Bank of Canada

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

1986

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Portrait by Cavouk, Toronto

Gerald K. Bouey, O.C.
Governor of the Bank of Canada
1973–1987

Bank of Canada · Banque du Canada Ottawa K1A 0G9

February 2, 1987

The Annual Report that follows was completed on January 31, 1987 and signed by Gerald K. Bouey, who retired as Governor of the Bank of Canada on that same date.

Mr. Bouey was appointed Governor on February 1, 1973 and reappointed in 1980. Over a period of thirty-nine years of service at the Bank, including the last fourteen years as Governor, Mr. Bouey made an outstanding contribution to the institutional and intellectual development of the Bank and to public economic policy for Canada.

Governor

Bank of Canada · Banque du Canada Ottawa K1A 0G9

January 31, 1987

The Hon. Michael H. Wilson, P.C.,
Minister of Finance,
O t t a w a .

Dear Mr. Wilson,

In accordance with the provisions of the Bank of Canada Act I am submitting my report for the year 1986 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 – 1986

General Observations

Canada's economic performance in 1986 was uneven. Although the country as a whole experienced further economic improvement, there were striking differences in economic conditions among the various regions. And unemployment, while on balance declining, remained high. Inflation stayed quite low by recent Canadian experience, but further progress towards price stability was difficult to see.

The most prominent features of the shortcomings in economic performance in Canada and elsewhere in the world have been the serious financial and economic imbalances that have emerged. These have frequently involved large buildups of debt of various kinds, both by governments and by the private sector. The resulting strains have been evident both within countries and among countries and have had major impacts on their external payments balances and exchange rates. Although the effects of these imbalances may appear to be recent, the causes go back considerably further. One way or another, most of the imbalances that now give concern have roots in the severe inflation of the 1970s and the mix of policies with which, in the end, it had to be fought.

I therefore want to spend some time at the beginning of this, my final Annual Report looking back at our experience in dealing with inflation. I shall have something to say about a series of related issues. Why did inflation erupt, why was it subsequently so difficult to bring under control, and why were the ensuing costs that inflation imposed on our society so much worse than anyone expected? But first let me emphasize that we have never regarded the control of inflation as an end in itself. Our goal has always been a strong economic performance for Canada – maximizing our employment and output – and our concern with inflation is based on the reality that our economy will not perform well under conditions of high inflation.

The Experience With Inflation And The Impact On The Canadian Economy

The surge of inflation that was unleashed in Canada and elsewhere in the early 1970s was the end result of excessively easy monetary and fiscal policies that were persistently followed over a number of years around the world. I have reviewed these developments on previous occasions, notably in my Report for 1980. Therefore, here I will just note that the willingness of countries at the beginning of the 1970s to press their policies so hard, so uniformly, in an expansionary direction appears to have been in large measure a response to the cumulative effects of international payments imbalances and to the consequential breakdown of the fixed exchange rate system. As exchange rate floating became more widespread, the response was a still greater inclination to add to monetary and fiscal ease to try to assure rapid domestic economic growth. In some cases, the view was that floating exchange rates had removed the constraint that the balance of payments had previously imposed on the use of more stimulative policies. In other cases, the concern was to try to avoid the supposedly restrictive economic effects of exchange rate appreciation through more rapid monetary expansion. In any event, the end result was that the expansionary stimulus was greatly overdone.

I know many people will recall the sharp increases in the price of energy in the 1970s in response to the actions of the OPEC cartel as being perhaps the prime source of generalized inflation. However, this emphasis is misplaced. The sharp rise in the price of oil, and indeed of other raw materials, was not the cause of inflation but, to a considerable extent, yet another product of the overheated economic atmosphere that existed at that time. Moreover, the uncertainty generated by continued inflation reduced the resistance to the still higher prices that were subsequently obtained for oil and other forms of energy.

In retrospect we here in Canada, as elsewhere, were too slow in responding to the initial pressures on our prices in the early 1970s, and once inflation erupted we responded to it with monetary policy that now looks to have been too gradual in its impact. Fiscal policy in the 1970s did not give priority to the task of containing and reducing inflation, although the government did impose wage and price controls from 1975 to 1978. In the rapidly changing economic environment of the time, our policy problems were greatly exacerbated by the difficulty of making reasonable judgements about how close to potential our economy was operating and how much policy tightening was needed to bring inflation down. In the event, interest rates during the 1970s turned out to be too low. Those who bet on inflation, and borrowed heavily to finance their bets, made money in that period. Those trying to save for the future or live on their savings lost out.

I have always believed that no good could come from inflation, but the consequences of high inflation have in fact been much worse than I feared. In part, the economic costs resulting from inflation have been so high because severe inflation persisted so long.

Temporizing with inflation did not bring us a higher level of economic activity and employment. Indeed, the years since inflation erupted in Canada have not been good ones – on average they have been years of low investment and productivity growth, and increased unemployment. Inflation is almost never stable and predictable. When prices are changing rapidly, the resulting uncertainty about the value of money undermines the efficient operation of our economic system, since it is based on money. A great deal of time and effort is diverted from useful economic activity into seeking protection from rising prices. Some people will succeed in protecting themselves, many will not; the results will never be fair.

Moreover, serious and persistent inflation led to all kinds of economic distortions in Canada and around the world. For example, past increases in the prices of many commodities were taken as evidence that these prices would continue to rise rapidly. Such expectations led to large investments that eventually contributed to the overexpansion of production of these commodities. Interest rates that were low relative to expectations of inflation encouraged large accumulations of debt for these as well as other purposes.

By the end of the 1970s, for a lot of people the assumptions about the future included continued high inflation. That is to say, an intense inflationary psychology, and an accompanying scepticism as to the likelihood that policy would really curb inflation, had taken hold in Canada. Real estate markets in particular had become dominated by speculative activity. Even as short-term interest rates were rising to their peak of over 22 per cent in 1981, many borrowers continued to take on substantial additional debts. How did they expect to be able to cope with those interest costs except through a further major acceleration of inflation?

I believe we had a close escape from an even more explosive inflation problem. Had we engaged in more rapid monetary expansion, accommodating the expanding demands for credit and allowing even more exchange rate depreciation in seeking to ward off those peaks in interest rates, the increased momentum of inflation would in the end have been a great deal more difficult to stop. As it was, inflation had become so endemic and the accumulated imbalances so substantial that the recession of 1981–82, which finally brought the upward climb in inflation to a halt in Canada, was far more severe than any previous economic slowdown in the postwar period.

In the unbalanced way inflation was

fought almost everywhere through the late 1970s and early 1980s, monetary policy was left to carry the brunt of the effort. In the face of persistently large fiscal deficits, the interest rates needed to combat inflation effectively were painfully high. I do not suggest that it would have been possible to avoid such high interest rates entirely. By the late 1970s, expectations that inflation would persist at very high rates had been allowed to develop too long for such a happy outcome. However, earlier, stronger and more sustained fiscal restraint than occurred in most countries would clearly have helped. Sectors sensitive to interest rates would not have had to bear so much of the burden. Such restraint would have been an improvement in Canada, and it would have been an improvement in the United States. I refer to the experience in the United States because, with short-term interest rates there rising to a peak of over 18 per cent, the impact on financial conditions in Canada was bound to be very great. In the event, interest rates moved up still higher in Canada largely because our inflation experienee was worse than in the United States, and because our financial markets were having to cope with large capital outflows in response to policies designed to encourage domestic purchases of foreign-owned businesses in Canada, espeeially in the energy sector.

In the aftermath of high inflation, some prices, such as those in markets for primary commodities and in the more speculative real estate markets, fell sharply. Those businesses and individuals that had borrowed heavily in the expeetation of continued sharp rises in prices encountered severe difficulties in servicing their debts. Many firms did not survive, and financial institutions have had to absorb record levels of loan losses. The efforts of both businesses and individuals to repair weakened financial positions and reduce the burden of their indebtedness contributed significantly to the depth of the recession and to the relatively moderate pace of domestic spending in the subsequent recovery.

While these debt problems have been severe for Canadians, they have been much more so for those developing countries that had borrowed large sums abroad in the 1970s and early 1980s to finance domestic spending of all kinds. These countries have encountered serious problems in servicing their external debts and have required a massive rescheduling of their maturing loans.

Lessons From Our Experience With Inflation

The main conclusion that I draw from our experience is that inflation is so disruptive to our economic performance, and so costly to eradicate once it becomes entrenched, that we must always be vigilant in guarding against any buildup of inflationary pressures.

The goal of monetary policy over time should therefore be to maintain as stable a price level as possible. This by no means implies that the Bank of Canada should ignore what is happening to jobs and production in making its monetary policy decisions, but it does underline the need for the central bank to pay special attention to actual and potential pressures on prices. Monetary and credit aggregates can be helpful indicators for central banks in this regard, and that is why in many countries monetary policy targets have been set in terms of these aggregates. More recently, financial innovations have made monetary aggregates difficult to use as targets, but it remains important nonetheless to monitor growth rates of money and credit rather closely, along with other indicators of the expansion of the economy in money terms.

Yet another conclusion for the operation of the central bank that I draw from our recent experience is that the room for policy manoeuvre becomes much more limited once inflation and expectations of further inflation have become entrenched. Even today, after several years of decelerating inflation, our recent history of inflation remains fresh in people's minds. Any indication that policymakers in Canada had become rather relaxed about taking risks with inflation would quickly trigger a sharp response from people seeking to protect themselves against expected increases in prices.

This restricted room for policy manoeuvre is nowhere more evident than in the performance of the exchange rate. Given our history of an inflation more severe than in many other major countries, the Canadian dollar has depreciated substantially against other currencies. And with this history, any pressures that lead to a significant decline in our exchange rate tend to generate concerns that such declines are likely to continue. Faced with a prospect of capital losses because of expected depreciation, investors require higher interest rates on investments in Canada as compensation. Since the root of the problem appears to be insufficient confidence that our financial policies will resist inflation, any attempt to offset these interest rate pressures through easier monetary policy only results in still more exchange rate decline and still higher interest rates. Of course, this is the very opposite of the results desired by those who recommend a more expansionary monetary policy. The only sure path to lower interest rates and a stronger currency is to strengthen the confidence of investors in Canada and abroad in our commitment to return to price stability.

