
Subscriptions and advances to international agencies	226	19	30
Foreign-pay securities (outside Gov't accounts)	164	45	—266
Demand notes payable to international agencies	—106	2	—229
Sub-total	—356	201	— 14
5. Net increase in other assets or reduction in other liabilities(1):			
Refundable corporation tax	—134	—106	82
Accrued corporation income tax(2)	— 31	—175	— 80e
All other assets and liabilities	—117	—135	—138
Sub-total	—282	—416	—136
6. Total Canadian dollar financing requirements (sum of items 2, 3, 4, 5)	253	1,276	1,049
7. Total Canadian dollar financing requirements were met by:			
Increase (+) in Canadian dollar securities outstanding outside Government accounts	303	978	1,109
Reduction (+) in Canadian dollar cash balances	— 50	298	— 60
Total (= Item 6)	253	1,276	1.049

e: Estimate.

(1) Excluding those shown under Item 7.

(2) A contra amount is included in the item "All other adjustments to national accounts basis" above.

Appendix

EXCHANGE OF LETTERS BETWEEN THE HONOURABLE MITCHELL SHARP, MINISTER OF FINANCE, AND THE HONOURABLE HENRY FOWLER, SECRETARY OF THE TREASURY OF THE UNITED STATES, DATED MARCH 7, 1968, RELATING TO THE APPLICATION OF UNITED STATES BALANCE OF PAYMENTS MEASURES TO CANADA.

Letter from Mr. Fowler to Mr. Sharp

Dear Minister Sharp:

Unique financial relations between our two countries have been a mutual support to both and to the international monetary system. These relations have served the interests of both our countries without interfering with the domestic policies of either.

As was said some years ago when it was agreed that Canada should be exempt under the interest equalization tax: "For many years the capital markets of the two countries have been closely interconnected and United States exports of capital to Canada have financed a substantial portion of the current account deficit with the United States. This need continues."

At the same time this special financial interdependence was underscored by the undertaking of Canadian authorities that it would not be the desire or intention of Canada to increase her foreign exchange reserves through the proceeds of borrowings in the United States.

It was agreed that active consultations would continue to strengthen the close economic relations between the two countries and facilitate measures for making the maximum practicable contribution to economic expansion and the strength and stability of both countries.

In keeping with this practice we and our colleagues have had the benefit of regular consultations prior to and since the New Year's day announcement by President Johnson of the deterioration in 1967 of the United States balance of payments and the special program designed to bring the United States balance of payments to or close to equilibrium.

We have reviewed the new situation and the new program particularly because of some concern in financial markets over the potential effects of the program on Canada's financial position.

Our over-all financial arrangements have worked well and to our mutual advantage. Our special relationships in the financial field include:

—All commercial bank lending to Canada regardless of maturities is exempt from the IET. Such loans to Canadian borrowers have priority under the federal reserve guidelines.

—There are no restrictions on the amount of long term loans to Canadian borrowers which can be made by United States non-bank financial institutions. Such long term loans are exempt from the IET, from the direct investment program and from the federal reserve guidelines.

—Canadian subsidiaries of United States companies as well as all other Canadian companies can come to the United States capital market and borrow free of the interest equalization tax to finance their investments in Canada.

We agree that the time has now come to adapt these special relations in the financial field to our mutual advantage in handling the new United States direct investment and federal reserve programs as well as Canada's reserve management policies.

The cardinal element in the present financial relationships between the United States and Canada is the fact that to the extent capital outflows from the United States to Canada of a kind now covered by the United States balance of payments measures are insufficient to finance Canada's current account deficit, Canadian borrowers would exercise their existing rights to borrow more in United States capital markets. Therefore any decline in the level of particular capital outflows to Canada from the level of past years caused by new United States measures could be expected to lead to increased borrowings by Canadian entities in the United States capital market.

In the light of this situation and to make sure that the flow of funds from the United States to Canada is adequate, the United States will undertake to exempt Canada from all the United States balance of payments measures affecting capital flows that are administered by the Department of Commerce or the Federal Reserve System.

By these arrangements Canada's financial position is assured insofar as capital imports from the United States are concerned, and the United States balance of payments objectives and program as announced on January 1st would not be affected.

I am sure that you will agree that it is desirable that we should continue to keep the economic and financial relationships between the two countries and with the rest of the world under continuing review, and that we should examine the detailed operation of this agreement and its impact on the balance of payments of both countries in the joint Canada - United States Ministerial Economic Committee and through regular meetings of our officials.

