Bank of Canada

Annual report of the Governor
to the Minister of Finance
and statement of accounts for the year

1977

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February 28th, 1978

The Hon. Jean Chrétien, P. C.,
Minister of Finance,
Ottawa.

Dear Mr. Chrétien,

In accordance with the provisions of the Bank of Canada Act I am transmitting herewith my report for the year 1977 and a statement of the Bank's accounts for this period, signed and certified in the manner prescribed in the by-laws of the Bank.

Yours sincerely,

Governor

Bank of Canada

Report of the Governor – 1977

General Observations

In 1977 Canada made further progress in recovering from the economic distortions produced by the intense inflationary pressures that were experienced earlier in the 1970s. By 1975 these pressures, which came from internal as well as external sources, had seriously undermined the ability of the Canadian economy to function well. Since that time both private and public responses to the problems facing the economy have been more realistic and, despite various current setbacks, the prospects for the future performance of the economy have improved correspondingly.

Perhaps the most troublesome legacy of the period of accelerating inflation was the widespread sense of unfairness created by the very uneven impact of the inflationary process on the incomes of different groups in the community. The normal link between incomes and economic performance became seriously weakened, and the various groups in the community felt impelled to join more and more vigorously in the scramble for increases in money incomes to restore or to protect their positions. The trouble with these reactions was that, however defensible they seemed from the point of view of those concerned, they were perverse from the point of view of the whole community. By continuing to feed the inflationary process long after the disappearance of excessive demand pressure in the economy, they were prejudicing the growth of employment and productivity in Canada on which ultimately the real income of the community depends.

What was badly needed was a slowing of the inflation of money incomes relative to output, that is, a trend back towards a matching of increases in income and increases in output. This is a difficult transition to accomplish and an extremely painful one if it is made rapidly. We in Canada are attempting to make it gradually over a period of years in the belief that a gradual approach will serve better in the longer run by attracting the public understanding and support required for a successful outcome. We are now over two years into the period of transition, and any fundamental assessment of the current position and prospects of the Canadian economy must rest heavily on how well the transition is proceeding.

I believe that we have made solid progress over the last two years. While we still have some distance to go, I think we should feel heartened by how far we have come and encouraged to press on. The trend of wage and salary increases has declined sharply from the extraordinary levels of two to three years ago and there is today evidence in many quarters of more realistic attitudes towards increases in money incomes. We now appear to have succeeded in getting the rate of increase in our labour costs back into the same range as in the United States, the first time that this has happened for many years. In a country as dependent on international trade as ours it is essential to our economic welfare that we be competitive internationally.

In respect of our international competitive situation one must, of course, also take account of the foreign exchange value of the Canadian dollar. With the deterioration that has occurred in recent years in the trend of costs of production in Canada relative to that in the United States it was virtually inevitable that sooner or later the Canadian dollar would fall to an appreciable discount in terms of the United States dollar. Such an adjustment had in fact become necessary to mitigate the impact of the relative increase in our costs on our international trade. The exchange rate adjustment came in late 1976 and during 1977. Since the United States dollar has in very recent months experienced a substantial depreciation relative to a number of important overseas currencies the depreciation of the Canadian dollar against these overseas currencies has been very large indeed.

It would have been very much better for Canada if we could have avoided the deterioration in our relative costs that made a large exchange rate adjustment necessary. But since we did not avoid it we must now cope with the exchange rate consequences in the interests of our ability to compete with the outside world. These consequences are that imports now cost us more than they did, more not only in terms of Canadian dollars but also in terms of the amount of Canadian goods and services that we must export to pay for them. There may be a disposition on the part of some Canadians to believe that they should be protected from the higher cost of imports by receiving extra increases in their money incomes but that would exacerbate rather than solve our economic problem. To the extent, on the other hand, that the consequences of the exchange rate adjustment are accepted without a futile inflationary effort to escape them, the stage will be set for a widespread and welcome increase in the demand for Canadian exports and for Canadian goods and services that compete with imports.

There is already evidence of a significant improvement in our merchandise trade balance. The balance of payments deficit on current account is still very large, however, and the Canadian dollar has been vulnerable to any ebbing of the flow of capital into Canada. The recently announced intention of the Government of Canada to borrow funds outside Canada in order to supplement the net inflow that occurs through other channels will assist in the orderly financing of the deficit.

My general view about matters related to the Canadian exchange rate is then that for a year or so our past has been catching up with us; that this involves difficult adjustments of many kinds over different time periods; that things have so far gone about as well as could reasonably have been expected; that the more successful we are in limiting the fallout from the movement in the exchange rate on our cost structure the better will be our economic base for moving forward; and that the best way to avoid future problems related to the external value of the Canadian dollar is to maintain its internal value.

There are other aspects of the scene during 1977 that also lead me to believe that Canada is making progress in dealing with its economic problems. During 1977 governments at all levels continued their efforts to bring their expenditures under firmer control and in this endeavour they seemed to have broad public support. Attitudes towards government spending have changed remarkably from those prevalent a few years ago that led to the burgeoning of the public sector in Canada. The change in attitudes goes beyond the scale of government spending to include on the part of governments themselves a willingness to look hard at the full effects of their various initiatives and to recognize effects that were not intended. There is now a much greater awareness that a satisfactory growth of employment and output cannot be achieved through demand management policies alone, that other policy measures have an important role to play in this regard and that they must be carefully designed and co-ordinated.

I shall have more to say about monetary policy later in this Report but in this context I would like to say that I am encouraged by the support that the Bank of Canada has received in its efforts to conduct monetary policy within the framework of a medium-term time perspective. I am naturally aware of the arguments that are made for aiming monetary policy at short-term objectives but history offers a great deal of evidence that this does not work very well. It is encouraging that the world-wide inflationary upsurge of the early 1970s has been widely understood as underlining the need for moderation and perspective in monetary management.

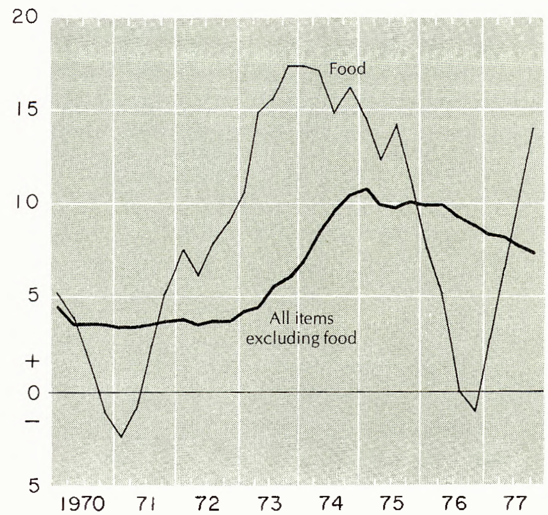
Not all commentaries on Canadian economic developments in 1977 give as much weight to positive aspects as this one and certainly there is no shortage of respects in which the performance of the Canadian economy fell well short of ideal. One major disappointment was the trend of employment and output. Employment rose appreciably over the year but not by as much as the labour force, with the result that the unemployment rate drifted upward more or less continuously during the year to $8^1/_2$ per cent at year-end. I share the general concern about this situation. In my view it underlines the need for, among other things, completing the transition to better cost and price performance.

Another unwelcome feature of 1977 was the trend of prices. An important contributing factor here was the exchange rate. As I have already said, the exchange rate adjustment was bound to come at some time and the important thing is to recognize that a change in the exchange rate on the scale we have experienced involves a "once and for all" adjustment that must be accommodated. It would therefore be a serious mistake to suppose that the unwelcome effect of the exchange rate adjustment on prices is evidence that Canada's anti-inflation program is not working.

Another element in the unfavourable price trend was the continuing adjustment in Canada of the price of energy towards world levels. Although it is being spread over a period of time, this too has some of the character of a "once and for all" adjustment that must be absorbed.

The most untimely element in the unhappy trend of prices in Canada in recent months has been food prices. Food prices are typically much more volatile than other consumer prices and are subject to a great many special influences of a short-run character such as production cycles and variations in weather. The result is that the food component of the Consumer Price Index has moved quite differently from the non-food component in most periods of the last few years. The exchange rate adjustment is, of course, a partial explanation of the sharp recent increase in the prices of some foods but other influences characteristic of food prices have been dominant. The underlying trend of prices in Canada is much better indicated by the non-food component of the Consumer Price Index than by the total Index, and it is of great importance that this be widely recognized. In spite of the exchange rate adjustment non-food prices have risen by only about 7 per cent over the last twelve months

Consumer Prices
Percentage change, four quarters ending



compared with almost 8½ per cent over the previous twelve months, and that result is encouraging.

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Through 1977 monetary policy continued to be conducted within the framework that I have outlined in my two previous Reports. This is a medium-term framework which in the present context gives priority to guiding monetary expansion along a path conducive to the gradual return of the Canadian economy to satisfactory levels of activity without inflation. I recognize, of course, that a monetary policy of this character will not of itself guarantee the end sought. Many other decisions throughout the economy will also have to be directed to the same purpose. But if monetary policy is not compatible with that objective, policies to that end in other areas will be frustrated no matter how well designed and executed they may be. Thus confidence in the integrity of monetary policy is a prerequisite to confidence in a society's ability to achieve and sustain good price performance in a free market economy.

Because decision-making throughout the economy is much influenced by expectations about future rates of inflation and because expectations about inflation are in turn influenced by expectations about monetary policy, it has, I think, been constructive that the Bank of Canada has adopted the practice of giving information about its future policy intentions in terms of monetary growth targets. This information is given in terms of a range within which the Bank will endeavour to cause the money supply* to track in the year or so ahead, and it is supplemented by the indication that over time the growth rates that define this range can be expected to be reduced towards those that would be consistent with a satisfactory level of economic activity with stable prices. It is intended that these assurances about the Bank's future actions should encourage groups throughout the community to base their economic decisions on the expectation of declining rates of inflation in Canada.

The Bank's approach to the conduct of monetary policy helps it respond constructively to changes in the trend of total spending in the economy. This was illustrated when the trend of total spending in Canada weakened in the latter part of 1976 in line with a slowing of real growth. The Bank reduced its Bank Rate in four steps from 9½ per cent in November 1976 to 7½ per cent in May 1977 and these reductions were followed by similar reductions in short-term market yields and in institutional deposit and lending rates. Those interest-rate initiatives could of course have been seen at the time as warranted on grounds other than the trend of the money supply – and they were in fact then so seen – but they were also strongly signalled by the trend of the money supply relative to the Bank's target range.

In the months since May 1977 the growth of total spending in the economy has been such that no Bank Rate initiative has been required to keep monetary expansion proceeding at a moderate rate and short-term interest rates in Canada have not moved far from the levels established after the Bank Rate reduction in May. Credit has continued to be readily available and the level of interest rates in Canada has not been high relative to the current rate of price inflation. Long-term interest rates have risen in recent months from the lower levels which they had reached at mid-1977 but the main contributing factor has been a similar increase in long-term rates in the United States.

*   *   *   *

We are now well into the third year of recovery from our disruptive burst of accelerating inflation. I have already said that I believe that we have made, and are making, solid progress towards a much sounder economic situation and

*Defined for this purpose as currency and chartered bank demand deposits, or M1.

that we have good grounds for feeling encouraged to press on. I have noted that in our progress we have recently encountered two adverse winds which must not be allowed to blow us off course, namely, the inflationary fallout of the major adjustment that has occurred in our exchange rate and the recent surge in food prices. I also recognize that our economic problems have been complicated by the questions that have been raised about the place of Quebec in the Canadian federation.