I must say that when I look back at the decline in the Canadian dollar over the past decade, I find it difficult to understand why there are still people who have great faith in exchange rate depreciation as an easy cure for our economic problems. As the exchange rate for the Canadian dollar has come down from parity with the U.S. dollar to a position where it is currently worth about 74.5 U.S. cents, have we achieved a comparable increase in our international competitiveness? Evidently we have not. Time and again our costs have risen more rapidly than those of our competitors abroad. That is where the basic problem has been.

Exchange rate depreciation always involves an upward push to domestic prices and is never easily accepted because this rise in prices undermines the purchasing power of wages and salaries. If people are already fearful about inflation, these additional price pressures only exacerbate their fears. Therefore, depreciation will make price stability more difficult and more costly to achieve. That is something that monetary policy cannot ignore.

Another conclusion that I believe is evident from this experience with inflation is that countries should strive for more balance in their mix of policies. I have already stressed the fact that interest rates would not have needed to be so very high if fiscal policy had been focused more on combating inflation. Moreover, even as inflation has declined, the persistence of large fiscal deficits in a number of countries has limited the extent of the decline in interest rates. In other words, the level of "real" interest rates (i.e., after adjustment for inflation) has remained high and has greatly aggravated the difficulties of those governments, businesses and individuals that are still struggling with the burden of debts accumulated during the inflationary period.

Given the size of the U.S. economy, the large fiscal deficits that opened up in that country during the 1980s have had a particularly strong international impact. The high interest rates needed in the United States to finance the deficit not only pushed up interest rates around the world but also contributed to a surge in the value of the U.S. dollar against many currencies. The result has been a sharp deterioration in the U.S. balance of trade and a buildup of damaging protectionist pressures.

The International Environment in 1986

The large fiscal and trade imbalances that accumulated were evidently not sustainable, and the process of unwinding them has begun. However, the process has proven to be slow and difficult, and developments in the international economy in 1986 were greatly affected by those difficulties.

It is true that the United States has taken an important first step in the adjustment process through its moves to reduce the size of the federal government deficit. These measures have contributed to substantial further declines in interest rates in the United States and have helped to bring down the value of the U.S. dollar to more reasonable levels. There have been interest rate reductions in the major overseas countries as well. The fall in the price of oil has also contributed to lower costs and lower interest rates. These are favourable developments for the world economy overall.

Yet it is also clear that this process of transition back to balanced and durable growth will not be easy. So far, some of the difficulties inherent in the process have been more apparent than the benefits. World economic growth did not speed up in 1986 as many had expected; on the contrary, it slowed somewhat. Sharp reductions in spending in the energy-producing regions have detracted importantly from the positive effects on demand of lower energy prices and interest rates. The realignment of currency values among the industrial nations that has taken place since the spring of 1985 has also failed to produce desired effects as rapidly as might have been hoped. The turnaround needed in U.S. external trade to maintain economic expansion in that country is not yet clearly apparent, and increases in domestic demand in other major industrial countries have thus far been inadequate to prevent slower expansion in the world economy.

When the factors encouraging more rapid world growth will reassert themselves is a matter of great current concern. Even in an environment of declining interest rates, a prolonged period of slow growth would exacerbate the already difficult circumstances of the many debtor countries of the developing world. This situation poses significant dangers both to those countries and to the international financial system. Slow growth could also further encourage protectionist pressures, especially in the United States but also in Europe. While such trends would have harmful effects on the world economy in general, they could prove particularly difficult for Canada. There are few countries in the world more dependent on international trade, or more open to international influences, than we are.

The Canadian Economic Environment in 1986

As I said at the beginning of these remarks, Canada's economic performance was rather mixed in 1986. This was largely because of international developments. Indeed, with the overall economy still below the limits of its capacity, with increases in labour costs still restrained, with interest rates down and private sector balance sheets increasingly in good order, the domestic conditions for healthy growth were for the most part in place.

The influence of these domestic forces can be seen vividly in the strong economic performance in central Canada. While the western and Atlantic regions were not isolated from this influence, they were more affected by the difficult international circumstances. Reaction to the decline in oil prices was both rapid and substantial. As the energy industry cut back on its spending, there were corresponding reductions in general business confidence and in employment. Similar problems have arisen in the Prairies from the reduction in world grain prices associated with agricultural subsidies and the trade tensions between the United States and the European Economic Community.

The persisting weakness of world commodity prices has had its initial and most noticeable impact outside central Canada, but the effects will eventually be felt by most Canadians. The fact is that a considerable part of what we produce in Canada and a still larger part of what we export are still related in one way or another to the resource sector of our economy. If the price of what we sell abroad declines, then Canadians on average will be less well off than otherwise. This is an unavoidable reality to which we must adjust.

In the conduct of its monetary policy in 1986, the Bank of Canada sought to bring about further interest rate reductions in the face of quite moderate increases in the growth of credit and total spending in the Canadian economy during the course of the year. Canadian interest rates did continue to trend downwards, as did interest rates in the United States. However, the Bank's moves to encourage this further easing of interest rates had to be made with considerable caution in the face of continued problems of confidence in the Canadian dollar during much of 1986.

Early in the year we were confronted with a bout of intense speculative pressure on our currency. There was no practical alternative to a strong policy response, and the differential of our interest rates above those in the United States widened markedly. Any substantial further depreciation would have constituted a risk to our less than satisfactory inflation performance, and failure on our part to resist the speculative pressures on the currency would have resulted in both a lower exchange rate and the persistence of higher interest rates. Such an outcome was simply not acceptable if we could do something to avoid it. That is why we acted as vigorously as we did last February. Slower but sustainable reductions in interest rates are preferable to faster, but ultimately unsustainable, movements.

Early in 1987 the Canadian dollar came under quite strong upward pressure in foreign exchange markets and moved to levels above 74 U.S. cents. As confidcnee in the future value of the Canadian dollar improved, domestic interest rates declined, and the differential with respect to U.S. interest rates narrowed.

Our determination during 1986 to resist further depreciation against the U.S. dollar was reinforced by the extent of the decline that has occurred over the last two years or so in the value of the Canadian dollar, along with the U.S. dollar, against major overseas currencies. At the present time Canadian industry appears to be competitive in international markets; if we take advantage of the situation, this should provide significant economic stimulus. Given our high national level of unemployment, such an additional stimulus to demand ought to be absorbed without an excessive inflationary risk. However, in important segments and regions of the economy it is far from clear that competitive pressures really are exerting the necessary moderating influence on wage and price behaviour. Indeed, it is disturbing to see labour costs moving up distinctly more rapidly in Ontario than elsewhere as employment in that province has expanded, since measured unemployment in Ontario is still at a level only slightly below 7 per cent. These regional differences, as well as our inflation performance, are analyzed in a later section of this Report that deals with economic activity.

Further progress has been made in reducing the size of the federal government deficit, consistent with the longer-term framework laid out in the Minister of Finance's statement of November 1984. As this performance has become more widely recognized, it has given increased credibility to the Government's commitment to continued deficit reduction over time. This in turn has provided a stronger underpinning of support for both securities and exchange markets and made it easier to conduct monetary policy.

I am well aware that reducing the deficit is difficult and that sudden changes in circumstances may temporarily impede progress. The fiscal support recently provided to the energy and agricultural sectors provides a clear example of the kind of additional spending the federal government can be called on to undertake. But however necessary such measures, they are best implemented in a framework of continued progress in achieving the goals of deficit reduction and debt containment.

Confidence in Financial Institutions

I want to turn now to another important development in the domestic financial scene. Events in 1986 demonstrated clearly the crucial role that confidence plays in the financial industry. The failure of two western-based banks in 1985 cast a shadow over other financial institutions. A number of other banks subsequently found it impossible to retain sufficient deposits to fund their loans. As lender of last resort, the Bank of Canada stood ready to make good this shortfall. While depositor confidence in these institutions was not restored, the liquidity support provided by the Bank of Canada did provide these banks with the time needed to pursue other solutions to their problems. In the event, all these institutions had to seek mergers with stronger partners.

I very much regret that it was not possible for these banks to regain public confidence and remain independent institutions. However, these events did serve to remind us of some important lessons. Confidence is crucial for the effective operation of financial institutions, but it can be easily lost. And once lost it is not easy to recoup. Indeed, in such circumstances even very substantial support by the central bank may be of little help in easing depositor concerns. Trust in the supervisory system for banks has an extremely important role to play in both restoring and maintaining confidence. In that connection, the findings of the Inquiry, headed by Mr. Justice Estey, into the collapse of the Canadian Commercial Bank and Northland Bank are important. While the Report of the Inquiry recommended a number of ways in which the supervision of banks should be improved, it found that the basic approach to bank supervision in Canada was fundamentally sound. I might note as well that the Estey Commission was satisfied that the Bank of Canada had exercised its responsibilities appropriately in regard to the Alberta banks.

The lessons gained from the failure of these two small banks and the spillover effects on other institutions have been kept very much in mind in the deliberations leading up to the federal government's recent announcement of proposed changes in the supervision of financial institutions. I am confident that the changes proposed will contribute to a stronger supervisory system and help to enhance confidence in the stability of financial institutions throughout Canada.

In this regard I should also mention the rapid changes that have been taking place in financial markets around the world. New instruments and new ways of doing business have proliferated, and the traditional distinctions among various types of financial institutions have become increasingly blurred in this highly competitive environment. This process has been encouraged and facilitated in a number of countries by alterations in the legislative and regulatory framework under which financial institutions and markets operate. Not surprisingly, given the openness of our capital markets, similar innovations and pressures for change have been occurring in Canada, and major revisions to regulations have been proposed or recently enacted by both the federal and provincial governments. These developments have the potential to bring about improvements in the quality, cost and range of services available to borrowers and savers both in Canada and elsewhere. At the same time the challenge is to make certain that the new regulatory régimes and associated supervisory arrangements around the world continue to play their role in ensuring that the financial industry operates within as solid and trustworthy a framework as it is possible to achieve.

* * *

In these observations I have emphasized the lingering effects of severe and persistent inflation and the problems generated by unbalanced mixes of fiscal and monetary policies. However, I should also emphasize that these are problems coming from the past. The process of adjustment to a more balanced world economy in the future is underway. The movement back to greater price stability and lower interest rates around the world has greatly enhanced the prospects for sustained economic growth. What is required now is to build on the initiatives taken in 1986 and increase the degree of commitment to international economic cooperation among the major industrial countries. We need to ensure that the difficulties that are bound to arise in the process of international adjustment will not be allowed to give rise to increased protectionism and overwhelm these positive forces for economic progress that are now at work.