I am satisfied that these arrangements will provide mutual support to our payments position and hence strengthen the international monetary system.

Sincerely yours,
Henry H. Fowler.

Letter from Mr. Sharp to Mr. Fowler

Dear Secretary Fowler:

I acknowledge receipt of your letter of today.

Canada has, as you are aware, a great interest in the strength and stability of the United States dollar and we have been deeply impressed by the steps you announced at the beginning of the year to reduce your balance of payments deficit. We have also been conscious of your desire to operate your program in a way which recognizes the special position of Canada.

I am of course very pleased that you have now reached the conclusion that you can, consistently with the objectives of your program, give further recognition to this special position by exempting Canada completely from your balance of payments program.

The unique position of Canada was reflected in the Interest Equalization Tax exemption and reserve target agreement reached in 1963. The Canadian government feels that the further steps you are now taking should be matched by further steps on the Canadian side. First to ensure that your balance of payments position is in no way impaired as a result of your action, I am informing you that it is our intention to take any steps necessary to ensure that the exemption from your program does not result in Canada's being used as a "pass-through" by which the purpose of your balance of payments program is frustrated.

It is also our intention to invest our entire holdings (apart from necessary working balances) of United States dollars in United States Government securities which do not constitute a liquid claim on the United States, with of course effective safeguards to our position should our reserve level require.

I agree that these arrangements are in the interests of both countries and in the general interest and that they provide further evidence of the close and mutually beneficial relationships between us.

Yours sincerely,
Mitchell Sharp.

EXCHANGE OF LETTERS BETWEEN THE HONOURABLE E. J. BENSON, MINISTER OF FINANCE, AND THE HONOURABLE HENRY FOWLER, SECRETARY OF THE TREASURY OF THE UNITED STATES, DATED DECEMBER 16, 1968, RELATING TO THE APPLICATION OF UNITED STATES BALANCE OF PAYMENTS MEASURES TO CANADA.

Letter from Mr. Fowler to Mr. Benson

Dear Minister Benson:

In completing the 1969 United States balance of payments program and while arranging for an orderly transition, I thought it would be useful to review the unique financial relationship which exists between our two countries. This was last described in the exchange of letters I had on March 7, 1968, with your predecessor, Mitchell Sharp. In my letter I noted: "Unique financial relations between our two countries have been a mutual support to both and to the international monetary system. These relations have served the interests of both our countries without interfering with the domestic policies of either." Events since March add a new endorsement to this judgment.

This unique relationship which our two countries share is a natural reflection of a common and peaceful border of some 5,500 miles. It reflects as well the importance of trade and capital and neighbors who move across this invisible boundary. Recognizing this interdependence, we have long since believed that it is not in the interest of either country to occasion destabilizing influences on our currencies which might inhibit the other country in the pursuit of its own economic objectives. To this end, our policies in this field have been to support our overall objectives to our mutual advantage.

This is the reason, notwithstanding the crisis then raging in the gold markets of the world and only shortly after the President's New Year's Day balance of payments measure, that in March we were able to exempt Canada from our balance of payments measures. This exemption and your reaction to it was indeed "mutual support." Canada was thus assured of access to our markets for a wide range of capital transactions, enabling Canada to continue its traditional method of financing its current account deficit with the United States and permitting financial institutions in both countries to operate flexibly.

This latest recognition of the interrelationship of our international payments is also the reason you have taken constructive actions to ensure that Canada is not used as a "pass-through" channel by which the purpose of the United States balance of payments program might be frustrated. Moreover, the policy under which you invest your foreign exchange holdings is to our mutual advantage.

This is also the reason that in the exchange of letters last March we reiterated the basic principle that it would not be Canada's intention to increase its foreign exchange reserves through borrowings in the United States. Implementation of this principle does not require that Canada's reserve level be limited to any particular figure. We are well aware of Canada's need for flexibility with respect to reserve levels in order to accommodate the adaptation of monetary policy to the changing needs of its domestic economy, seasonal factors and other influences of a temporary nature. This statement of objectives recognizes that under circumstances in which an improvement in the payments position of the United States is essential to the strengthening of the world monetary system, it is in Canada's own interest to avoid hindering the achievement of this objective by unnecessary borrowing in the United States. In recent times capital markets in other countries have developed a capacity which has attracted borrowers from many countries. Canadian authorities have taken advantage of these expanding capital markets to raise funds in substantial quantities. These developments now offer Canada an alternative means of achieving an increase in its reserves whenever Canadian authorities believe this is desirable. In addition, Canada has given strong support to the arrangements for new Special Drawing Rights which, when activated, will offer a source of regular and automatic additions to international reserves. Both our countries, along with other nations, actively support the ratification of this new facility in the International Monetary Fund and the activation of these reserve assets as soon as possible.