Before much longer we shall face yet another test, the phasing out of the mandatory income guidelines administered by the Anti-Inflation Board. For the first time in quite a while decisions on incomes and prices for large segments of the economy will have to be made solely on the joint responsibility of those directly involved. These decisions will be made in a market environment that is not going to be strong enough to absorb anything more than modest increases in incomes and prices without the loss of potential jobs and output. It is therefore very important that wage- and price-setting decisions should not be distorted by a resurgence of inflationary expectations. Since monetary policy has some influence on expectations I have been at pains to emphasize that no one should look to monetary policy to accommodate inflationary increases in costs and prices through excessive monetary expansion.

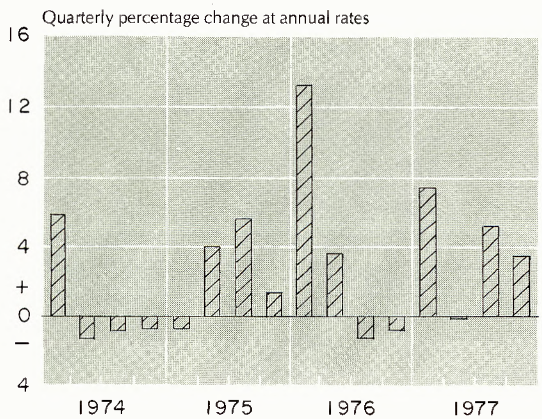
A successful passage through the months ahead will require realistic and responsible decisions by a great many Canadians – realistic in their relationship to current economic conditions and responsible in their moderation and time perspective. I have previously observed that one of the consequences of Canada's recent inflationary surge was the erosion of the willingness and confidence of individuals and groups to act in this way. It is essential to the collective interest that such willingness and confidence be again manifested.

If we in Canada continue our progress towards better control of our prices and costs we shall unquestionably benefit from higher levels of employment and output than would otherwise be possible. Better price performance will strengthen business and consumer confidence and assure a high and rising level of domestic demand. Better price performance will improve the competitive position of Canadian suppliers in foreign markets and in relation to foreign goods in Canadian markets. The prospects are that economic growth will be appreciable in our major foreign markets and that the opportunities to export will be there if Canada can meet the competition. The key to resolving a large part of Canada's economic problems and to promoting its future economic prosperity lies in fact in those things that are involved in being competitive – enterprise, efficiency and incomes governed by real output. For more than two years we have been moving in the right direction, and our prospects are good if we do not lose heart.

Economic Developments

The hesitation that had been evident in the pace of economic activity since mid-1976 continued through the first half of 1977 as a pick-up in output in the early part of the year proved to be short-lived. However, in the second half of the year there was a firming in demand and output. In particular the foreign trade balance strengthened as the trend of imports eased further and exports continued to expand. For the year as a whole, real Gross National Expenditure (GNE) averaged only 2½ per cent higher than in 1976 but the gain through the four quarters of the year was 4 per cent.

Gross National Expenditure
Constant (1971) dollars



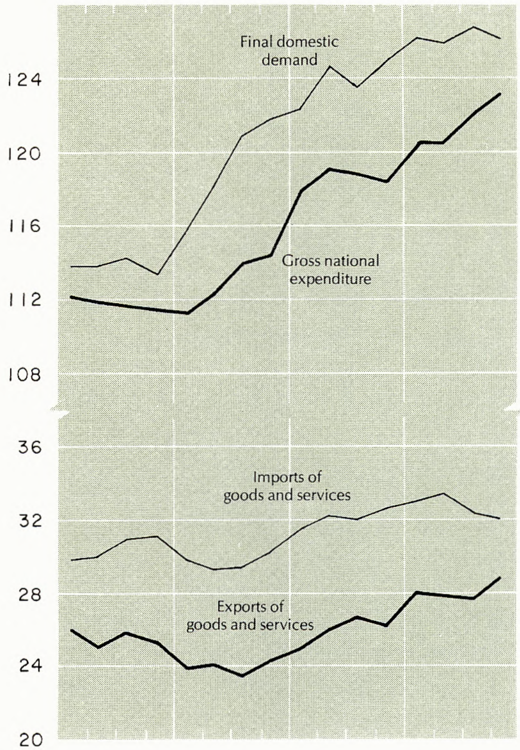
Employment grew more steadily than output during the year, increasing by approximately 2½ per cent through the four quarters. This was appreciably faster than in either of the two previous years, but it was less than the growth in the labour force, which rose strongly in response to a further sharp rise in the number of women deciding to seek work. As a consequence the recorded rate of unemployment moved up to reach a seasonally adjusted level of 8½ per cent at year-end. The growth in employment was unevenly distributed among the main regions of the country. Gains ranged from close to 3½ per cent in Ontario and the Prairies to not much more than 1½ per cent in the other three regions. The change in unemployment rates was similarly dispersed, with relatively small increases in Ontario and the Prairies and larger increases in Quebec and the Atlantic Provinces. Thus regional differences in unemployment rates tended to widen rather than narrow in 1977.

The comparatively strong advance in employment relative to the growth in output meant that in 1977 labour productivity, that is output per person employed, averaged only ¾ per cent more than in the previous year. Productivity had picked up somewhat in 1976 after registering considerable weakness in the two preceding years but in 1977 the increase was again well below the long-term average. It is evident that forces related to cyclical developments in economic activity have played an important role in limiting the advance in productivity in recent years, but non-cyclical forces may also have been at work.

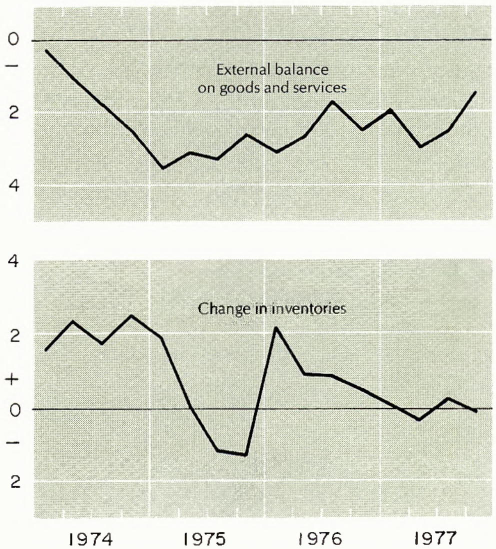
Over the four quarters of 1977 the rise in total spending and incomes in money terms (GNE) slowed further to just under 10 per cent compared with an increase of 12½ per cent through the four preceding quarters. This deceleration reflected a less rapid rise in the over-all

Major Economic Indicators
Seasonally adjusted

Domestic and foreign demand
Billions of constant (1971) dollars

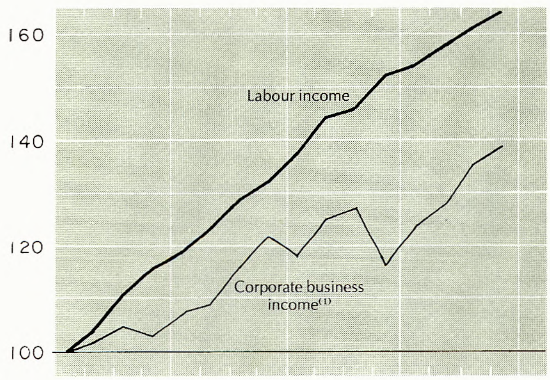


Percent of GNE (current dollars)

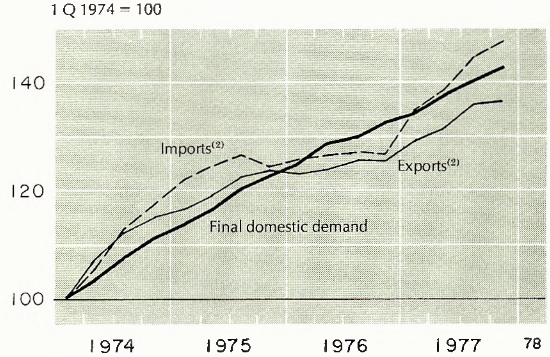


Labour market
Millions of persons

Income aggregates
1 Q 1974 = 100



Price deflators
1 Q 1974 = 100



[1] Corporate profits, corporate capital consumption allowances and the inventory valuation adjustment
[2] Goods and services

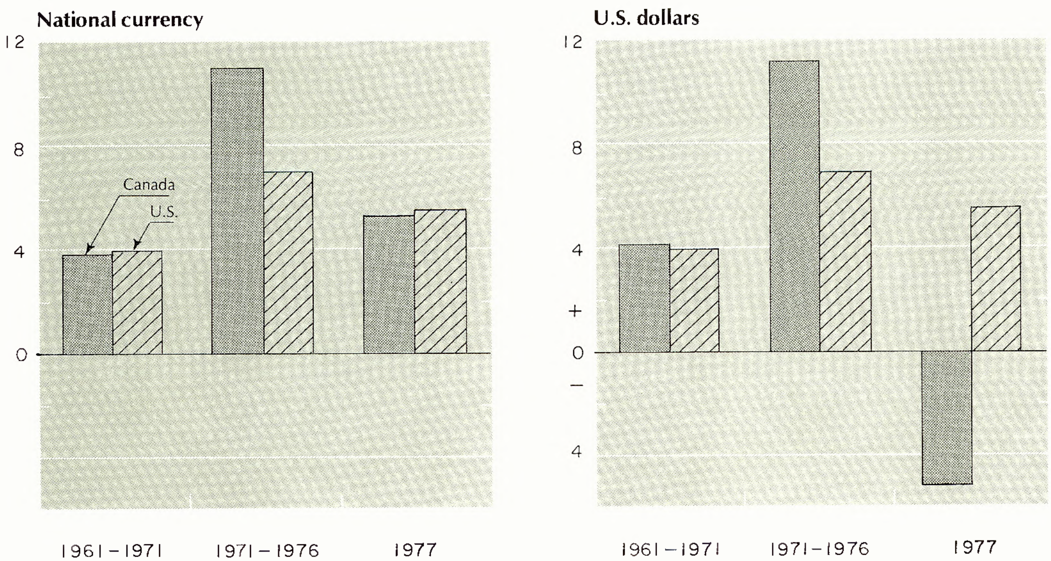
price level for output (as measured by the GNE deflator) and in the unit costs which underlie it. During this same period the GNE price deflator went up 5½ per cent, or considerably less than half the peak rate of increase recorded as recently as 1974.

The pace at which the main components of real demand developed during 1977 was far from even. However, the principal feature was the sharp improvement in Canada's external trade position in real terms – the net balance between exports and imports of goods and services in constant dollars. Domestic demand registered a very moderate gain over the four quarters of 1977.

The performance of domestic demand in the first half of the year was greatly influenced by weakness in the volume of consumer outlays. This in turn reflected a slower rate of growth of money incomes and a renewed acceleration in consumer prices. Furthermore, the personal savings rate for the half year moved up after having fallen back somewhat in the latter part of 1976 from earlier very high levels. A secondary source of weakness in the first half of 1977 was the decline in both farm and non-farm inventories, the latter being mainly a response at the distribution level to the lack of buoyancy in consumer spending. While government spending on goods and services and business investment in plant and equipment rose in the first half of the year, housing investment declined in lagged response to the moderating trend of housing starts from the record pace attained in late 1975 and early 1976.