Economic and Financial Developments

Economic Activity and Inflation

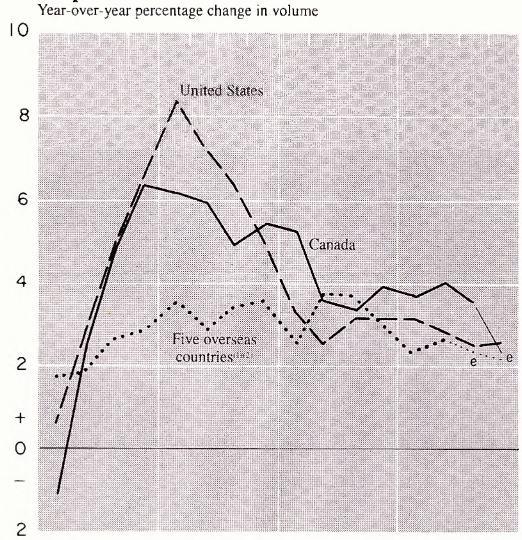
The pace of economic activity in Canada moderated during 1986 and came more into line with growth rates in other industrialized countries. Some further progress was made in reducing the aggregate rate of unemployment, yet across the regions and sectors of the country there was a marked contrast in performance. Led by a surge in household and business spending, growth in central Canada was quite robust. Elsewhere, particularly in western Canada, developments originating outside the country restrained growth. The energy and agricultural sectors were adversely affected by a sharp fall in crude oil and grain prices. These declines contributed to an appreciable decline in Canada's international terms of trade and slower growth in national income. External demand for Canadian products also moderated because of relatively slow growth both overseas and in the United States.

Little additional progress was made during 1986 in bringing down inflation in Canada. This reflected the fact that several factors, some temporary in nature, continued to exert upward pressure on consumer prices, offsetting the beneficial effects of lower energy prices and relatively modest increases in labour costs.

International Comparisons

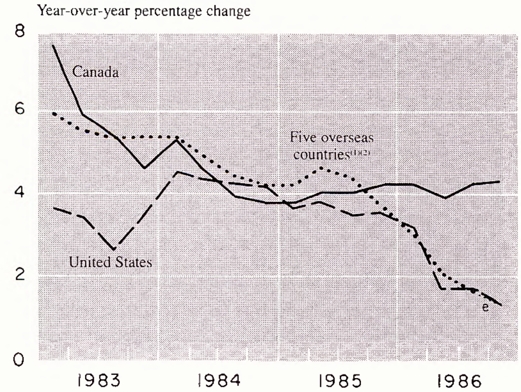
Output

Year-over-year percentage change in volume



Consumer Price Index

Year-over-year percentage change



[1] Japan, Germany, France, United Kingdom, Italy

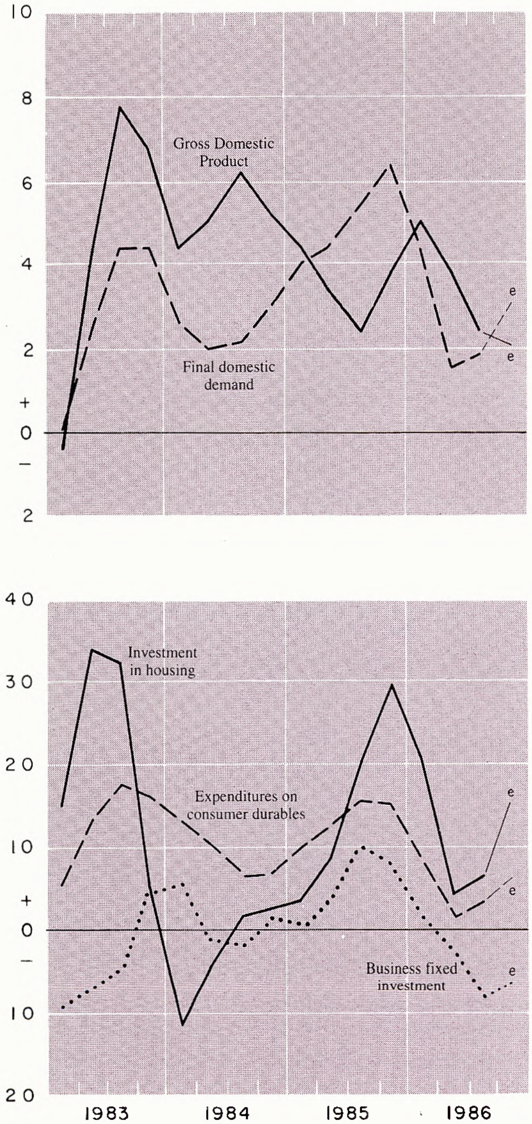
[2] 1982 weights

[e] Estimate

Economic Activity

Total spending in current dollar terms appears to have risen by about 6 per cent in Canada between the fourth quarter of 1985 and the fourth quarter of 1986, somewhat less than the year before. While the volume of production of most kinds of goods and services rose less rapidly during 1986, the extent of the slowdown

Growth in Real Expenditures in Canada
Latest two quarters over previous two quarters
Percentage change at annual rates



[e]Estimate

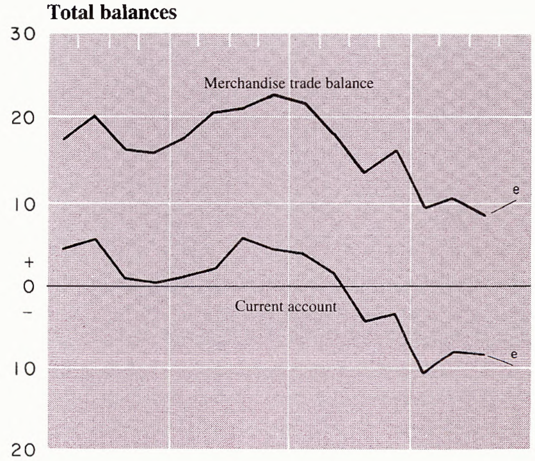
varied considerably. Those sectors of the economy most sensitive to international developments experienced the weakest growth.

The main impetus for growth came from demand generated by the household sector. Encouraged by a somewhat lower average level of interest rates, a third year of relatively low inflation and steady gains in employment, individuals reduced their savings relative to income to the lowest level since 1973 and assumed higher levels of debt. Consumer expenditures on goods and services as well as investment in new and renovated housing rose strongly, particularly during the second half of the year. While a temporary rise in interest rates contributed to slower growth in final domestic demand early in the year, production levels were sustained over the period by an increase in the rate of inventory accumulation, which then slowed as demand recovered.

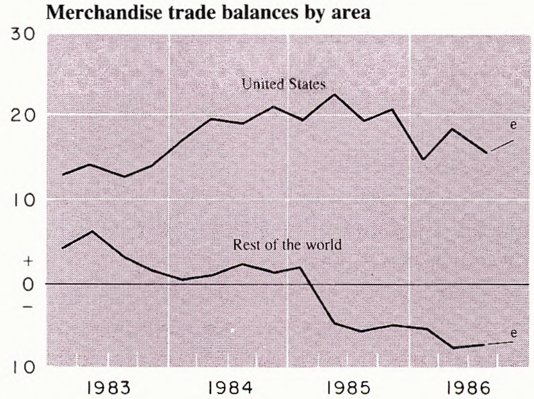
As an important producer and net exporter of both energy and grain, Canada was significantly affected in 1986 by the sharp decline in the world prices for these commodities. Capital investment programs in the energy sector, particularly spending on oil and gas exploration and development, were scaled back substantially

Current Account of the Balance of Payments: Selected Balances
Billions of dollars
Seasonally adjusted at annual rates

Total balances



Merchandise trade balances by area



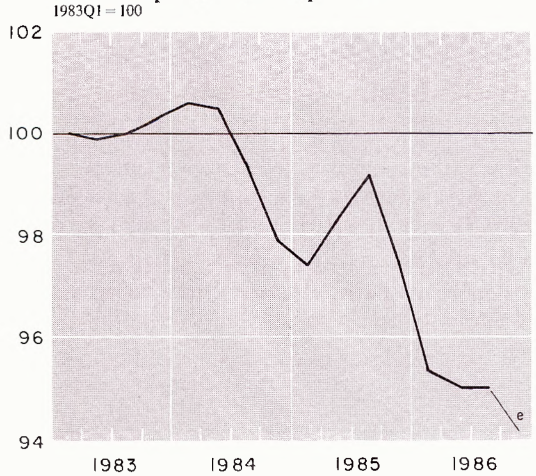
[e]Estimate

following the decline in crude oil prices. Outlays on non-energy investment projects were higher than the year before, but did not rise enough to offset the decline in energy investment. Given the general uncertainty about future energy price movements, companies were not inclined to move rapidly to take full advantage of lower energy costs in their investment plans.

The decline in energy and grain prices contributed as well to a deterioration in the balance on international trade. However, other factors also played a role as the current account deficit widened to about \$9 billion, or 1¾ per cent of the value of Gross Domestic Product. The merchandise trade surplus declined significantly in volume terms as the effects of relatively strong domestic demand within Canada and modest growth in demand abroad offset Canada's generally favourable competitive position. In consequence, Canada's trade surplus with the United States dropped significantly, and there was a widening of the trade deficit with the rest of the world. A favourable development, reflecting the attraction of Expo 86, was the marked improvement in the net travel account to a near-balanced position during the summer months.

There were important regional dimensions to the decline in oil and grain prices. As the main energy-consuming region, central Canada gained appreciably from the fall in

Canadian International Terms of Trade
Ratio of Export Prices to Import Prices
1983Q1 = 100



ᵉEstimate

energy prices. This stimulus, together with the general strength of household demand and increased investment outlays for modernization and expansion in several major manufacturing industries, produced a high level of activity in this part of the country. The strength of demand, particularly in southern Ontario, outpaced supplies in certain industries with the result that price and cost pressures mounted. This was most evident in the market for both new and existing housing, where speculative buying appeared to become a factor.

In marked contrast, the energy-producing provinces, particularly Alberta, experienced severe difficulties because of the decline in energy prices. Oil-producing firms suffered sharp reductions in revenues and profits and in response reduced employment and investment spending. The partial recovery in world oil prices towards the end of the year will, if maintained, contribute to some improvement in this situation over time.