In undertaking this review of our relationship, I have been very much aided by the knowledge and experience our respective governments have gained through the close consultations which form such an important part of this relationship. These consultations will, of course, continue to permit us to keep each other fully informed of our views regarding current financial developments.

The unique financial arrangements we have developed, expressed first with the joint statement of July 21, 1963 and brought up to date today, provide support to the payments positions of both countries and hence strengthen the international monetary system.

Sincerely yours,
Henry H. Fowler.

Letter from Mr. Benson to Mr. Fowler

Dear Secretary Fowler:

I welcome the review of financial relationships between Canada and the United States which you have provided in your letter of today's date.

As you have noted, the Canadian Government is keenly aware of the importance to Canada and to the world, as well as to the United States, of the strength of the United States dollar and, as a means to that end, of a continued improvement in the international payments position of the United States.

With this in mind, the Canadian Government has adopted policies to ensure that the exemption of Canada from the United States balance of payments programme would not endanger the success of that programme. In particular, we have taken steps to prevent Canada from becoming a "pass-through" channel for the flow of capital from the United States. We have also found various appropriate means of supporting the payments position of the United States. Thus the Canadian Government has invested its United States dollar reserves (in excess of working balances) in special non-marketable issues of the United States Treasury. It also turned to the expanding capital markets of Europe to find funds with which to rebuild Canada's foreign exchange reserves. In the course of this year substantial sums have been added to our reserves as a result of borrowings of the Government of Canada and other Canadians outside the United States, and the investment of these sums has provided support to the payments position of the United States. We expect, as you note in your letter, that the implementation of the Special Drawing Rights scheme in the International Monetary Fund will provide an additional well-regulated source of new reserve assets.

I too have found very useful the close consultations which have come to form such an important aspect of the relationship between our two countries. I look forward to a continuation of them as a means of keeping each other fully informed of our views regarding current financial developments.

In the light of all these considerations I can reiterate to you that it is not an objective of Canadian policy to achieve permanent increases in our exchange reserves through unnecessary borrowing in the United States. I fully share the view expressed in your letter that the implementation of this principle does not require that Canada's reserve level be limited to any particular figure, and that our reserves may be expected to fluctuate to accommodate the adaptation of monetary policy to the changing needs of the domestic economy, seasonal influences, and other influences of a temporary nature.

Yours sincerely,
E. J. Benson,
Minister of Finance.

STATEMENT BY THE MINISTER OF FINANCE DATED MAY 3, 1968, ANNOUNCING GUIDELINES FOR THE CHARTERED BANKS.

The Honourable E. J. Benson, Minister of Finance and President of the Treasury Board, announced today that following discussions with the chartered banks which the Bank of Canada undertook pursuant to the exchange of letters of March 7, 1968 between the Secretary of the United States Treasury and the Minister of Finance, the chartered banks are now conducting their operations in foreign currencies in such a way as to accord with the understandings reached in that exchange.

It will be recalled that Canada was granted exemption from the U.S. balance of payments measures affecting capital flows which are administered by the Department of Commerce and the Federal Reserve Board, and that in his letter to Mr. Fowler Mr. Sharp said that Canada would ensure that this exemption would not result in Canada's being used as a "pass through" by which the purpose of the United States balance of payments program would be frustrated.

The understanding reached with the chartered banks is embodied in three guidelines, which are appended. They provide in effect that Canadian banks will not be a channel for outflows of funds from the United States which impair the balance of payments of the United States without improving Canada's external position. The guidelines place no restrictions on the flow of funds from the United States to Canada through Canadian banking channels.

The Minister expressed his appreciation to the chartered banks for their co-operation.