With the improvement in retail sales that began about mid-year consumer spending in real terms rebounded strongly in the third quarter, but did not advance further in the final months of the year in the face of modest growth in real

Unit Labour Costs[1]
Average annual percentage changes based on fourth quarters



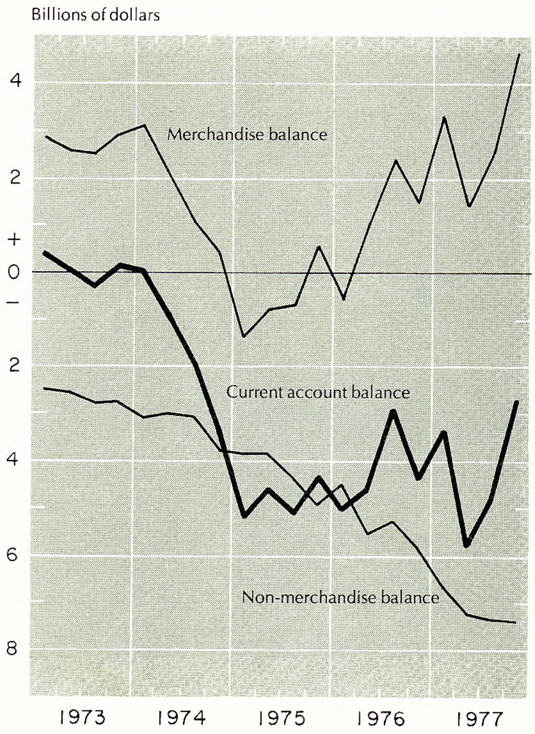
[1] Wages, salaries and supplementary labour income (for Canada excluding retroactive payments) per unit of real GNE.

personal disposable income and a relatively strong increase in personal savings. However, there was renewed growth in non-farm inventories through the second half, apparently reflecting in part some renewed willingness to add to trade stocks in response to the improvement in sales. Other areas of domestic spending were generally lacking in strength. Business fixed investment declined, partly in response to a drop in non-residential construction activity as the advance in energy investment tapered off after several years of very steep increases. The level of investment was still sufficient to result in some increase in productive capacity, but at an appreciably slower rate than in earlier years, and the extent to which available capacity was used appears to have increased modestly.

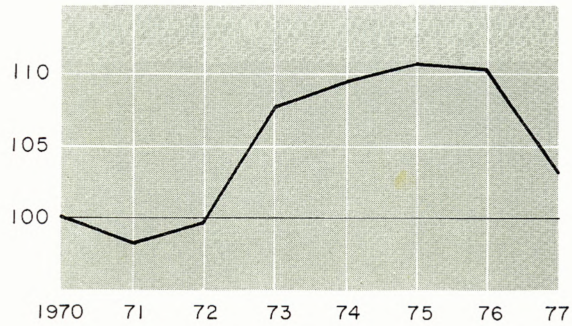
Developments in Canada's external trade afforded a sharp contrast with the modest growth of domestic demand. Export volumes registered a definite upward trend while real imports in fact declined in the second half of the year. These developments were encouraged by the improvement in the competitive position of Canadian suppliers vis-à-vis foreign suppliers. As can be seen in the preceding chart the rise in Canadian unit labour costs in domestic currency terms came down in 1977 to the U.S. range after several years of divergence. In addition there was a gain in cost competitiveness in 1977 relative to foreign suppliers as a consequence of the depreciation of the exchange rate.

Another development in 1977 that had an important effect on the external balance and on domestic real incomes was the markedly slower rise in the prices of Canadian exports than in the prices of imports. Despite this deterioration in our international terms of trade, which came after several extraordinarily favourable years and appears to have reflected both prices in world markets and exchange rate developments, the trade balance in current dollars did show an improving trend through the year and the surplus in 1977 was about \$3 billion compared with \$1 billion in 1976. This gain was offset by continuing

Current Account of the Balance of Payments
Current dollars, seasonally adjusted at annual rates, quarterly



Terms of Trade[1]
Based on fourth quarters, 4 Q 1970 = 100



[1] Ratio of price deflator for exports of goods and services to deflator for imports of goods and services.

growth in the deficit on interest and travel payments so that the over-all current account deficit remained about $4 billion.

The deceleration in 1977 in the rise in total money incomes was almost entirely due to a much more moderate advance during the year in labour income. The extent of this moderation in 1977 was exaggerated somewhat because of the very high retroactive wage payments made in 1976 in respect of earlier years but attributed to labour income in that year. However, the slowing was still considerable even after correction for this factor. Profits, on the other hand, registered a strong recovery during 1977 after experiencing a sizeable decline the year before. A very important factor in improving profits was the effect on export and import-competing industries of the exchange rate change, which made production for export more profitable and encouraged the substitution of domestic production for imports. The exchange rate change was also a favourable factor for farm incomes, but the accrued net incomes of farm operators averaged considerably less than in the previous year. This reflected both the drop in farm output, particularly a lower wheat crop following the bumper harvest of 1976, and the continued increases in farm operating costs.

With the slowing in the rise in labour income there was a marked easing in the escalation of labour costs per unit of output, by far the most important component of domestic costs of production. In view of the slower rise in labour productivity during 1977, this improvement in cost performance was entirely attributable to the more moderate increase in average money wages. Average weekly earnings, which are not so affected by retroactive payments as the labour income estimates, rose by approximately 9 per cent through the four quarters of the year after advancing by 11 per cent during 1976. In the latter part of 1977 the increase in earnings was running still lower, at an annual rate close to 8 per cent.

Newly negotiated wage settlements under major collective bargaining agreements tend to be a leading indicator of changes in average earnings, and here also there was an appreciable further moderation during 1977, continuing the pattern established since the introduction of the anti-inflation program. The improvement in 1977 was not so dramatic as in 1976, but nonetheless the average annual increase over the life of contracts in the final quarter of the year was down to 7 per cent and first year increases averaged 7½ per cent. The moderation in the size of new settlements has been apparent for all main areas of the economy, including both the commercial and the non-commercial sectors.

Although domestic costs of production advanced more slowly in 1977, domestic prices came under more intense upward pressure as a result of a sharp rise in import prices. Mainly because of the large change in the exchange rate, import prices rose by close to 17 per cent over the four quarters of 1977 after advancing by less than 2 per cent in 1976 and by 6 per cent in 1975. The impact of higher import costs was particularly visible in the area of food prices.

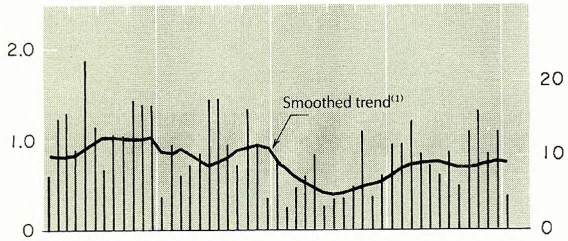
These price pressures were evident at the wholesale level. Industry selling prices increased by 8 per cent over the four quarters of 1977, or almost double the rise in 1976. Selling prices for the food and beverages sector rose by more than 9 per cent in this period after registering a decline in 1976. However, it is noteworthy that the acceleration in industry prices generally during 1977 was comparatively modest considering the extent of the change in the exchange rate. This indicates the important moderating effect exerted by the slower rise in domestic costs.

In the case of retail prices the same factors were at work except that in this area the adverse swing in food prices showed up still more dramatically. Food costs make up more than one quarter of the Consumer Price Index (CPI) and by the end of 1977 the twelve-month increase in food prices had climbed to over 15 per cent in contrast to a slight decline in the previous twelve months. A

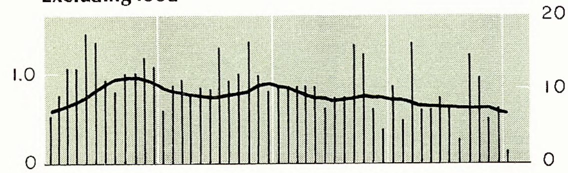
Price and Cost Indicators

Rates of change in consumer prices
Seasonally adjusted, month-to-month percentage change

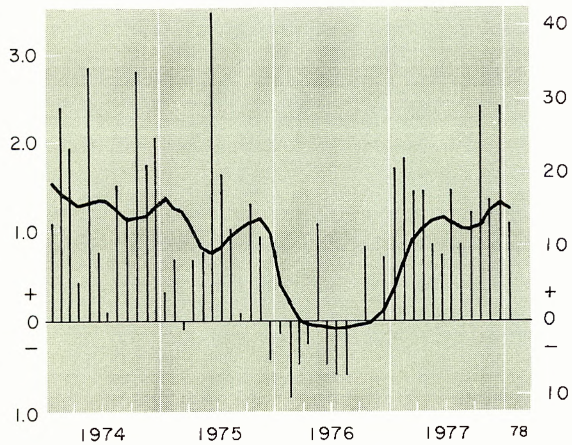
Total
Monthly rate



Excluding food

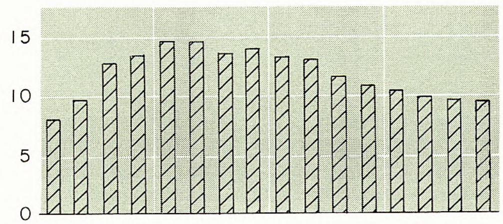


Food

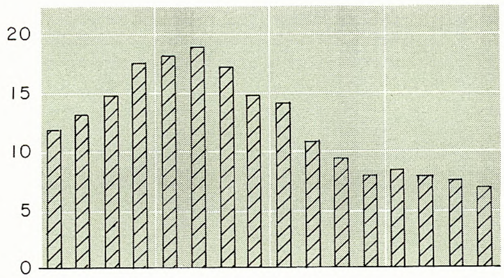


(1) 3 months over 3 months, 6 months ago
(2) Goods and services

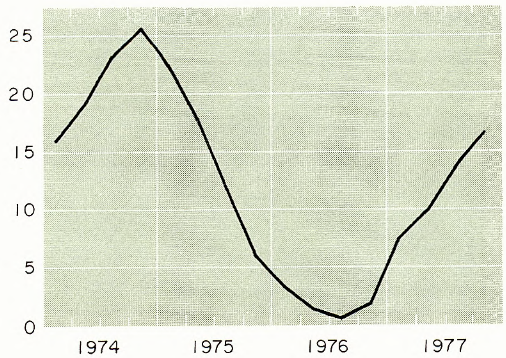
Average weekly earnings – Industrial composite
Year-over-year percentage change, quarterly



Wage settlements over life of contract
Average annual percentage change, quarterly



Implicit GNE import deflator(2)
Year-over-year percentage change, quarterly

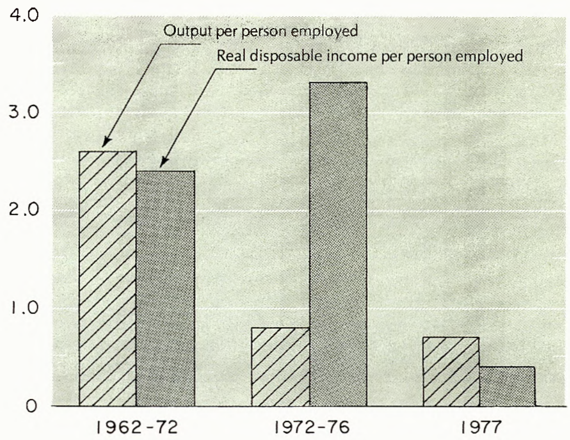


number of factors appear to have combined to produce this result. Besides the direct effect of the decline in the external value of the Canadian dollar on imported foods, there were some adverse developments in the context of the North American agricultural market. Beef prices rose sharply as did the prices of fruits and vegetables. In the case of beef a major contributing factor was the coming to an end of a period of heavy slaughter induced by uneconomic cattle prices. For fruits and vegetables, supplies were cut back early in the year by frosts in Florida and more recently by poor harvest conditions in Canada and the southwestern United States. Food prices continued to rise in January 1978 but less rapidly than in other recent months.

Consumer prices other than food continued to show an improving trend during 1977 notwithstanding the influence of higher import costs. By year-end the twelve-month increase in the CPI excluding food was under 7½ per cent, or a full percentage point less than the rise for the corresponding period of 1976. For January 1978 the twelve-month increase was less than 7 per cent. As in the case of industry selling prices, this performance reflected a moderation in domestic costs that tempered greatly the upward push from the exchange rate change. This easing is mirrored especially clearly in the component of the CPI measuring the prices of services other than shelter and energy. For this element, which is affected mainly by domestic cost developments and only very indirectly by international factors, the increase over the twelve months to December 1977 was down to 5¾ per cent, or about half the pace for 1976.