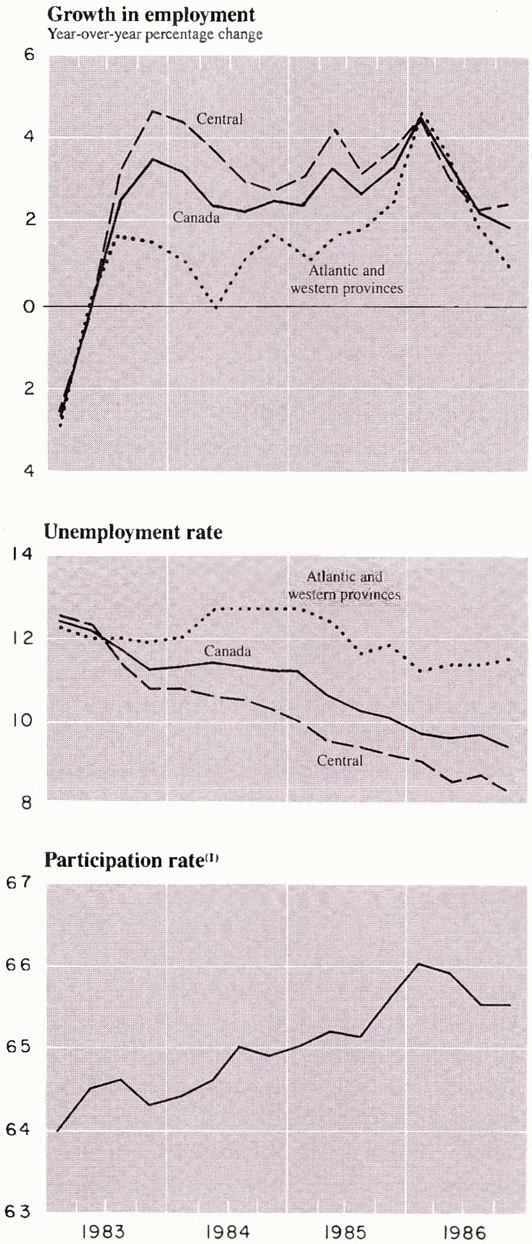
Conditions in the western agricultural sector also deteriorated. In addition to the strong downward pressure on grain prices arising from the subsidization programs of major world producers, the quality of the Canadian grain crop was low because of wet conditions during the harvest. As a consequence, farm incomes in western Canada were adversely affected and also became more dependent on government stabilization programs.

The resource sector as a whole continued to feel the strain of low commodity prices, while the lumber industry was additionally affected by protectionist actions in the United States and by a strike in British Columbia in the second half of the year that affected much of the industry. However, in certain other respects, economic conditions did improve outside central Canada. In the West, Expo 86 attracted an influx of tourists, and prices increased somewhat for livestock, pulp and paper and some wood products. In the Atlantic region, expanding foreign markets for fish products boosted both prices and output.

Employment rose appreciably in Canada during 1986. However, compared to the previous year, the distribution changed considerably, reflecting the divergence in activity across sectors and regions. Employment growth was particularly strong in financial services and particularly weak in the energy-producing sector. Employment gains in the goods-producing sector of the economy were generally limited. In such industries, there has been increasing emphasis on achieving productivity gains in order to reduce costs and increase competitiveness in domestic and international markets.

The proportion of the working-age population employed or seeking employment declined through most of 1986, partially reversing the rising trend evident since early 1983. Some workers, particularly those in the primary industries, may have decided to withdraw from the labour force given limited job prospects and the costs of relocation. Early retirement plans have also been introduced in many of these industries as one means of reducing labour costs. Overall, in an environment characterized by difficult adjustments in both product and labour markets, the aggregate unemployment rate remained relatively high, although by year-end it had fallen to under 9½ per cent from 10 per cent the year before.

Selected Labour Market Indicators



(1) Proportion of labour force population working or actively seeking work

Inflation

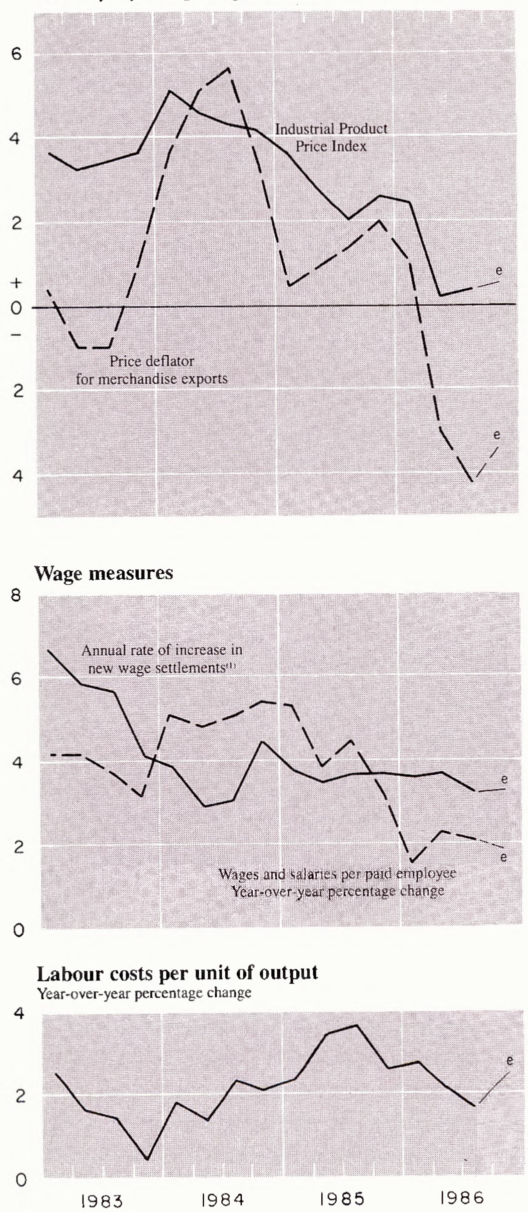
The rate of increase of prices and costs in 1986 was again subject to a number of offsetting forces. On the one hand, the prices of goods produced in Canada rose less rapidly than in 1985 because of lower energy prices, weak commodity prices generally, and more moderate increases in production costs. On the other hand, a number of factors continued to exert upward pressure on the prices of goods and services consumed in Canada. At the end of the year the Consumer Price Index was nearly 4¼ per cent higher than a year earlier, approximately the same rate of increase as during 1985.

One of the main factors exerting downward pressure on inflation during the past year was the sharp fall in crude oil prices. Led by a substantial drop in fuel oil and gasoline prices, energy prices at the retail level declined by about 13 per cent. If this drop had not occurred, the Consumer Price Index would have been about one per cent higher. The fall in energy prices had a significant impact on the rate of increase of producer prices as well, and, given that Canada is a net exporter of energy, it also contributed to the sharp decline in Canada's international terms of trade.

During 1986 the rise in labour costs per unit of output continued to be quite restrained, largely because the increase in the average earn-

Indicators of Producer Prices and Costs

Industrial product prices and deflator for merchandise exports
Year-over-year percentage change



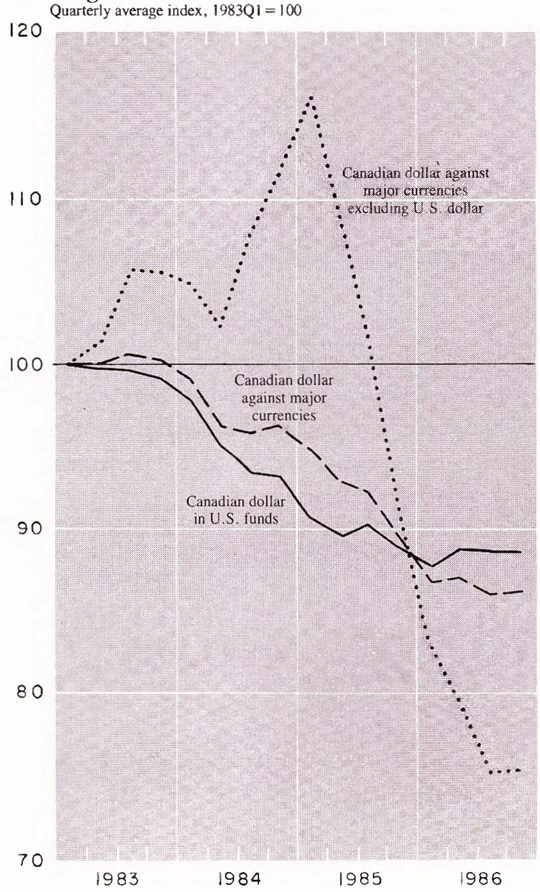
(1)Excludes those settlements with cost of living adjustment clauses
eEstimate

ings of wage and salary workers was only about 2 per cent. This moderate rise in average wage rates primarily reflected the pressures of competition in both labour and product markets. Indeed, unemployment levels remain above historical averages and the prices at which producers are able to sell their products remain generally quite weak. The lower inflation of the past two or three years, relative to the experience of the 1970s and early 1980s, has been an additional factor contributing to the moderation in wage pressures.

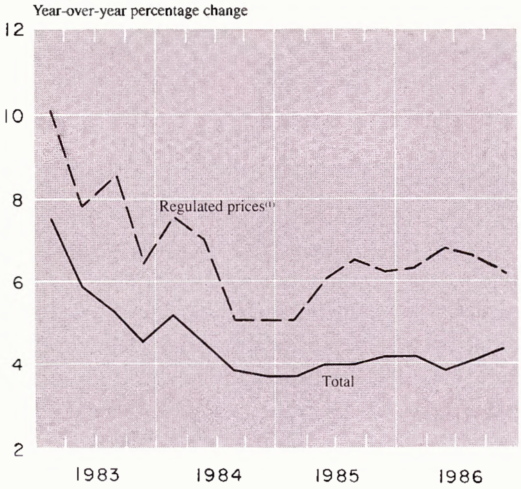
At the consumer level, several factors offset the favourable impact on prices of the drop in energy prices and the moderation in production costs. The depreciation of the Canadian dollar continued to exert upward pressure on the domestic price level. In addition to the cumulative effects of depreciation against the U.S. dollar over the past two to three years, the sharp depreciation against overseas currencies since early 1985 has had a major impact. In this environment the prices of automotive products imported from overseas rose by about 6 per cent during 1986, and the prices of other imported consumer

Exchange Rates

Quarterly average index, 1983Q1 = 100



Consumer Price Index



(1) Includes energy (gasoline and fuel oil prior to June 1985 only), tobacco and alcohol, regulated rent, property taxes, public transportation, communications, water, cablevision, regulated post-secondary education courses, vehicle registration fees, drivers' licenses and agricultural products subject to regulation.

goods rose by about 8 per cent. The price of meat and fresh vegetables also rose particularly rapidly in 1986. Pork prices increased strongly in response to a pronounced reduction in supplies coming on the market, and the 1986 vegetable crop was adversely affected by growing conditions. However, by year-end there was evidence that supply pressures in these areas had begun to ease.