1. The total of a bank's foreign currency claims on residents of countries other than Canada and the United States should not rise above the level of the end of February 1968 unless the increase is accompanied by an equal increase in its total foreign currency liabilities to residents of countries other than Canada and the United States.
2. If there should be a decline in the total of a bank's foreign currency liabilities to residents of countries other than Canada and the United States from the level at the end of February 1968 the bank should achieve an equal reduction in its total foreign currency claims on residents of countries other than Canada and the United States as quickly as the liquidity of such assets will permit.
3. Each bank should allow an increase in its U.S. dollar liabilities to residents of the United States from the level at the end of February 1968 only to the extent that the increase is fully matched by the sum of (1) the increase from that date in the bank's U.S. dollar claims on residents of Canada, (2) the decrease from that date in the bank's U.S. dollar liabilities to residents of Canada, and (3) the decrease from that date in the bank's own spot position in U.S. dollars.

STATEMENT BY THE MINISTER OF FINANCE DATED JULY 24, 1968, ANNOUNCING GUIDELINES FOR FINANCIAL INSTITUTIONS OTHER THAN BANKS.

The Honourable E. J. Benson, Minister of Finance, today recalled that in an exchange of letters on March 7, 1968, between the Secretary of the United States Treasury and the Minister of Finance, Canada was granted exemption from the U.S. balance of payments measures affecting capital flows which are administered by the Department of Commerce or the Federal Reserve Board, and that Canada undertook to ensure that this exemption would not result in Canada being used as a "pass-through" by which the purpose of the United States balance of payments program would be frustrated.

Mr. Benson noted that on May 3, 1968, the chartered banks had accepted a guideline which was designed to keep the total of each bank's foreign currency claims on residents of countries other than the U.S. and Canada from rising above the level of the end of February, 1968, unless the increase is accompanied by an equal increase in its total foreign currency liabilities to residents of countries other than Canada and the U.S.

Today he asked that a similar guideline be accepted by all other financial institutions operating in Canada, including trust companies, mortgage loan companies, sales finance companies, mutual funds, pension funds, insurance companies, investment companies, investment dealers, and small loan companies. The Minister asked that each of these financial institutions manage its affairs in such a way that the total of its foreign currency claims on residents of countries other than Canada and the United States, in the form of deposits, loans and portfolio investments in bonds and stocks, does not rise above the present level unless the increase is accompanied by an equal increase in its total foreign currency liabilities to residents of countries other than Canada and the United States, or arises from net earnings of foreign branches or subsidiaries.

The Minister said that his officials will be getting in touch with Canadian financial institutions either directly or through their associations to ask them to improve the information available to him on their foreign currency assets and liabilities.

In addition, Mr. Benson requested all Canadian investors to continue to comply with the request made in March, 1966 by the then Minister of Finance, the Honourable Mitchell Sharp, to all Canadian investors, including all financial institutions, not to acquire securities denominated in Canadian or United States dollars which are issued by United States corporations or their non-Canadian subsidiaries and which are subject to the United States interest equalization tax if purchased by United States residents. Investments in such securities made by Canadian financial institutions in order to cover foreign currency liabilities to non-residents of Canada and the United States were exempt from this request. All Canadian financial intermediaries are asked not to facilitate transactions which would be contrary to this guideline concerning such "off-shore" securities.

The Minister expressed confidence that Canadians would co-operate in protecting the national interest by following these guidelines. If there are cases in which financial institutions find that the conduct of their operations in accordance with these guidelines gives rise to special difficulties he asked that the institutions take these up with his officials. In particular he would be prepared to consider approval of investments in countries outside Canada and the United States to meet essential legal or customary requirements for cover for foreign currency liabilities in such countries, if this cover cannot otherwise be provided.

STATEMENT BY THE MINISTER OF TRADE AND COMMERCE DATED SEPTEMBER 19, 1968, ANNOUNCING GUIDELINES FOR CANADIAN INCORPORATED COMPANIES, OTHER THAN FINANCIAL INSTITUTIONS.

The Honourable Jean-Luc Pepin, Minister of Trade and Commerce, today announced a program applicable to Canadian incorporated companies, other than financial institutions, which is designed to ensure that their investments outside of Canada and the United States will be compatible with Canada's unrestricted access to the United States capital market.