One very striking feature of the last few years has been the unusual movements in real personal disposable income, that is personal income after taxes adjusted for the rise in consumer prices. Normally, increases in real income per person employed correspond fairly closely with increases in labour productivity, the

Trends in Productivity and Real Incomes
Average annual percentage changes



main longer run determinant of improvements in the standard of living. As the chart illustrates, this correspondence was very close over the period 1962–72. However, over the four years 1972–76 there was a remarkable divergence between the trends of real income and productivity; real disposable income per person employed grew at an unusually rapid rate even though the increase in productivity was well below the long-run average of about 2 per cent a year. This divergence was made possible by the interaction of a number of unusual and temporary developments of which a very important one was the boost to real incomes from the exceptionally favourable development of Canada's international terms of trade through most of the period. Since then the improvement in the terms of trade has been largely reversed and the rise in productivity has continued to be modest. In these circumstances the gain in 1977 for real personal disposable income per person employed was small.

Monetary and Financial Developments

This section of the Report discusses in more detail the aims of monetary policy and describes the operations undertaken by the Bank of Canada to achieve them. The section includes a summary of developments in monetary aggregates and credit flows during 1977 and goes on to provide a record of the Bank's activities in its role as agent for the Government of Canada in the operation of the Exchange Fund Account and in the management of the public debt.

Monetary Policy

The Bank of Canada continued during the year to pursue a policy of bringing about a gradual moderation over time of the rate of monetary expansion. In accordance with this policy the Bank announced in October the second reduction in its target range for the growth of currency and chartered bank demand deposits (M1).

The initial target for monetary expansion, announced in the fall of 1975, had been a trend rate of increase for M1 of not less than 10 per cent a year but not as high as 15 per cent, measured from the average level of M1 for the second quarter of 1975. In August of 1976 the limits of the target range were reduced to 8 per cent and 12 per cent a year respectively, measured from a base period of three months centred on March 1976. The October 1977 reduction in the target limits was to 7 per cent and 11 per cent a year respectively, with the base period being the month of June 1977. The growth from the previous base period to June 1977 was approximately 9 per cent so that the new base was below the centre of the previous target range.

For practical purposes the Bank's target range for M1 can be viewed as a band of uniform width with limits 2 per cent above and 2 per cent below the mid-point of the range rather than as the gradually widening area between two different growth rates. Large month-to-month variations in the growth rate of M1 are to be expected, whereas the target set by the Bank is intended to apply to the average rate of growth of the money supply over considerably longer periods. Expressing the target range as a band of uniform width accommodates short-term fluctuations in the money supply equally well at all times during the period that the target is in effect.

The Bank's monetary growth targets are chosen with a view to accommodating a future growth of total expenditure (in money terms) in the economy that would be capable of supporting a reasonable expansion of output and employment accompanied by a continuing reduction in the rate of inflation. The present target range of 7 per cent to 11 per cent a year would, on the basis of past experience, be capable of accommodating a growth in the dollar value of national expenditure in 1978 of up to some 12 per cent per annum without the need for any major change in levels of short-term interest rates. Such growth in national expenditure would in turn be consistent with real growth in the Canadian economy of over 5 per cent provided that the rate of price inflation continues to decline.

It should be emphasized, however, that in the short run monetary policy is only one of the determinants of the rate at which aggregate expenditure in the economy will in fact grow, and it has little direct influence on how much of any additional spending will be reflected in increased output and employment and how much in higher prices. The latter result depends on how responsive price and cost decisions are to market conditions. In these circumstances monetary policy is being conducted in a way that gives it some of the properties of an automatic stabilizer so far as the level of spending in the economy is concerned. If the growth of money expenditure deviates significantly from an acceptable path, this tends to be reflected in the money supply exceeding or falling below the limits of the target range. In the ordinary course of events the Bank then offers resistance to the deviations by putting upward or downward pressure on short-term interest rates. Such action not only guides monetary growth back towards the target path but also influences the growth of money expenditure in the desired direction.

The Bank does not consider that its use of monetary growth targets can be approached in a mechanical way and it continues to analyze a broad range of economic and financial information for policy purposes. Such analysis is clearly necessary both in setting and changing money supply target ranges and in assessing the timing, the magnitude and the economic impact of the short-term interest rate initiatives that the Bank may consider from time to time. In interpreting movements in money supply relative to the target range, the Bank is continually analyzing the influences to which M1 is responding. Among these are changes in the levels of spending in the economy, changes in interest rates and changes in institutional arrangements that may give rise to shifts in the relationship of M1 to other economic variables.

Interest Rate Developments

A description of interest rate developments over the past year or so can conveniently be divided into two periods. From late 1976 through to May 1977 the Bank of Canada facilitated a reduction in short-term interest rates in response to the weaker trend that had developed in total spending in the economy and that was reflected in growth of M1 below the target set by the Bank. Over this period the Bank Rate was reduced in four steps by a total of two percentage points. The initial Bank Rate reduction from 9½ per cent to 9 per cent was on November 22. A second reduction to 8½ per cent took place on December 22 after an improvement in the somewhat unsettled conditions in both the foreign exchange and domestic financial markets that had prevailed for a time. The third ½ percentage point reduction in the Bank Rate, effective February 1, 1977, brought the rate down to 8 per cent.* No further action was taken by the Bank until May. During the intervening period both the movement of M1 and other indications of the growth of spending in the economy suggested that there was room for a further decline in interest rates and effective May 9 the Bank Rate was reduced to 7½ per cent.

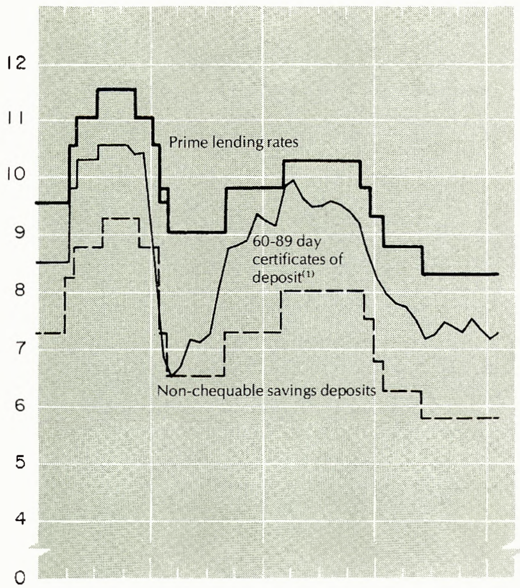
Short-term market interest rates and most administered rates set by financial institutions generally declined in line with the successive reductions in the Bank Rate. For example, yields on short-term paper declined from about 9¼ per cent to about 7¼ per cent and the chartered banks' prime lending rate was lowered from 10¼ per cent to 8¼ per cent. Rates paid by

* At the same time the required minimum secondary reserve ratio which the chartered banks must meet was reduced from 5½ per cent to 5 per cent.

Interest Rates

Short-term

Chartered bank typical rates



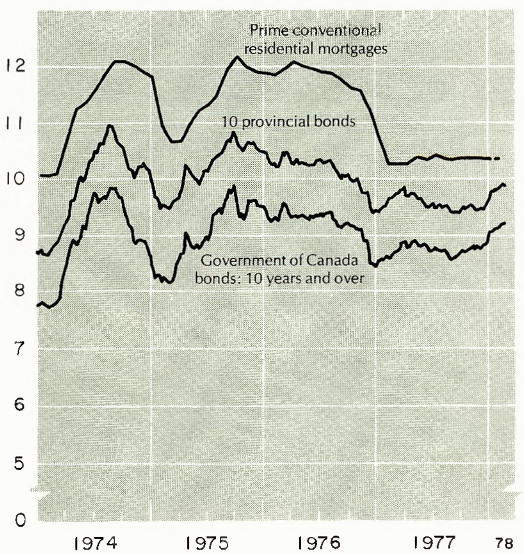
(1) Prior to November 1974, rates prevailing under the Winnipeg agreement.

Short-term (3-month) rates

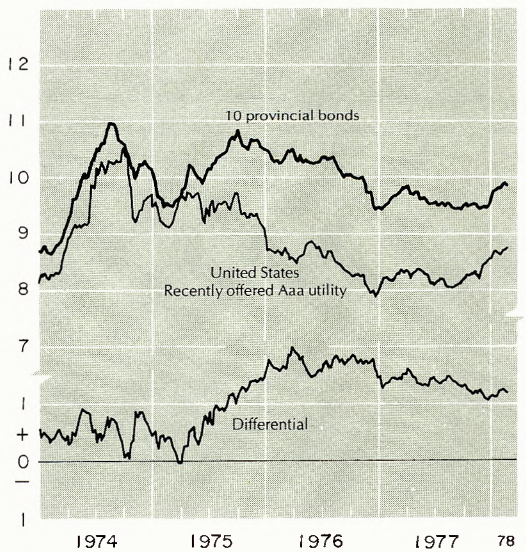
(1) Finance company paper.
(2) Dealer-placed commercial paper.

Long-term

Canada



Canada – U.S. comparisons



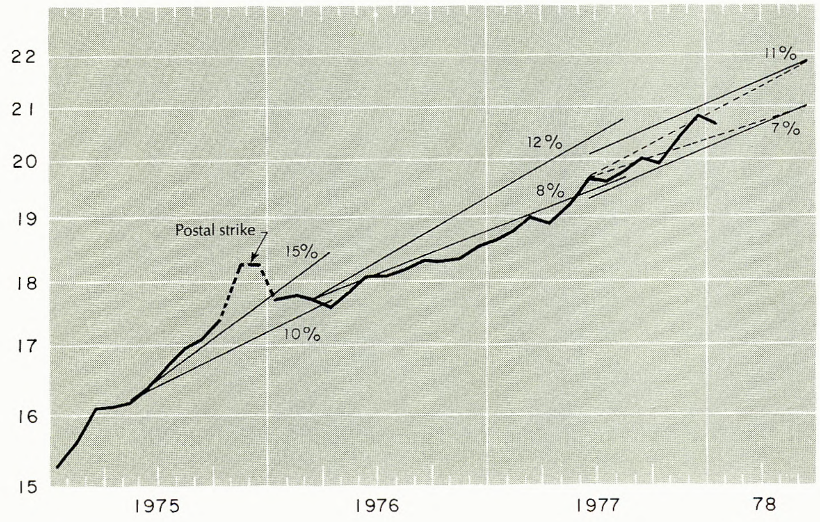
banks on non-chequable savings deposits declined by $2\frac{1}{4}$ percentage points, re-establishing the spread between bank deposit and lending rates that had existed before March 1976. Typical rates for conventional mortgages declined by $1\frac{1}{2}$ percentage points to $10\frac{1}{4}$ per cent. Longer term interest rates also were influenced by the reduction in short-term rates but they moved on a different path and their decline over the period was much less.

In the period since May there has been some acceleration in the growth of spending in the economy, M1 has moved back within the target range, and the Bank has resisted any tendency for short-term interest rates to move very far in either direction from the levels reached shortly after the May reduction in the Bank Rate. By contrast short-term interest rates in the United States have risen by about 2 percentage points since the early spring of 1977. As a consequence of these different trends, the differential between short-term interest rates in the two countries has been reduced by almost 4 percentage points since November 1976. The differential between long-term interest rates in Canada and the United States also has narrowed over the past year or so, although by very much less. Long-term rates in the two countries moved along broadly similar paths, declining gradually until mid-summer. Since then long rates have risen appreciably in both countries but the movement in Canada lagged behind that in the United States and has been somewhat less.