In addition, prices were affected through 1986 by increases in a number of provincial and federal sales and excise taxes, and most prices subject to regulation of one form or another continued to rise at rates well above the rate of increase of the overall Consumer Price Index.

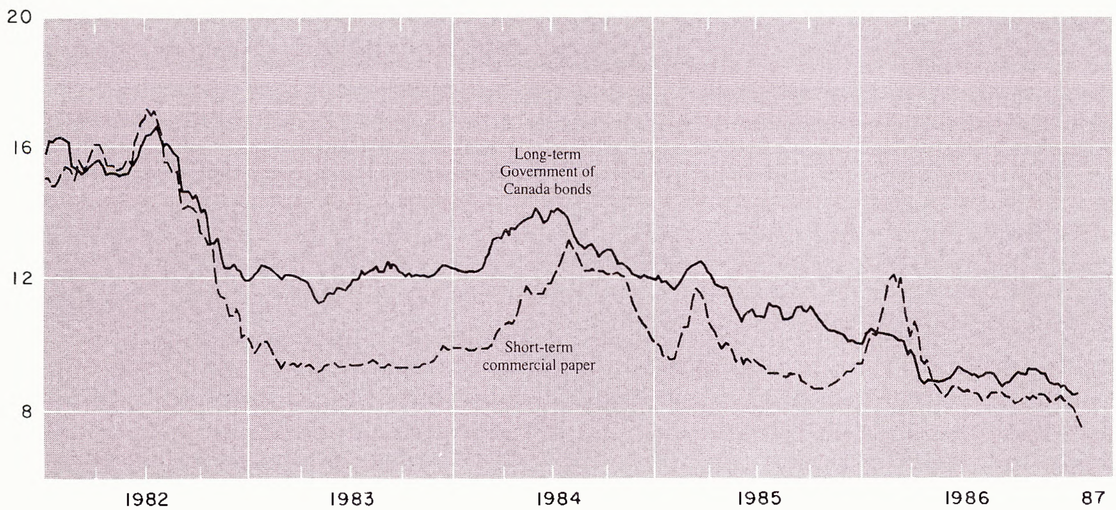
While Canada's inflation performance in 1986 was disappointing in some respects, many of the forces leading to higher prices seem temporary in nature and domestic costs continue to rise at a relatively low rate. However, current regional disparities represent a risk to a more favourable outcome in the future. In Ontario, labour markets have been rather tight, and consumer prices in the Toronto area rose by over 5¼ per cent during the year. If inflation continues to accelerate in the high-growth regions of the country, or spills over and affects wage and price decisions in other regions, the process of adjustment towards greater price stability in Canada could be impeded. To date, however, cost and price pressures outside of central Canada continue to be quite moderate reflecting the lower levels of economic activity in those regions.

Financial Developments

Interest rates in Canada continued to trend downwards during 1986, following similar if somewhat larger movements in the United States. While this underlying pattern was interrupted in the early months of the year by an increase in Canadian interest rates in response to developments in the exchange market, rates subsequently fell back to the lowest levels seen since the late 1970s. The exchange rate, following an abrupt decline to record low levels through the first months of 1986, recovered by the spring. It then remained in a narrow range around 72 U.S. cents through the rest of the year before rising sharply to above 74½ U.S. cents at the end of January 1987.

The overall demand for credit expanded at a more moderate pace in 1986 than in the previous two years, mainly as a result of slower growth in borrowing by the federal government. Private sector credit continued to grow at about the same pace as in 1985 as weaker business demands were offset by increased strength in the demand for credit by households. Most of the major monetary aggregates also grew somewhat less rapidly during the year, reflecting for the most part the general slowing in total spending in the economy. In addition, a number of the monetary aggregates were affected to some degree by continuing financial innovation and institutional changes.

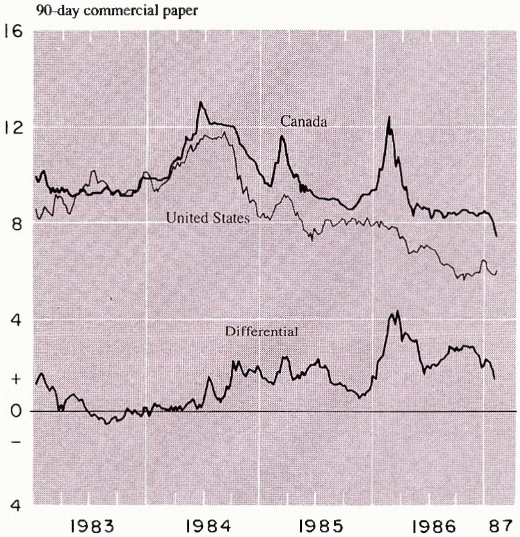
Canadian Interest Rates



Interest Rates and Exchange Rates

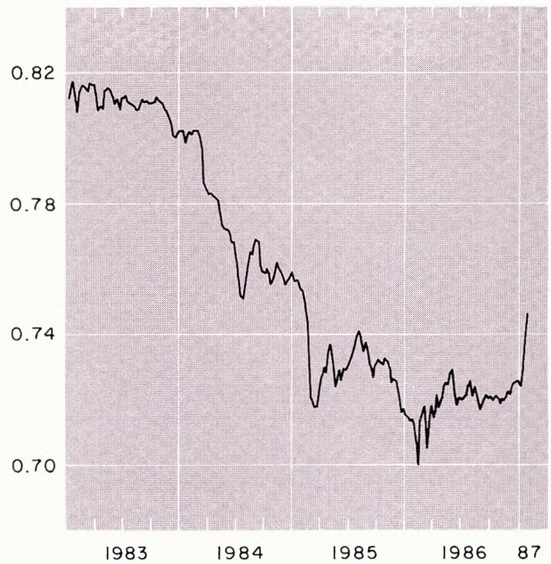
The sharp increases in domestic short-term interest rates early in 1986 were the culmination of pressures that had begun in the autumn of 1985 in response to a weakening Canadian dollar. The principal sources of downward pressure on the dollar were the continuing weakness in international commodity prices, the gathering consensus that growth would slacken in Canada's principal export markets, and uncertainties about the federal government deficit in the light of a forthcoming budget. These factors, along with rather narrow differentials between Canadian and U.S. short-term interest rates, contributed to an erosion of confidence that the existing exchange rate could be maintained. As the exchange rate weakened in response, speculative pressures were set in motion that both accentuated this downward movement and caused short-term interest rates to move upwards.

Canada-U.S. Short-Term Interest Rates
90-day commercial paper



In early February, with the dollar having fallen to 69 U.S. cents from over 73 U.S. cents in the preceding October, the Government and the Bank of Canada responded with a program of aggressive intervention in the exchange market and actions in the money markets to reinforce the upward adjustment that was already taking place in domestic short-term interest rates. In addition, the Government announced its intention to borrow abroad to bolster its exchange reserves. Short rates peaked at levels of 12 to 13 per cent in early March, by which time 30-day commercial paper rates were almost 4½ percentage points above their lows of the previous autumn, and the differentials between Canadian and U.S. rates had widened to more than 5 percentage points. The rise in rates was much steeper at the very short end of the term structure, suggesting that the market believed the need for sharply higher rates was temporary.

Exchange Rate
Canadian dollar in U.S. funds



These actions succeeded in breaking the speculative momentum that had developed in exchange markets against the Canadian dollar, and by the spring the dollar had recovered to over 72½ U.S. cents. The recovery was supported by other developments as well. After some initial hesitation in the exchange market, the federal government's February budget proposals seemed to be well received, and there was an increased realization that earlier assessments of the overall impact on the Canadian economy of weak markets for oil and other primary commodities may have been overly negative. As the exchange rate strengthened, short-term interest rates came down, and by May the earlier rise in rates had been completely reversed.

The scope for lower domestic interest rates was enhanced by the decline in interest rates that was occurring in the United States and elsewhere. Twice during this period, in March and in April, the U.S. Federal Reserve lowered its discount rate by a half percentage point. Market interest rates also fell. These actions, taken in the face of weaker economic growth and moderating inflation in the United States, were accompanied by interest rate declines in most of the overseas industrial countries.

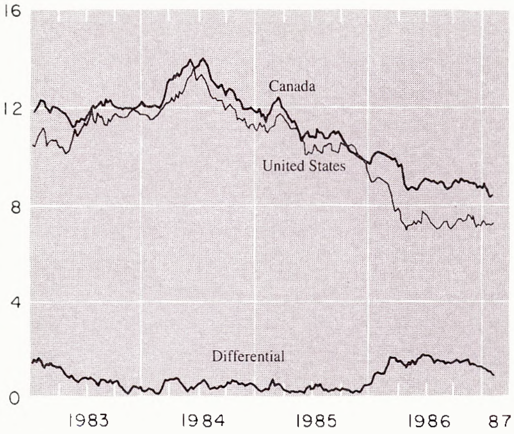
The relative stability during the latter half of 1986 in the exchange value of the Canadian dollar against the U.S. dollar, and in domestic interest rates, stands in sharp contrast to their earlier volatility. From May until year-end, the Canadian dollar traded within a narrow range around 72 U.S. cents, while short-term interest rates were little changed, drifting down from around 8½ per cent at mid-year to about 8¼ per cent at the end of the year. Despite the relative stability of the exchange rate and further declines in U.S. short rates, confidence in the Canadian dollar strengthened only slowly. Expectations of a weaker dollar because of actual and potential trade disputes with the United States and a deterioration in the current account of the balance of payments contributed to the persistence of relatively wide differentials between short-term interest rates in Canada and the United States. Overall, however, short-term rates in both countries during 1986 reached their lowest levels since the late 1970s.

Long-term interest rates also declined during 1986. Yields on longer-term Government bonds, which had been as high as 14 per cent or more in 1984, had fallen to about 10 per cent by the beginning of 1986. However, this trend was temporarily broken as short-term rates rose sharply in January and February. The decline resumed only when the rise in domestic short-term rates began to be reversed and when long-term bond yields in the United States dropped sharply in response to the steps taken by Congress aimed at reducing the large U.S. budgetary deficit. By mid-year, Canadian long-term rates had fallen to about 9 per cent, where they remained until after year-end.