This action is being taken as a follow-up to the arrangements set out in the exchange of letters between the United States Secretary of the Treasury and the Canadian Minister of Finance, dated March 7th, 1968, providing for the exemption of Canada from the United States balance of payments measures affecting capital flows. As part of the arrangement Canada undertook to ensure that the exemption did not result in Canada being used as a "pass-through", by which the purposes of the United States program are frustrated. Guidelines to implement this undertaking with respect to operations of the chartered banks were announced by the Minister of Finance in May and guidelines for other financial institutions were announced in July.

The Minister emphasized that it is important that the flow of investment overseas should not be increased as a consequence of the unrestricted access of Canadian business to the United States capital market. In this connection the Minister noted that annual investment overseas by Canadian non-financial companies was normally modest in amount, and a continuation of a normal volume of Canadian investment of this kind would be in order. The Government is not proposing the establishment of quotas for individual non-financial companies in order to ensure that the aggregate flow of investment overseas from such companies is held to moderate dimensions but the Government is instead requesting that these companies adhere to certain priorities as indicated in the following guidelines:

> As regards investment in continental Western Europe, Canadian companies are asked not to embark on new investment programs or otherwise increase their assets in such countries in any way involving the transfer of capital funds or other forms of financing from Canada or the United States except in cases where firm commitments have been made or where it can be clearly demonstrated that such investment could be expected to bring unusually large and early benefits to Canada's trade and payments position and cannot be adequately financed from overseas sources.
>
> As regards investment in other developed countries overseas, companies are asked to exercise restraint in embarking on new investment undertakings which involve capital transfers or other forms of financing from Canada or the United States and to give priority to investment which will contribute importantly to improvement in Canada's trade and payments.
>
> The general restraint to be exercised with respect to capital transfers to overseas countries is not intended to inhibit desirable investment in less developed countries.

Nothing in these guidelines is to restrict the financing of Canadian exports.

As part of the program Canadian incorporated companies are being asked to provide information quarterly on international capital transfers actually made, and also to provide information on planned capital transfers to overseas countries for 1968 and 1969 in cases where transfers in excess of $200,000 annually are contemplated. The forward plans submitted will be carefully reviewed in light of the need to keep total Canadian investment overseas within moderate dimensions consistent with the exemption from the United States balance of payments restrictions. Particular attention will be given to programs which involve the use of funds obtained from the United States either directly or indirectly.

STATEMENT BY THE HONOURABLE MITCHELL SHARP, MINISTER OF FINANCE, TO THE HOUSE OF COMMONS, MARCH 16, 1966.

When the United States balance of payments guidelines were being discussed in this house on February 2, I said that it would be most undesirable if the effect of these guidelines was to induce strong new demands upon capital markets in Canada. I also indicated that if necessary we would take whatever action is appropriate to protect Canadian interests. Prior to our meeting with United States Secretaries in

Washington it seemed clear that pressures on our capital markets were being accentuated as an indirect result of the United States guidelines, and we discussed this with them.

Under the guidelines, United States companies are being encouraged to raise funds abroad for their international operations. In response to this, well known United States companies and their foreign subsidiaries are issuing dollar securities for sale outside the United States. To the extent that this search for funds abroad by United States companies attracts funds from Canada, it puts abnormal pressure on the Canadian market and could force Canadian borrowers to rely more heavily on the United States capital market.

It has been, and continues to be, the policy of the government to encourage Canadians to invest their savings in Canadian development. We are now entering our sixth consecutive year of significant economic growth. Heavy demands are being made on our capital markets as Canadian industry expands its capacity and improves its efficiency and as Canadian governments and municipalities undertake to provide the many services required by our expanding economy.

To meet this situation I am, on behalf of the government, making the following request today to Canadian investors.

To help ensure that Canadian savings are available to meet the present large demands for capital in Canada the government is asking all Canadian investors, including financial institutions such as the banks, life insurance companies, and trust and loan companies, as well as other corporations, pension funds and individuals, not to acquire securities, denominated in Canadian or United States dollars, which are issued by United States corporations or their non-Canadian subsidiaries and which are subject to the United States interest equalization tax if purchased by United States residents. Investments in such securities made by Canadian financial institutions and pension funds to cover foreign currency liabilities to non-residents of Canada and the United States are exempt from this request.

Canadian borrowers have co-operated with the government's requests in the past for the exercise of some temporary restraint in borrowing abroad in the national interest. I feel certain that Canadian investors on their side will co-operate fully with this request which is also in the national interest.