During the first half of the year there was on occasion a disposition in the market to accelerate the rate of decline of short rates in Canada and the Bank's management of chartered banks' cash reserves was on average somewhat restrictive. Over the remainder of the year market expectations shifted back and forth with the Bank acting, sometimes vigorously, to dampen the resulting movement in short-term interest

Money Supply and Target Growth Ranges
Seasonally adjusted

Currency and demand deposits
Billions of dollars, monthly – Ratio scale



rates. As shown in Appendix Tables II and III, these operations involved quite large swings in the cash reserves of the chartered banks, in the amount of central bank credit and in the Bank's portfolio of Government securities.*

Trends in Monetary Aggregates

During much of 1976 and the early months of 1977 the growth of the M1 aggregate in Canada displayed a persistent tendency to fall somewhat short of the 8 per cent a year lower limit of the target range in effect at that time. This was mainly a reflection of the relatively slow growth of money expenditure in the economy from the second quarter of 1976 through to the second quarter of 1977 and the Bank of Canada responded by effecting the series of reductions in the level of short-term interest rates described above.

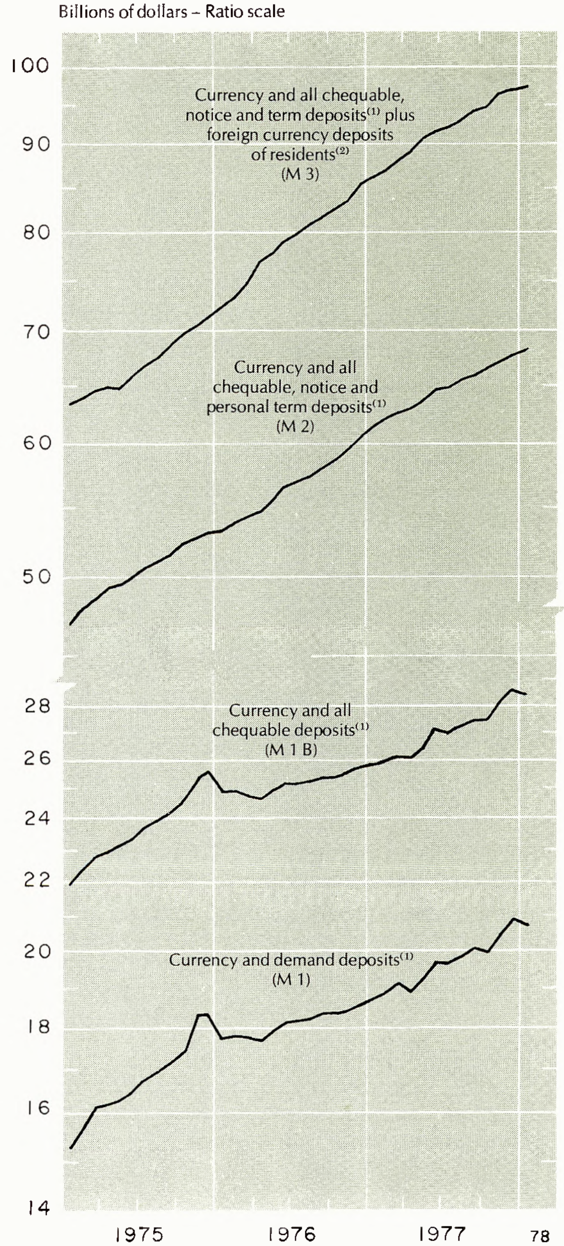
There was also some evidence during this period of the tendency noted in last year's Annual Report for large holders of demand deposit balances to take advantage of facilities made more readily available to them by the chartered banks for minimizing their average holdings of these deposits. Although this shift in the public's money-holding habits appears to have contributed to the weakness in the growth of M1, the over-all magnitude of the shift does not seem to have been very great. The Bank has kept this tendency in mind in interpreting the movement of M1 and in setting the base period for the new target range.

By June of 1977 the growth of M1 had come back within the Bank's 8 per cent to 12 per cent target range, the annual rate of increase since the February to April 1976 base period having risen

*Appendix Table II also shows the amount of central bank credit outstanding during each reserve period during 1977. Between February and April there were advances outstanding on a continuous basis to the Unity Bank of Canada (monthly statements of assets and liabilities of the Unity Bank, as published in the Canada Gazette, show advances from the Bank of Canada at February and March month-ends). These advances were made by the Bank of Canada in its capacity as lender of last resort; they were unusual in term, in amount relative to the size of the bank and in that the collateral accepted included promissory notes and marketable securities of issuers other than the Government of Canada. The advances were repaid in full in April.

Monetary Aggregates

Average of Wednesdays – seasonally adjusted



(1) Deposits (less private float) at chartered banks denominated in Canadian dollars, excluding Government of Canada deposits. Private float excludes float relating to Government of Canada and Bank of Canada transactions.
(2) Foreign currency deposits of residents booked at chartered banks in Canada.

to approximately 9 per cent. This June level of M1 was chosen in due course as the up-dated base from which the new 7 per cent to 11 per cent target range was to be measured. The trend rate of growth of M1 from June to the latest three months has been on average somewhat above the middle of the target range.

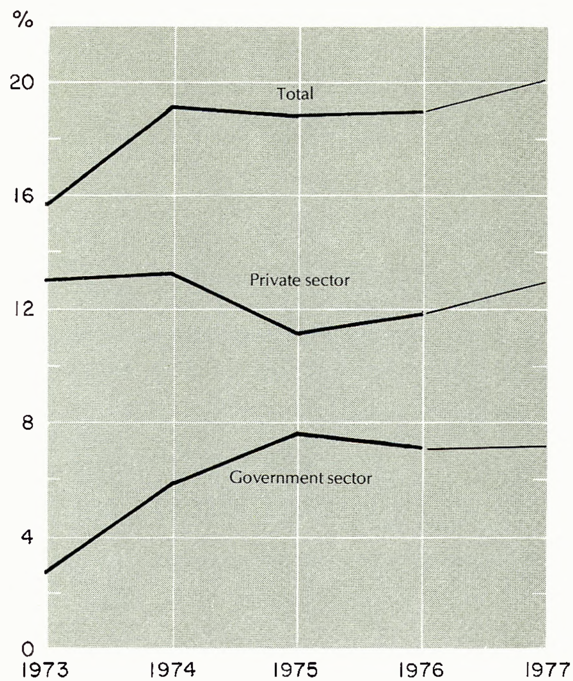
The trend in the growth of the broadly-defined monetary aggregates has been rather different from that of M1. Through much of 1976 and early 1977 these aggregates grew very rapidly but since the middle of 1977 that growth has slowed markedly. This deceleration in the rate of expansion of the broad aggregates does not reflect the recent pattern of growth in money expenditure in the economy. Indeed, since mid-1977 there has been some acceleration of money expenditure growth compared to that over the previous four quarters. What in fact has happened in the more recent period is that the proportion of total funds channelled through the banking system has declined. Bank credit extended to both individuals and businesses grew more slowly in 1977 than in the previous year and banks have therefore been less aggressive in bidding for deposits. This shows up particularly in the rates of growth of term deposits which are typically the marginal sources of funds to the banking system. The slower growth in bank credit appears primarily to have reflected a restructuring of debt by businesses which led to a greater reliance on other sources of funds. A large increase in issues of marketable securities by the business sector was used in part to fund short-term bank loans.

Credit Flows

Although the desire of borrowers to restructure their financial positions resulted in a slower growth of the banking system, it nonetheless contributed to a significant expansion in the credit demands of major Canadian borrowers during 1977. Indeed, as shown in the accompanying chart, total funds raised as a proportion of the dollar value of GNE – a measure relating total borrowing to total money expenditures – rose further in 1977 from the already high levels in the immediately preceding years. This increase largely reflected a strong demand for funds by the private sector and particularly by non-financial businesses and mortgage borrowers; total funds raised by all levels of government relative to GNE was unchanged. This particular balance of sectoral credit demands was somewhat unusual since it is more typical of periods of strong cyclical expansion than of the hesitant pace of economic activity experienced last year.

In this instance the sharp rise in borrowing by non-financial businesses seems to have exceeded their requirements for the financing of

Funds Raised by Major Non-financial Borrowers
As a percentage of GNE



Funds Raised by Major Non-financial Borrowers

	Billions of dollars 1974	1975	1976	1977
Borrowers				
Non-financial businesses				
loans	6.4	4.0	6.3	5.7
short-term paper	1.4	0.2	0.3	0.0
bonds	1.2	2.2	2.3	3.5
stocks	0.4	0.9	1.0	2.0
direct investment from abroad	0.7	0.7	– 0.3	0.3e
Mortgage borrowers(1)	6.2	7.2	9.0	11.9e
Consumers	2.9	3.3	4.0	3.4e
Sub-total private borrowers	19.3	18.4	22.5	26.8e
Provinces and municipalities(2)				
loans	0.3	0.4	0.1	– 0.2e
short-term paper and treasury bills	– 0.1	0.3	– 0.2	– 0.1
bonds — purchased with CPP funds	1.2	1.4	1.5	1.6
— other	3.1	6.5	7.9	5.7
Government of Canada				
treasury bills	0.9	0.6	1.6	2.4
marketable bonds	0.8	0.7	1.8	3.8
Canada Savings Bonds	2.4	2.7	0.8	1.7
Sub-total government	8.7	12.6	13.4	14.9e
Total Borrowing	28.0	31.0	36.0	41.7e
Channels of financing				
Financial institutions				
loans — banks	8.0	7.7	9.8	9.4
— other institutions	7.3	6.7	9.2	11.1e
security purchases — banks	1.4	– 0.0	1.5	3.0
— other institutions	2.2	4.5	4.7	6.9e
Sub-total financial institutions	18.9	18.9	25.2	30.4e
Securities purchased directly by other domestic investors				
non-marketable	2.4	2.9	0.9	1.6
other	1.1	0.8	– 1.1	0.9e
Securities purchased by non-residents(3)	1.8	4.3	8.2	4.6e
Direct investment from abroad	0.7	0.7	– 0.3	0.3e
Financing from government sector	2.1	2.6	2.5	2.0
Bank of Canada	1.0	0.8	0.6	1.9
Total Financing	28.0	31.0	36.0	41.7e

e: estimate.

(1) These are principally mortgages secured by residential property. The figures exclude mortgage lending by governments and their agencies, notably CMHC, which is reflected in the financing requirements of the respective governments.

(2) Includes borrowing by government enterprises. Loans from the Government of Canada are excluded.

(3) Includes net new issues placed in foreign markets by non-financial borrowers; net new issues placed in Canada and purchased by non-residents; and net purchases (or sales) of outstanding Canadian securities by non-residents.

spending on both fixed and inventory investments. During 1977 there was a fairly strong increase in internally generated funds while a moderate rise in fixed investment expenditures was largely offset by a decline in inventory accumulation. As a result the considerable expansion in the credit market activity of Canadian businesses in both the bond and equity markets appears to have been directed towards strengthening balance sheet structures through a refunding of short-term liabilities and an accumulation of financial assets. It would seem from the extent of these activities that the non-financial business sector has during the past year made some progress in improving its financial position.

The strong expansion in mortgage borrowing during 1977 occurred despite a slowing in the pace of housebuilding activity from the high levels of the previous year. In part this strength was due to mortgage borrowers having earlier delayed taking up loan commitments in anticipation of the decline in mortgage rates that took place through the latter part of 1976 and early 1977. In addition there was an extraordinary level of activity in the re-sale housing market which added considerably to the demand for housing funds. The wider differential between the mortgage rate and the personal loan rate at banks and other financial institutions through much of the year provided some incentive for borrowers to increase the size of their mortgages upon renewal, with the additional funds being used to purchase consumer durables or consolidate debt. Even after allowing for this change in the channels of financing, however, the volume of consumer credit appears to have grown more slowly in 1977 as a result of the modest pace of consumer durable expenditures during the year.