With a reduction in U.S. long-term rates during the year that was substantially greater than in Canada, the rate differential between the two countries widened appreciably.

Canada-U.S. Long-Term Interest Rates

Federal government bonds

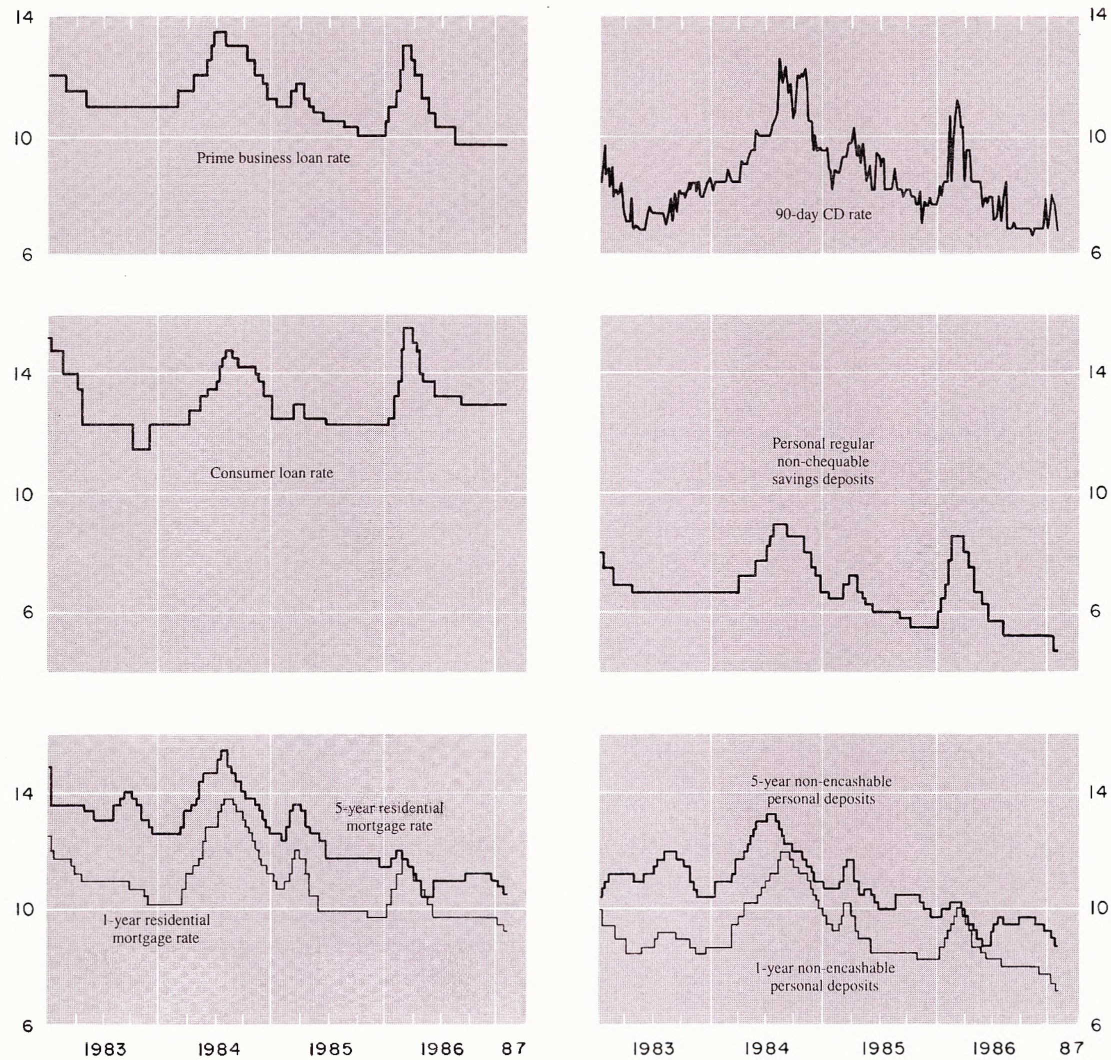


Lingering concerns about the exchange rate and relative inflation prospects in Canada and the United States may have played a role in these developments.

Movements in administered interest rates in Canada generally followed closely those of market interest rates of comparable maturity, though there was some tendency for the spread between bank lending rates and market rates to widen. During the first half of 1986, interest rates on shorter-term loans and deposits at financial institutions rose and then declined in response to the movements in market interest rates. Interest rates on longer-term maturities, notably five-year mortgages and deposits, were relatively stable through this period and even rose modestly for a time in the second half of the year owing to a stronger demand for residential mortgage financing and a shift in borrowers' preferences towards longer terms. Consumer loan rates, which increased by nearly 3 percentage points in the early months of the year, subsequently declined by only 2 percentage points because of a pickup in loan demand and at year-end were at levels higher than those experienced through most of 1985. However, most administered interest rates finished 1986 at their lowest levels since 1978.

During January 1987 short-term rates in Canada declined a good deal further and differentials against U.S. rates narrowed as the Canadian dollar moved upwards quite strongly against the U.S. dollar. These market pressures were reflected in somewhat smaller declines in long-term rates as well as reductions in a number of

Selected Administered Interest Rates at Banks



administered rates, including the prime lending rate at the chartered banks.

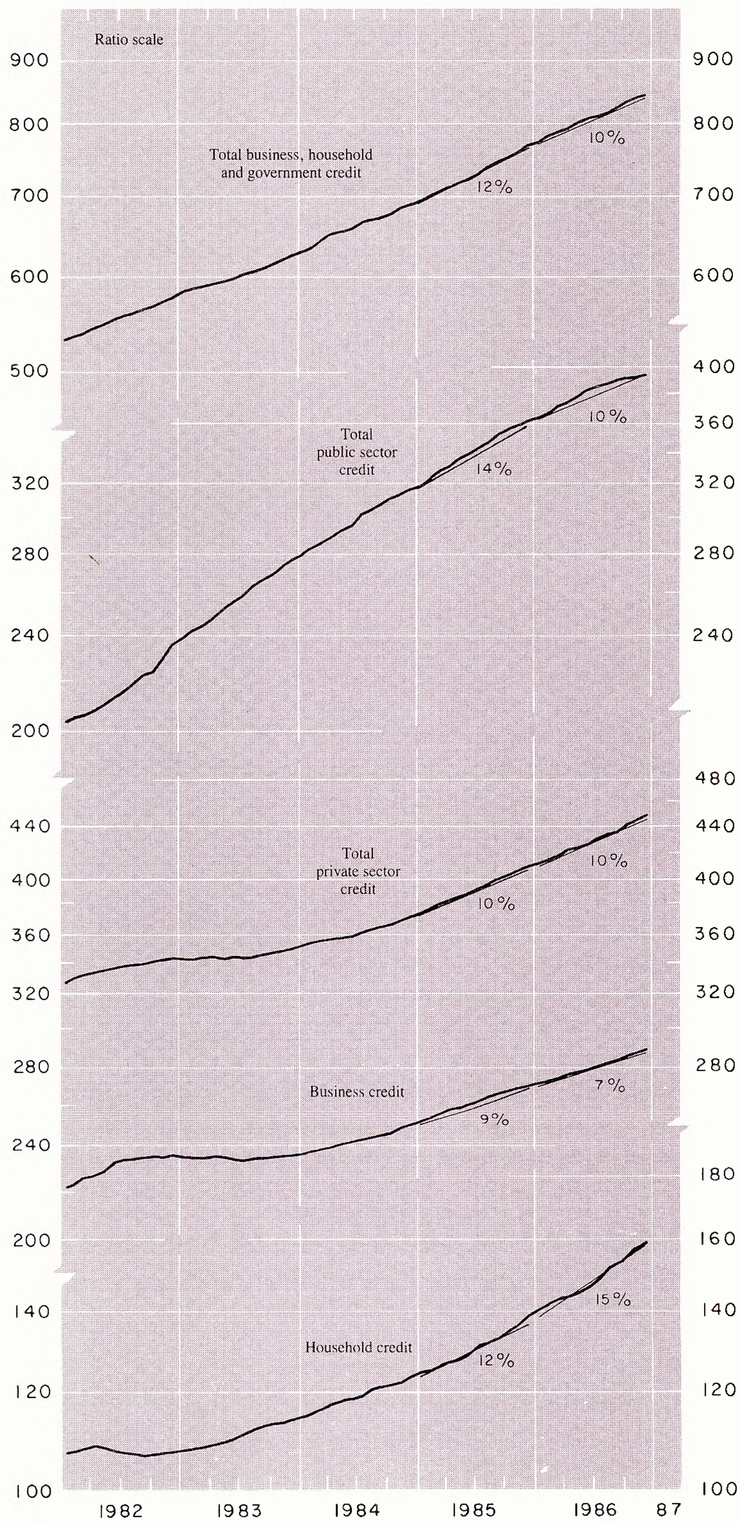
Credit Developments

The rate of increase in the outstanding borrowing of the private sector remained around 10 per cent in 1986, despite some slowing in the growth of total spending in Canada. As a result, the ratio of private sector credit outstanding to Gross Domestic Product rose for the second consecutive year following three years of decline. The increase in the ratio was due entirely to a pickup in household credit. Residential mortgage financing was especially buoyant in reaction to mortgage interest rates that for much of the year were at the lowest levels in almost a decade. But despite the increased willingness on the part of households to use credit to finance increased spending, debt outstanding as a proportion of personal income remains below the peak levels reached during the late 1970s.

The slowing in the growth of business credit was especially noticeable in short-term borrowing. In contrast, equity and bond financing grew strongly in spite of a marked falloff in capital investment spending. Lower long-term interest rates and improved equity prices during

Credit Aggregates: Amounts Outstanding

Billions of dollars, seasonally adjusted



Total public sector credit:
Loans extended to, and bonds and bills issued by federal, provincial and municipal governments, and guaranteed bonds issued by provincial and municipal government enterprises

Total private sector credit:
Total of business and household credit

Business credit:
Loans and financial leases extended to, and acceptances, short-term paper, bonds and equities issued by non-financial businesses

Household credit:
Consumer credit and residential mortgage loans extended by selected lenders

Growth rates are calculated as fourth quarter to fourth quarter changes the year provided an incentive for firms to undertake further debt restructuring and a general strengthening of their balance sheets.