For some time the Bank of Canada and the Department of Finance have, in answer to enquiries, been discouraging the issue of securities in Canada by foreign borrowers. I feel that we should continue to discourage such issues since the use of Canadian savings in this way could bring increased pressures on our capital market and lead to increased borrowings in the United States by Canadians under the exemption from the interest equalization tax. I am confident that our financial institutions will continue to assist us in carrying out this policy.

BANK OF CANADA STATEMENT OF INCOME AND EXPENSES

(thousands of dollars)

	1968	1967
Income		
On investments (including deposits)	$203,323	$193,240
All other income	179	204
Total income	$203,502	$193,444
Operating Expenses		
Salaries[1]	$ 6,257	$ 5,658
Contributions to pension and insurance funds	542	501
Other staff expenses[2]	467	349
Directors' fees	30	28
Auditors' fees and expenses	85	83
Taxes (municipal and business)	1,306	1,248
RCMP guards and electric protection	225	175
Insurance	67	60
Bank notes — production and shipment	4,887	5,591
Data processing and computer costs	344	257
Other equipment and premises (net)	706	371
Printing of publications	107	117
Other printing and stationery	292	219
Postage and express	259	241
Telephones and telegrams	219	189
Travel and transfer expense	206	184
Interest paid on unclaimed balances	68	59
All other expenses	282	242
Total operating expenses	$ 16,349	$ 15,572
Depreciation on Buildings and Equipment	998	848
Net Income Paid to Receiver General of Canada	186,155	177,024
	$203,502	$193,444

(1) The number of staff averaged 1,045 in 1968 and 1,002 in 1967

(2) Includes overtime pay, medical services and cafeteria expense.

ASSETS

	1968	1967
Deposits payable in foreign currencies		
Pounds sterling and U.S.A. dollars	$ 95,765,052	$ 90,641,089
Other currencies	156,521	251,509
	95,921,573	90,892,598
Cheques on other banks	152,236,827	105,583,628
Advances to chartered and savings banks	5,000,000	3,000,000
Accrued interest on investments	50,940,327	46,473,690
Investments — at amortized values		
Treasury bills of Canada	453,368,678	538,304,355
Other securities issued or guaranteed by Canada maturing within three years	1,540,915,405	1,269,681,384
Other securities issued or guaranteed by Canada not maturing within three years	1,890,338,307	1,940,122,952
Debentures issued by Industrial Development Bank — Note	305,041,830	270,231,238
Securities issued by the United Kingdom and the United States of America	10,752,213	10,710,303
	4,200,416,433	4,029,050,232
Industrial Development Bank		
Total issued share capital at cost — Note	49,000,000	45,000,000
Bank premises		
Land, buildings and equipment Cost less accumulated depreciation	22,150,087	17,348,143
Net balance of Government of Canada collections and payments in process of settlement	58,183,461	72,995,671
Other assets	1,716,238	1,280,080
	$4,635,564,946	$4,411,624,042

Note: The audited financial statements of the Industrial Development Bank as at September 30, 1968 were issued to the public on December 9, 1968.

L. RASMINSKY, Governor
Ottawa, January 28, 1969

A. J. NORTON, Chief Accountant

AS AT DECEMBER 31, 1968
(with comparative figures as at December 31, 1967)

LIABILITIES

	1968	1967
Capital paid up	$ 5,000,000	$ 5,000,000
Rest fund	25,000,000	25,000,000
Notes in circulation	3,229,211,295	2,978,939,617
Deposits		
Government of Canada	47,447,900	42,171,527
Chartered banks	1,114,326,553	1,062,017,745
Other	38,380,403	37,925,605
	1,200,154,856	1,142,114,877
Liabilities payable in foreign currencies		
To Government of Canada	26,983,626	32,367,592
To others	1,301,224	2,450,753
	28,284,850	34,818,345
Bank of Canada cheques outstanding	146,459,854	224,406,917
Other liabilities	1,454,091	1,344,286
	$4,635,564,946	$4,411,624,042

Auditors' Report • We have examined the statement of assets and liabilities of the Bank of Canada as at December 31, 1968. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances. In our opinion, the accompanying statement of assets and liabilities presents fairly the financial position of the Bank as at December 31, 1968.

JACQUES RENÉ DE COTRET, C.A.
of René de Cotret & Cie.

T. C. KINNEAR, F.C.A.
of Price Waterhouse & Co.

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* Appointed February 1969

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