Within the public sector the large increase in the federal Government's borrowing requirements was largely offset by a decline in the requirements of provincial and municipal governments. This reduction in funds raised by the provincial-municipal sector was from an unusually high level in 1976 when some issuers borrowed outside Canada to meet future as well as current financing requirements. At the same time there was also a substantial improvement in the budgetary positions of junior governments, as measured on a national accounts basis, due in part to the strong financial position of the resource-producing provinces in Western Canada and to transfers from the federal Government under various fiscal programs and arrangements.

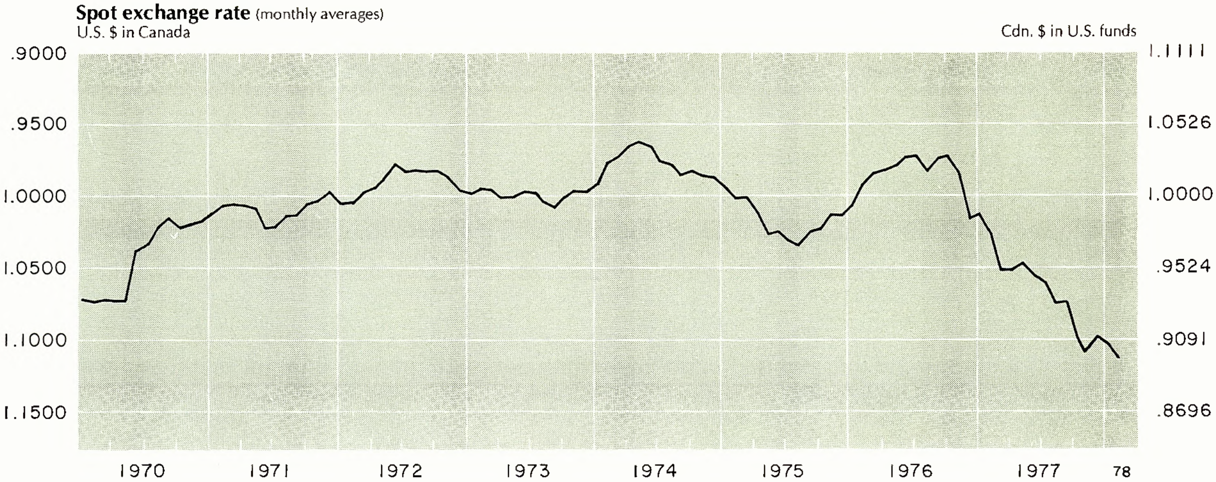
Another significant development in 1977 with respect to credit flows was the sharp decline from the extraordinarily high levels of 1976 in the use by Canadian borrowers of foreign markets as a source of funds. The proportion of total funds provided from abroad fell from a high of 22 per cent in 1976 to 12 per cent in 1977. The decline in these flows of capital from abroad was an important feature of the foreign exchange market over the past year.

Foreign Exchange Market

The external value of the Canadian dollar declined in stages from about U.S.$1.03 in October 1976 to around U.S.$.90 in the autumn of 1977 and at the end of February 1978 it was U.S.$ .8967.

Some decline in the exchange rate from its mid-1976 level was to be expected sooner or later because of the erosion in recent years of Canada's international competitive position. By 1976 Canada had developed a large deficit in its balance of payments on current account which was being readily financed by capital inflows. Since October 1976 a number of new elements have affected the financing of the deficit and thus the exchange rate. New uncertainties have arisen in connection with political developments in Quebec and their effect on Canada's economic prospects generally. In addition, net long-term borrowing abroad by provinces and municipalities has declined from the unprecedented level of 1976 because of the reduced over-all cash requirements of these governments

Exchange Rate



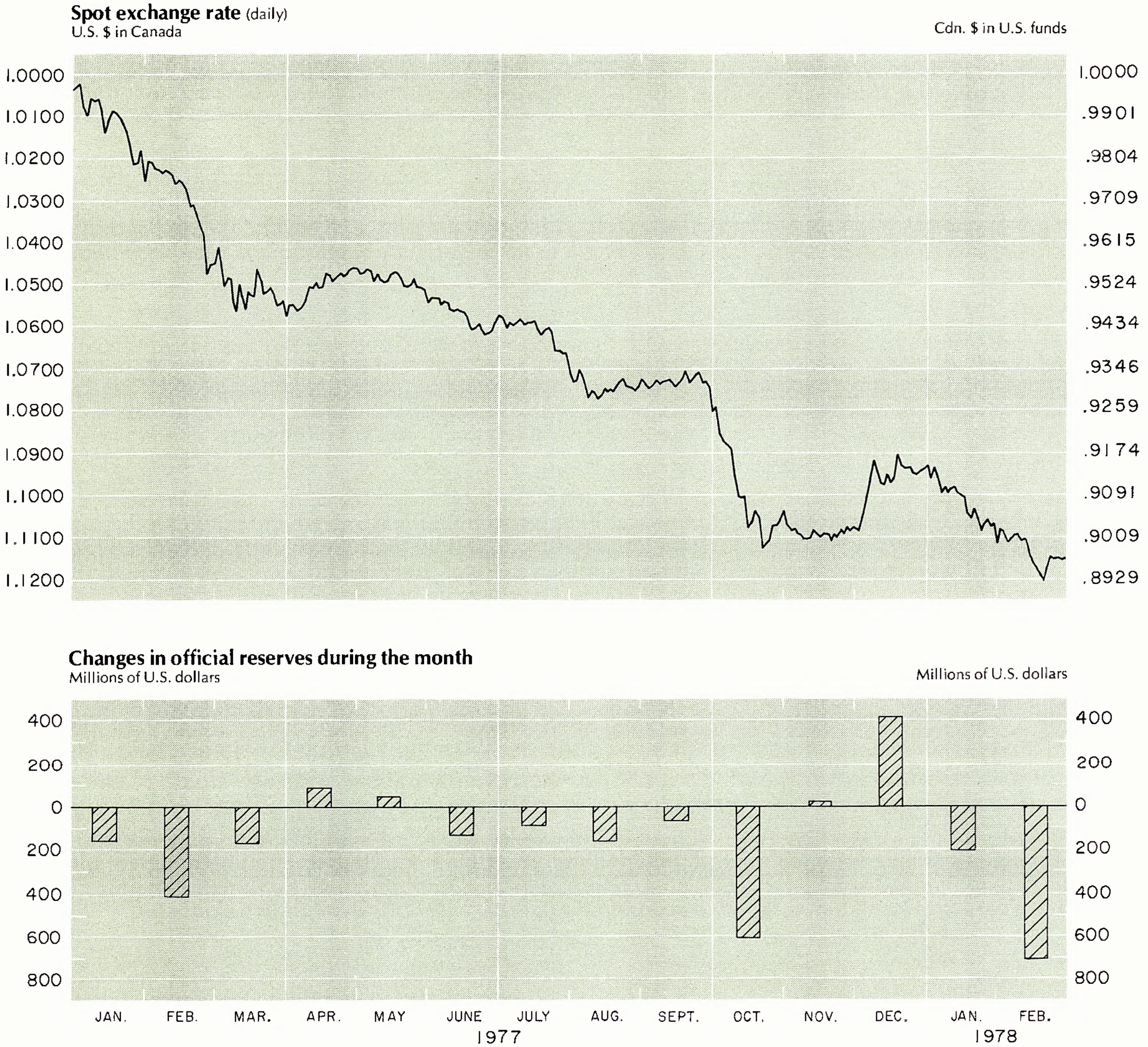
in 1977 and the narrower long-term interest rate differentials between Canada and the United States. The convergence of Canadian and U.S. money market interest rates described earlier has also been a factor. In these circumstances the net inflow of capital has on occasion tended to fall short of matching the current account deficit and the exchange rate has declined.

As agent for the Exchange Fund Account of the Minister of Finance, the Bank of Canada bought and sold U.S. dollars throughout 1977 to maintain orderly conditions in the market for the U.S. dollar in Canada. With the value of the Canadian dollar moving downwards during the year, at times under intensive pressure, these operations resulted in a substantial net decrease in Canada's official reserves. These declined by U.S.$1,235.9 million in 1977 and amounted to U.S.$4,607.5 million at year-end. At the end of February official reserves amounted to U.S.$3,698.8 million.

The Bank of Canada, as fiscal agent of the Government of Canada, arranged with Canadian chartered banks the U.S. dollar revolving standby credit facility announced by the Minister of Finance on October 27, 1977. The facility was arranged to enable the Exchange Fund Account to replenish its holdings of U.S. dollars if and when circumstances require. It is to be available for seven years and entitles the Government to borrow up to U.S. $1.5 billion for terms of one, two, three or six months at its option and to re-borrow the amounts repaid. The Government pays a standby fee of $^{3}/_{8}$ of one per cent per annum on the undrawn amount of the facility, and may cancel all or any portion of the unused facility at any time without penalty. The interest rate on any drawings would be at the then prevailing London interbank offered rate for U.S. dollar deposits for the relevant term plus a margin of $^{5}/_{8}$ of one per cent per annum during the first three years and a margin of $^{3}/_{4}$ of one per cent per annum during the last four years of the agreement. Funds drawn would be raised in the international market.

On February 21, 1978, the Minister of Finance

Exchange Rate and Official Reserves



announced the intention of the Government of Canada to borrow funds outside Canada to assist in financing the current account deficit of the balance of payments. The Minister also indicated that, as an interim step in advance of such borrowing, the Government would draw on the revolving standby credit facility with the Canadian chartered banks. The first of a series of drawings was announced on February 27.

Debt Management

In its role as agent for the Government of Canada in the management of the public debt, the Bank of Canada engaged in financing operations during 1977 which resulted in an increase of $6,340 million in the par value of outstanding marketable securities and of $1,668 million in the outstanding amount of Canada Savings Bonds.

A net total of $2,470 million was raised through additions to the outstanding stock of treasury bills, of which $470 million was in the form of additions to the one-year bill auctions. In July the Minister of Finance announced a change in the scheduling of one-year treasury bill tenders to regular four-week intervals beginning August 4, 1977. One-year bills had previously been auctioned quarterly. The holdings of treasury bills outside the banking system increased by $1,279 million to a level of $2,708 million and now account for more than one quarter of the total amount of treasury bills outstanding.

Over the year the amount outstanding of Government of Canada direct and guaranteed marketable bonds payable in Canadian dollars increased by $3,870 million on a par value basis. (Details are given in Appendix Table IV.) There were seven offerings of such bonds during 1977, three of which involved major refundings of maturing issues. All the offerings included tranches of short-, medium- and long-term bonds. On four occasions a fourth tranche consisting of bonds with a term of about 10 years was added to the new issue package. Gross amounts of $1 billion were offered on two occasions; the largest net amount offered to the public in a single issue was $500 million in December. Of the total new marketable bonds issued, 16 per cent were short-term maturities (due in three years or less), 47 per cent were medium-term (due in more than three years but less than ten years) and the remaining 37 per cent were long-term (due in ten years or more). The average term to maturity of outstanding marketable direct and guaranteed bonds lengthened by twelve months to seven years five months.

Major changes in the Canada Savings Bond program were introduced in 1977. They involved the elimination of the traditional coupon bond and its replacement by a new compound interest bond on which interest accrues and compounds automatically until maturity and the modification of the regular interest bond, with interest payable annually by cheque, to allow payment of such interest directly into the owner's deposit account. The 1977/78 Series of Canada Savings Bonds offered investors a nine-year bond with interest at 7 per cent in the first year and 8¼ per cent in each of the remaining eight years for an over-all average annual yield to maturity of 8.06 per cent. After allowing for redemptions, the amount of Canada Savings Bonds outstanding increased by $2,338 million in the fourth quarter of 1977 and by $1,668 million over the year. The new issue of Canada Savings Bonds has remained on sale; gross sales to the end of January 1978 totalled $2,771 million.