Public sector borrowing requirements have been declining steadily for the past four years, a reflection of both a slowing in the rate of expenditure growth and rising revenues. Higher revenues have been generated by the cyclical recovery in the economy, and there have been as well a number of tax increases during this period as part of government efforts to slow the rate of growth in outstanding debt. Further gains were made in this regard in 1986, particularly at the federal level.

Monetary Aggregates

The growth rates of all the major monetary aggregates slowed in the first six months of 1986, reversing the rapid increases evident through most of the previous year. Although growth picked up towards the end of 1986, for the year as a whole it remained below the pace of 1985 for most aggregates. While the behaviour of the monetary aggregates during 1986 corresponded reasonably closely to the general movements of income and interest rates, financial innovations and other institutional developments continued to exert an influence on the growth of particular monetary aggregates. Such developments included significant shifts in the market shares of banks and near-banks and the introduction of new deposit instruments. There was also evidence of a further move towards "securitization" in financial markets, whereby direct lending between lenders and borrowers has tended to displace the intermediation of funds by financial institutions, thus dampening the growth of some broad monetary aggregates.

The effects of fluctuations in interest rates and total spending growth during the year were especially evident in the movements of the narrowest monetary aggregate, M1. The increase in short-term interest rates at the beginning of the year, combined with lower nominal spending growth, produced a steep decline in M1, as households and businesses reduced their holdings of transactions balances. M1 growth accelerated in the latter part of the year, however, in response to the sharp decline in interest rates in the second quarter and a pickup in the rate of growth of nominal spending. Unlike many earlier periods, financial innovations did not exert a strong distorting influence on M1 growth in 1986.

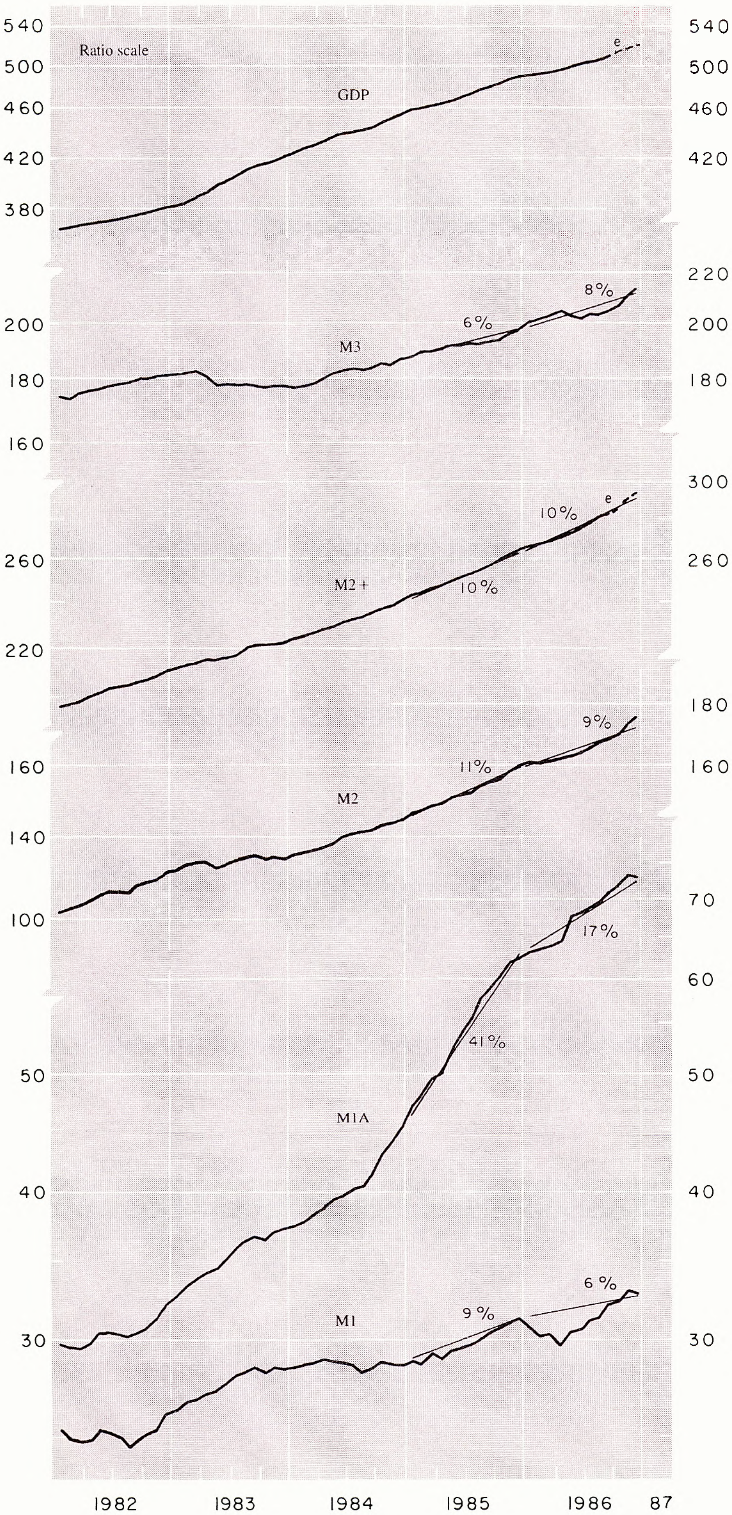
Financial innovations did, however, continue to contribute to substantial volatility in the growth of M1A. In particular, new savings accounts offering attractive rates of interest on high balances were introduced and aggressively marketed by banks and near-banks beginning in late 1985. These accounts, which are classified as non-chequable and are therefore excluded from the M1A measure of transactions balances, attracted a large volume of funds that otherwise would have been placed in daily interest chequing accounts.

The broader money measures, such as M2 and M2+, continued to reflect the major fluctuations in aggregate spending over the year as well as certain institutional developments. The reduction in holdings of Canada Savings Bonds over the year, a result of heavy redemptions in the first quarter and a smaller than normal fall campaign, acted to increase the growth of these broader aggregates. Aggressive competition by near-banks to obtain a larger share of the personal deposit market is reflected in a somewhat higher rate of growth in the aggregate M2+, which consists of M2 plus near-bank deposits.

New market developments continued to have a significant impact on the behaviour of the broad aggregate M3. Increased reliance by commercial borrowers on direct forms of financing, most notably short-term commercial paper and bankers' acceptances, as well as bond and equity financing, have reduced the demand for bank credit. Therefore, the funding requirements of the chartered banks have grown at a slower pace and have in turn reduced the growth of M3. The recent shifts towards longer-term financing and more direct forms of financing have increased the variability in the current movements of M3 and added an element of uncertainty about its likely future trend.

Monetary Aggregates and Gross Domestic Product

Billions of dollars, seasonally adjusted



GDP:
Total spending on goods and services at current prices

M3:
M2 plus non-personal fixed-term deposits plus foreign currency deposits of residents booked in Canada

M2+:
M2 plus personal savings deposits at trust and mortgage loan companies, credit unions and caisses populaires

M2:
M1A plus other notice deposits plus personal term deposits

M1A:
M1 plus daily interest chequable savings deposits plus non-personal notice deposits

M1:
Currency and demand deposits

Growth rates are calculated as fourth quarter to fourth quarter changes

[e]Estimate

Growth in the world economy was slower than expected in 1986, and the problems associated with large imbalances in international payments and international debt continued to dominate the economic scene. The process of exchange rate realignment among major currencies, initiated in 1985, continued into 1986, and the thrust of policies aimed at reducing international imbalances in fiscal positions was also maintained. Nevertheless, progress on both the fiscal and balance of payments fronts has been slow, and protectionist pressures have remained strong. At the end of 1986, the large U.S. payments deficit and the corresponding Japanese and German surpluses were still at record levels. However, the inflation performance of most industrial countries improved further during the year, and there were further declines in the general level of interest rates.

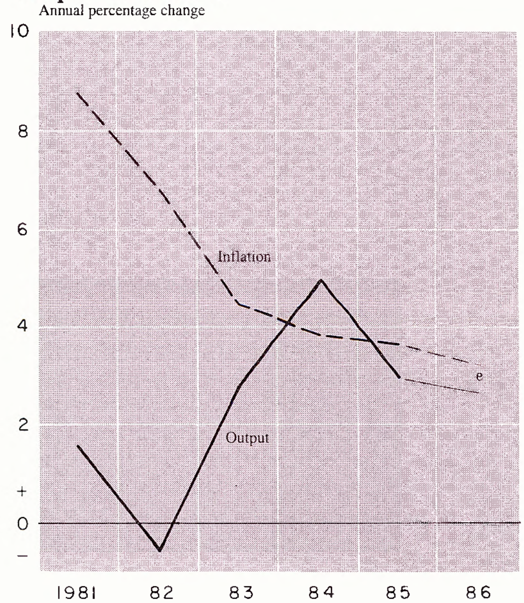
Without the support of a more rapid expansion of world economic growth, the position of many heavily indebted developing countries remained difficult despite the beneficial effects of lower interest rates. Oil-exporting debtors were particularly affected by the sharp decline in the price of oil that occurred in 1986. Nevertheless, some progress has been made on the road to a more viable situation by several of the developing countries through the adoption of strong adjustment programs with the support of the international financial community.

Industrial Countries

The economies of the industrial countries continued to advance in 1986 but at a somewhat slower pace than had generally been expected. The dominant events in 1986 were the

Major Industrial Countries[1][2]: Output and Inflation

Annual percentage change



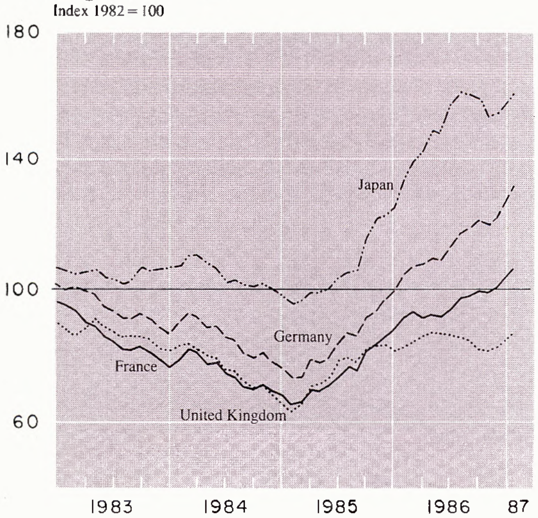
[1] United States, Japan, Germany, France, United Kingdom, Italy, Canada
[2] 1982 weights
[e] Estimate

large changes in exchange rates and the price of oil. Throughout the world the countries and sectors favoured by these changes tended to increase their spending gradually, while for those affected negatively by these factors, the associated falloff in domestic spending was more abrupt. As a result, the combined rate of growth of the seven principal OECD countries was estimated to be somewhat below the 3 per cent rate recorded in 1985.