The final dates for the exercise of the extendible options on two earlier issues of marketable bonds fell during the year. Holders of an issue of 9 per cent bonds due February 1, 1978 had the option on or before October 31, 1977 of exchanging their holdings into an equal par value of 9 per cent bonds maturing February 1, 1980. In total $344 million of the bonds were exchanged, leaving $6 million of the original issue to mature in February 1978. Holders of an issue of 9¼ per cent bonds maturing April 1, 1978 had the option up to January 1, 1978 to exchange their holdings into an equal par value of 9¼ per cent bonds maturing April 1, 1984. Holders of $322 million of these bonds exchanged their bonds, leaving $3 million of the original issue to mature on April 1, 1978.

In March 1977 the Government cancelled $23.3 million of bonds which it had acquired under purchase fund provisions. There were $7.9 million of 5½ per cent bonds due August 1, 1980, $10.9 million 9½ per cent bonds due June 15, 1994, $1.5 million 9½ per cent bonds due October 1, 2001 and $3.0 million 8¾ per cent bonds due February 1, 2002.

Appendix Tables

APPENDIX TABLE I

Bank of Canada Assets and Liabilities

Monthly changes, millions of dollars

	Government of Canada securities at book value	Net foreign currency assets	Investment in Industrial Development Bank	All other assets (net)	Note circulation	Canadian dollar deposit liabilities: Chartered banks	Canadian dollar deposit liabilities: Government of Canada	Canadian dollar deposit liabilities: Other
1977								
January	− 340	+375	− 40	−351	−609	+228	+11	+ 13
February	+ 755	−955	-	− 52	− 22	−182	−22	− 25
March	− 200	+477	-	− 85	+ 37	+129	−12	+ 38
April	+ 91	− 65	− 40	+326	+163	+168	+ 1	− 20
May	+ 400	+ 34	-	−268	+234	− 70	+ 7	− 5
June	− 354	+ 66	-	+449	+130	− 34	+ 6	+ 59
July	+ 435	−185	− 41	− 59	+148	+ 9	−13	+ 5
August	+ 442	− 70	-	−349	− 1	+ 42	− 2	− 16
September	− 143	−462	-	+470	− 78	− 52	+ 1	− 6
October	+ 925	−307	− 49	−250	+ 99	+ 92	+ 4	+124
November	+ 9	+246	-	−293	+136	+ 18	− 4	−188
December	− 180	+676	-	+326	+589	+188	+17	+ 28
Total	+1,840	−170*	−170	−136	+826	+536	− 6	+ 7
1978								
January	− 366	− 10	− 41	−116	−623	+136	−23	− 23

* Includes a decline of $209 million in temporary swap transactions with the Exchange Fund Account. As at December 31, 1977, these temporary swaps stood at $1,159 million.

APPENDIX TABLE II

Chartered Bank Cash Reserves

Millions of dollars unless otherwise indicated

		Total minimum cash requirements	Average holdings of Bank of Canada notes	Required minimum Bank of Canada deposits	Average holdings of Bank of Canada deposits	Number of juridical days in period
1977						
January	1-15	4,405	1,102	3,303	3,328	9
	16-31				3,335	11
February	1-15	4,445	1,303	3,142	3,163	11
	16-28				3,181	9
March	1-15	4,435	1,107	3,328	3,355	11
	16-31				3,343	12
April	1-15	4,496	1,080	3,416	3,431	10
	16-30				3,451	10
May	1-15	4,464	1,086	3,378	3,402	10
	16-31				3,394	11
June	1-15	4,473	1,173	3,300	3,330	11
	16-30				3,323	11
July	1-15	4,497	1,133	3,364	3,387	10
	16-31				3,394	10
August	1-15	4,587	1,164	3,423	3,468	11
	16-31				3,473	12
September	1-15	4,533	1,203	3,330	3,366	10
	16-30				3,358	11
October	1-15	4,615	1,193	3,422	3,466	9
	16-31				3,504	11
November	1-15	4,685	1,199	3,486	3,527	10
	16-30				3,522	11
December	1-15	4,809	1,183	3,626	3,674	11
	16-31				3,682	9
1978						
January*	1-15	5,005	1,186	3,819	3,874	9
	16-31				3,844	12
February*	1-15	5,095	1,423	3,672	3,691	11

* Preliminary.

(1) Advances to banks and Purchase and Resale Agreements with money market dealers summed and divided by number of juridical days.

Excess cash reserves		Advances to chartered banks and PRA outstanding			
Cumulative excess reserves at end of period	Average excess reserve ratios	Number of days outstanding		Average outstanding[1]	
		Advances	PRA	Advances	PRA
230	.033	1	9	1.4	111.5
362	.043	1	10	1.4	157.7
229	.027	10	11	9.7	65.6
348	.050	9	7	21.9	152.3
298	.035	11	8	33.2	96.7
177	.019	12	4	32.5	23.9
149	.019	8	5	15.2	58.2
351	.044	–	8	–	104.6
237	.030	–	7	–	34.8
175	.021	1	7	1.8	48.7
321	.036	1	8	1.2	106.3
241	.027	1	6	5.3	95.9
220	.028	1	8	5.8	109.0
294	.037	–	8	–	176.2
501	.056	–	10	–	156.4
606	.062	3	8	21.3	46.8
359	.044	1	3	2.4	22.5
305	.034	2	4	5.5	37.1
394	.052	1	7	6.8	147.4
898	.098	7	10	51.6	165.0
409	.049	1	9	0.5	133.3
399	.043	–	7	–	88.2
523	.056	–	4	–	47.8
503	.066	3	4	22.3	11.8
493	.064	1	5	6.7	32.6
300	.029	1	10	–	64.6
217	.023	1	9	0.5	108.1

APPENDIX TABLE III

Bank of Canada Net Transactions in Government of Canada Securities

Delivered basis, par value in millions of dollars

Net purchases from (+) or net sales to (−) investment dealers and banks

	Treasury bills	Bonds[1] 3 years and under	Bonds[1] 3–5 years	Bonds[1] 5–10 years	Bonds[1] Over 10 years	Bankers' acceptances[2]	Sub-total of bills and bonds and bankers' acceptances	Securities under PRA
1977								
January	− 125.0	−48.3	− 47.1	-	-	−76.9	− 297.3	+158.2
February	+ 239.7	-	-	-	-	− 3.5	+ 236.2	− 33.3
March	− 12.3	-	-	-	-	− 8.5	− 20.8	−154.0
April	+ 120.9	-	-	-	-	-	+ 120.9	− 61.1
May	+ 111.3	-	-	-	-	-	+ 111.3	+200.1
June	− 9.3	+30.0	− 30.0	-	-	-	− 9.3	−200.1
July	+ 325.4	+50.5	− 50.5	-	-	-	+ 325.4	-
August	+ 440.7	-	-	-	-	+ 0.5	+ 441.2	+ 87.5
September	− 36.0	-	-	-	-	− 0.5	− 36.5	− 87.5
October	+ 517.4	-	-	-	-	+ 8.0	+ 525.4	+116.5
November	+ 105.2	-	-	-	-	− 8.0	+ 97.2	+ 37.3
December	− 80.0	+ 3.9	-	-	-	+13.7	− 62.4	−153.8
Total	+1,598.0	+36.1	−127.6	-	-	−75.2	+1,431.3	− 90.2
1978								
January	+ 22.5	+30.5	-	-	-	−13.7	+ 39.3	+101.2

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

(2) Includes maturing bankers' acceptances.

Bankers' Acceptances

Net transactions with Government and other client accounts							
Purchases (+) of new issues less matured holdings		Net purchases from (+) or net sales to (−) Government and client accounts		Net change in holdings of Government of Canada securities and bankers' acceptances			
Bills	Bonds	Bills	Bonds	Bills	Bonds	Bankers' acceptances	Total
+ 66.8	–	− 326.2	+ 4.0	−294.5	− 51.3	−48.7	− 394.5
+ 179.1	+ 500.0	− 133.8	− 1.3	+290.4	+ 480.1	−23.6	+ 746.9
+ 76.1	–	− 143.6	− 1.5	−194.8	− 17.6	−31.4	− 243.8
+ 112.4	+ 125.6	− 183.2	− 23.5	+ 17.7	+ 74.9	− 1.5	+ 91.1
+ 73.4	+ 292.1	− 229.1	− 18.7	+ 71.0	+ 343.2	+14.9	+ 429.1
+ 74.6	–	− 232.7	− 8.8	−282.8	− 78.6	−14.9	− 376.3
+ 164.6	+ 178.4	− 208.8	− 22.7	+281.2	+ 155.7	–	+ 436.9
+ 167.3	–	− 245.5	–	+439.6	+ 7.3	+ 3.6	+ 450.5
+ 39.9	+ 223.4	− 240.7	− 47.3	−313.9	+ 168.8	− 3.6	− 148.7
+ 197.4	+ 250.0	− 81.5	− 40.2	+708.5	+ 228.5	+30.6	+ 967.6
− 25.2	–	− 131.0	–	+ 5.7	− 1.5	−25.9	− 21.7
+ 70.4	+ 250.0	− 245.3	− 35.0	−386.8	+ 201.7	+ 9.0	− 176.1
+1,196.8	+1,819.5	−2,401.4	−195.0	+341.3	+1,511.2	−91.5	+1,761.0
+ 60.0	− 37.1	− 520.9	− 12.2	−359.3	− 10.2	− 0.2	− 369.7

APPENDIX TABLE IV

Government of Canada Direct and Guaranteed Marketable Securities*: New Issues and Retirements

Date in 1977		Issues offered	Term to maturity	Yield to maturity	Millions of dollars par value	
					Amount delivered	Amount retired
Issues payable in Canadian dollars - direct						
Feb.	1	7½% Feb. 1, 1980	3 yrs.	7.69	250	
		7¾% Apr. 1, 1982	5 yrs. 2 mos.	7.87	300	
		8¾% Feb. 1, 2002[1]	25 yrs.	8.82	300	
					850	7
Feb.	4	Treasury bills	364 days		275	225
Mar.	21					23[2]
Apr.	1	7½% Feb. 1, 1980[3]	2 yrs. 10 mos.	7.63	225	
		7¾% Apr. 1, 1982[4]	5 yrs.	7.93	375	
		8% Oct. 1, 1986[5]	9 yrs. 6 mos.	8.23	175	
		9½% June 15, 1994[6][7]	17 yrs. 2½ mos.	9.29	175	
					950	675
May	6	Treasury bills	364 days		325	250
May	15	7½% Feb. 1, 1980[8]	2 yrs. 8½ mos.	7.74	125	
		8% July 1, 1982	5 yrs. 1½ mos.	8.12	275	
		9¼% May 15, 1997[9]	20 yrs.	9.31	200	
					600	69
July	1	7½% June 1, 1980	2 yrs. 11 mos.	7.55	125	
		8% July 1, 1982[10]	5 yrs.	8.00	325	
		8¼% July 1, 1987	10 yrs.	8.36	225	
		9¼% May 15, 1997[11][12]	19 yrs. 10½ mos.	9.19	325	
					1,000	649
Aug.	5	Treasury bills	364 days		115	250
Sept.	1	7½% June 1, 1980[13]	2 yrs. 9 mos.	7.62	125	
		8% July 1, 1982[14]	4 yrs. 10 mos.	8.12	300	
		8¼% July 1, 1987[15]	9 yrs. 10 mos.	8.44	200	
		9¼% May 15, 1997[16][17]	19 yrs. 8½ mos.	9.16	375	
					1,000	500
Sept.	2	Treasury bills	364 days		115	
Sept.	30	Treasury bills	364 days		115	
Oct.	15	7½% June 1, 1980[18]	2 yrs. 7½ mos.	7.62	50	
		8% Oct. 15, 1982	5 yrs.	8.06	250	
		9% Oct. 15, 1999[19]	22 yrs.	9.00	350	
					650	
Oct.	28	Treasury bills	364 days		150	
Nov.	18	Treasury bills	364 days			200
Nov.	25	Treasury bills	364 days		150	

(Continued)

Date in 1977	Issues offered	Term to maturity	Yield to maturity	Millions of dollars par value: Amount delivered	Amount retired
Dec. 15	7½% June 1, 1980[20]	2 yrs. 5½ mos.	7.77	50	
	8% Oct. 15, 1982[21]	4 yrs. 10 mos.	8.19	225	
	8¼% July 1, 1987[22]	9 yrs. 6½ mos.	8.44	100	
	9% Oct. 15, 1999[23][24]	21 yrs. 10 mos.	9.05	375	
				750	
Dec. 23	Treasury bills	364 days		150	
Dec. 31					7[25]
	Total bonds			5,800	1,930
	Total treasury bills*			1,395	925
Issues payable in foreign currencies - direct and guaranteed					
Apr. 15					1[26]
Oct. 15					1[26]

* Excludes three-month and six-month treasury bills which accounted for $2,000 million of the net increase over the year in total securities outstanding.

(1) These bonds are eligible for purchase by the Purchase Fund created February 1, 1977.

(2) Cancellation of $7.9 million 5½% August 1, 1980 bonds, $10.9 million 9½% June 15, 1994 bonds, $1.5 million 9½% October 1, 2001 bonds, and $3.0 million 8¾% February 1, 2002 bonds by the Purchase Fund.

(3) In addition to $250 million 7½% February 1, 1980 already outstanding.

(4) In addition to $300 million 7¾% April 1, 1982 already outstanding.

(5) In addition to $235 million 8% October 1, 1986 already outstanding.

(6) In addition to $794 million 9½% June 15, 1994 already outstanding.

(7) These bonds are eligible for purchase by the Purchase Fund created June 15, 1974.

(8) In addition to $475 million 7½% February 1, 1980 already outstanding.

(9) These bonds are eligible for purchase by the Purchase Fund created May 15, 1977.

(10) In addition to $275 million 8% July 1, 1982 already outstanding.

(11) In addition to $200 million 9¼% May 15, 1997 already outstanding.

(12) These bonds are eligible for purchase by the Purchase Fund created May 15, 1977.

(13) In addition to $125 million 7½% June 1, 1980 already outstanding.

(14) In addition to $600 million 8% July 1, 1982 already outstanding.

(15) In addition to $225 million 8¼% July 1, 1987 already outstanding.

(16) In addition to $525 million 9¼% May 15, 1997 already outstanding.

(17) These bonds are eligible for purchase by the Purchase Fund created May 15, 1977.

(18) In addition to $250 million 7½% June 1, 1980 already outstanding.

(19) These bonds are eligible for purchase by the Purchase Fund created October 15, 1977.

(20) In addition to $300 million 7½% June 1, 1980 already outstanding.

(21) In addition to $250 million 8% October 15, 1982 already outstanding.

(22) In addition to $425 million 8¼% July 1, 1987 already outstanding.

(23) In addition to $350 million 9% October 15, 1999 already outstanding.

(24) These bonds are eligible for purchase by the Purchase Fund created October 15, 1977.

(25) Cancellation of guaranteed debt by Purchase Funds.

(26) Partial redemption at par of U.S. pay 5% October 15, 1987 for Sinking Fund.

BANK OF CANADA Statement of Income and Expense

Year Ended December 31, 1977
(with comparative figures for 1976)

	1977	1976
	(thousands of dollars)	
INCOME		
Investment revenue and other income		
After deducting interest paid on deposits		
(1977 $5,442 – 1976 $3,215)	$844,199	$757,174
EXPENSE		
Salaries[1]	$ 20,903	$ 18,125
Contributions to pension and insurance funds	3,199	3,362
Other staff expenses[2]	1,588	1,456
Directors' fees	38	37
Auditors' fees and expenses	175	155
Taxes – municipal and business	4,023	4,540
Bank note costs	14,043	14,948
Data processing and computer costs	2,233	1,800
Maintenance of premises and equipment – net	3,987	3,153
Printing of publications	503	466
Other printing and stationery	791	665
Postage and express	552	475
Telecommunications	701	650
Travel and staff transfers	859	696
Other expenses	724	725
	54,319	51,253
Depreciation on buildings and equipment	3,677	2,681
	57,996	53,934
NET INCOME PAID TO RECEIVER GENERAL FOR CANADA	786,203	703,240
	$844,199	$757,174

(1) The number of staff averaged 1,578 in 1977 and 1,458 in 1976; the approximate number of employee years worked was 1,589 in 1977 and 1,450 in 1976.

(2) Includes cafeteria expenses, retirement allowances, overtime pay, educational training costs and medical services.

BANK OF CANADA Statement of Assets and Liabilities

as at December 31, 1977
(with comparative figures for 1976)

ASSETS	1977	1976
	(thousands of dollars)	
Deposits payable in foreign currencies:		
Pounds sterling and U.S.A. dollars	$ 118,761	$ 62,493
Other currencies	1,346	623
	120,107	63,116
Advances to chartered and savings banks	40,500	23,000
Bills bought in open market, not including treasury bills, at amortized values	13,669	104,786
Investments — at amortized values:		
Treasury bills of Canada	2,418,345	2,085,613
Other securities issued or guaranteed by Canada maturing within three years	3,467,585	2,917,069
Other securities issued or guaranteed by Canada not maturing within three years	4,339,219	3,382,813
Debentures issued by Industrial Development Bank	686,914	858,429
Securities issued by the United Kingdom and the United States of America	1,141,034	1,367,934
Other securities	2,633	2,633
	12,055,730	10,614,491
Bank premises:		
Land, buildings and equipment at cost less accumulated depreciation	65,041	61,448
Cheques drawn on other banks	744,613	746,154
Accrued interest on investments	192,049	160,901
Net balance of Government of Canada collections and payments in process of settlement	176,225	65,333
Other assets	8,486	3,993
	$13,416,420	$11,843,222

LIABILITIES	1977	1976
	(thousands of dollars)	
Capital paid up	$ 5,000	$ 5,000
Rest fund	25,000	25,000
Notes in circulation	8,638,550	7,813,050
Deposits:		
Government of Canada	26,002	32,536
Chartered banks	3,704,549	3,169,346
Other deposits	130,924	123,535
	3,861,475	3,325,417
Liabilities payable in foreign currencies:		
Government of Canada	99,744	55,830
Other	153	151
	99,897	55,981
Bank of Canada cheques outstanding	780,447	551,827
Other liabilities	6,051	66,947
	$13,416,420	$11,843,222

Governor, **G. K. BOUEY**

Acting Chief Accountant, **C. J. GODDING**

Auditors' Report We have examined the statement of assets and liabilities of the Bank of Canada as at December 31, 1977 and the statement of income and expense for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, these financial statements present fairly the financial position of the Bank as at December 31, 1977 and the results of its operations for the year then ended in accordance with the attached summary of significant accounting policies, applied on a basis consistent with that of the preceding year.

PIERRE CHOUINARD, C.A.
de la firme Samson, Bélair & Associés

M. A. MACKENZIE, F.C.A.
of the firm Clarkson, Gordon & Co.

Ottawa, Canada, January 20, 1978

Summary of Significant Accounting Policies

a. Form of Presentation

The form of the statement of assets and liabilities meets the requirements of the Bank of Canada Act.

b. Revenues and Expenses

Revenues and expenses have been accounted for on the accrual basis.

c. Investments and Bills

In accordance with the requirements of the Bank of Canada Act, these assets have been recorded at their cost adjusted for amortization of purchase discounts and premiums. The amortization as well as gains and losses on disposition have been included in income.

d. Translation of Foreign Currencies

Assets and liabilities in foreign currencies have been translated to Canadian dollars at the rates of exchange prevailing at the year-end.

e. Depreciation

Depreciation has been recorded at the following annual rates applied on the declining balance method:

Buildings	5%
Equipment	20%

Board of Directors

G. K. Bouey	OTTAWA Governor *Member of the Executive Committee*
R. W. Lawson	OTTAWA Senior Deputy Governor *Member of the Executive Committee*
R. W. Campbell	CALGARY, ALTA.
C. A. Dagenais	MONTREAL, QUE.
W. Dodge	OTTAWA, ONT.
W. R. Jenkins	CHARLOTTETOWN, P.E.I.
W. A. Johnston	WINNIPEG, MAN.
S. G. Lake	RAMEA, NFLD.
J. W. E. Mingo, Q.C.	HALIFAX, N.S.
J. H. Potts, Q.C.	TORONTO, ONT.
Mme Y. Lefebvre-Richard	MONTREAL, QUE.
J. A. Stack	SASKATOON, SASK. *Member of the Executive Committee*
J. Taschereau	QUEBEC, QUE. *Member of the Executive Committee*
A. Walton	VANCOUVER, B.C.

Ex-officio

T. K. Shoyama	OTTAWA Deputy Minister of Finance *Member of the Executive Committee*

Senior Officers

G. K. Bouey, *Governor*
R. W. Lawson, *Senior Deputy Governor*

G. E. Freeman, *Deputy Governor*
*B. J. Drabble, *Deputy Governor*
J. N. R. Wilson, *Adviser*
A. J. Norton, *Adviser*
D. B. Bain, *Associate Adviser*
J. S. Roberts, *Secretary*

Alain Jubinville, *Deputy Governor*
D. J. R. Humphreys, *Deputy Governor*
Jacques Bussières, *Adviser*
W. A. McKay, *Adviser*
Serge Vachon, *Associate Adviser*

*On leave of absence as an Executive Director of the International Monetary Fund

J. M. E. Morin, *Auditor*

Securities Department

D. G. M. Bennett, *Chief*

F. Faure, *Deputy Chief*
V. O'Regan, *Securities Adviser*

A. W. Noble, *Deputy Chief*

Toronto Division

J. T. Baxter, *Chief*

Montreal Division

J. Clément, *Chief*

W. E. Deans – *Vancouver Representative*
A. G. Keith – *Edmonton Representative*

Research Department

J. W. Crow, *Chief*

D. R. Stephenson, *Deputy Chief*

C. Freedman, *Research Adviser*

Department of Banking and Financial Analysis

G. G. Thiessen, *Chief*

W. R. White, *Deputy Chief*

G. W. King, *Research Adviser*

International Department

J. E. H. Conder, *Chief*
A. C. Lamb, *Chief, Foreign Exchange Operations*

Department of Administrative Operations

R. H. Osborne, *Chief*

T. D. MacKay, *Deputy Chief*

L. A. Vaughan, *Chief, Currency Division*

Public Debt Department

J. M. Andrews, *Chief*
J. M. McCormack, *Public Debt Adviser*

Computer Services Department

Edith M. Whyte, *Chief*
E. W. Chinn, *Deputy Chief*

Secretary's Department

J. S. Roberts, *Secretary*

Comptroller's Department

D. A. Thompson, *Comptroller*
A. Rousseau, *Chief Accountant*

Department of Personnel Administration

R. L. Flett, *Chief*
H. A. D. Scott, *Personnel Adviser*

Agencies

HALIFAX	E. L. Johnson, *Agent*
SAINT JOHN, N.B.	R. E. Burgess, *Agent*
MONTREAL	J. E. R. Rochefort, *Agent* R. Marcotte, *Assistant Agent*
OTTAWA	C. A. St. Louis, *Agent*
TORONTO	R. E. A. Robertson, *Agent* K. W. Kaine, *Assistant Agent*
WINNIPEG	A. H. Potter, *Agent*
REGINA	G. H. Smith, *Agent*
CALGARY	H. Prowse, *Agent*
VANCOUVER	D. G. Warner, *Agent*