Among these major countries, the marked slowing in the Japanese economy, together with weaker growth in the United States in the second half of the year, more than offset any pickup in the European countries. Domestic demand was less buoyant in the United States, reflecting mainly the move towards fiscal restraint and a sharp drop in energy-related investment. This weakness in the United States was exacerbated by the limited response of trade flows to a lower exchange rate and by the low level of demand for U.S. exports from oil producers and other developing countries still struggling to deal with their international debt problems. Although the volume of exports of the major surplus countries, Germany and Japan, were similarly affected by weak demand from developing countries, their current account surpluses remained high, given the benefit of much lower prices for their oil imports.

Exchange Rate Trends[1]

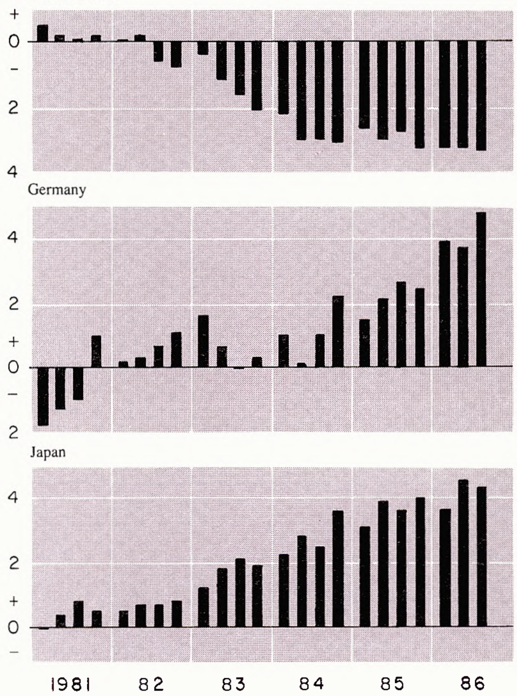
Index 1982 = 100



[1]Monthly average of the value of national currencies in terms of the U.S. dollar

Current Account Balances of United States, Germany and Japan

Expressed as a percentage of GDP



National sources

Current account imbalances among major industrial countries remain large, but there are some signs that the currency realignments are causing the magnitude of the imbalances to level off, measured as a percentage of GDP. Further progress will in part depend on the continued pursuit of policies to achieve a better balance in the fiscal situations of the industrial countries, and policies to ensure that international payments adjustments are not impeded by protectionist measures.

In this connection, the progress made in 1986 towards international policy coordination and interest rate reduction has been helpful. The Tokyo Summit emphasized cooperation among the seven major countries and, in the face of strengthening protectionist pressures in many countries, it was agreed to launch a new round of trade negotiations under the auspices of the General Agreement on Tariffs and Trade. These negotiations will, for the first time, encompass trade in services and agricultural products. The continuing and massive subsidies provided to agriculture by the European Economic Community and the United States pose a serious threat to the viability of many agricultural producers, not only in other developed nations such as Canada, but also for many countries in the developing world.

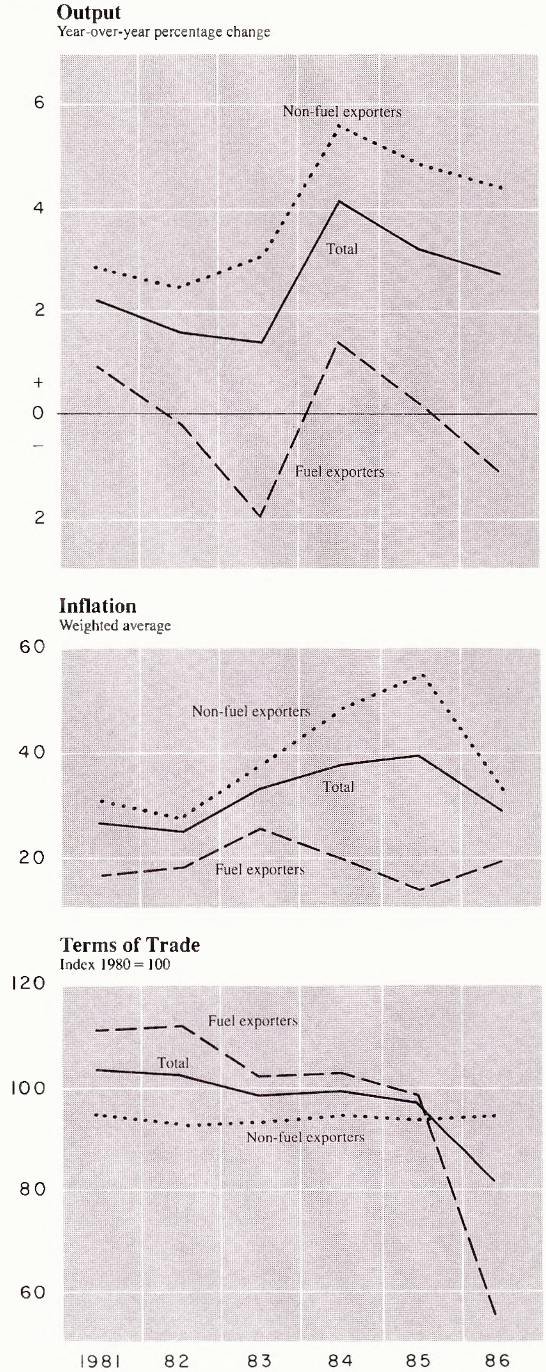
Developing Countries

In 1986 the impact of external developments on the developing countries varied considerably. On the one hand, the fall in oil prices and in international interest rates had a beneficial effect on many countries. The group of countries for which oil and fuel products are not a major source of export revenues saw their terms of trade remain virtually unchanged, in spite of continuing weakness in the prices of the commodities that make up their traditional exports. In those countries, growth rates fell only slightly, and there was little change in their total current account deficit. On the other hand, the terms of trade of the fuel-exporting countries deteriorated very sharply, contributing to a fall in output in these countries as a group and to a substantial worsening in their collective current account position.

A number of heavily indebted countries continued to find it difficult to meet their scheduled debt service payments. The adjustment efforts of these countries have been complicated by the relatively unfavourable international environment and the limited availability of external financing. An increasing number of countries have been implementing wide-ranging programs designed to bring about a fundamental adjustment of their economies. Such programs have encompassed both macroeconomic policies, including policies designed to reduce inflation, and structural reform measures which in general represent a move to a more market-oriented approach. In time, such initiatives should improve the efficiency and competitiveness of their economies, help them to benefit from development programs and encourage the financial support needed for development.

These adjustment efforts need coordinated support from the international financial

Developing Countries



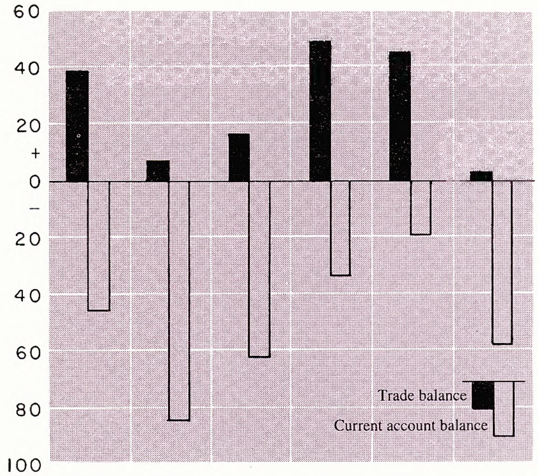
Source: IMF

community. In 1986, the International Monetary Fund and the World Bank provided policy advice and financial assistance for such adjustment,

Developing Countries

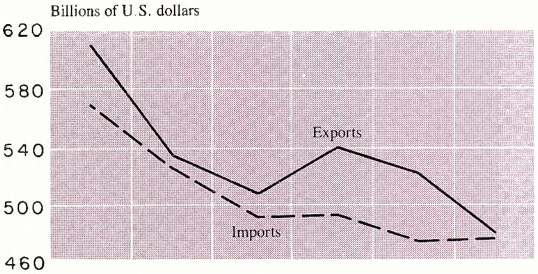
Trade and current account balances

Billions of U.S. dollars



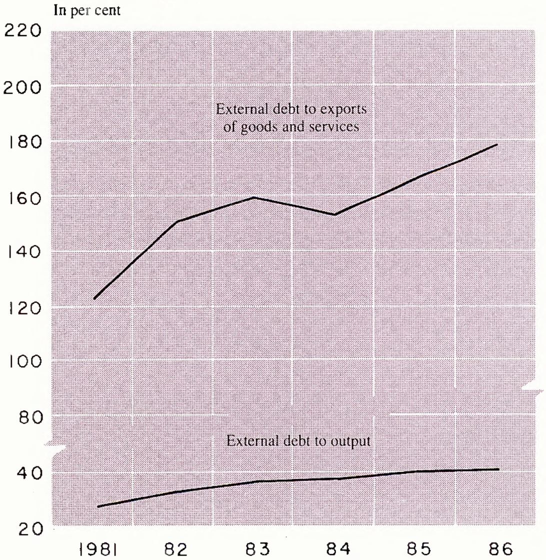
Merchandise trade

Billions of U.S. dollars



External debt ratios[1]

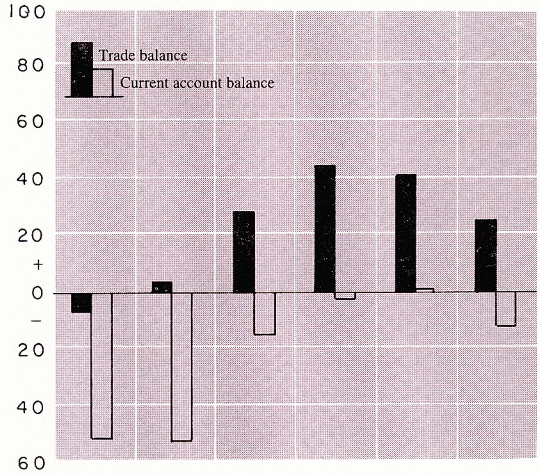
In per cent



Fifteen Heavily Indebted Developing Countries[2]

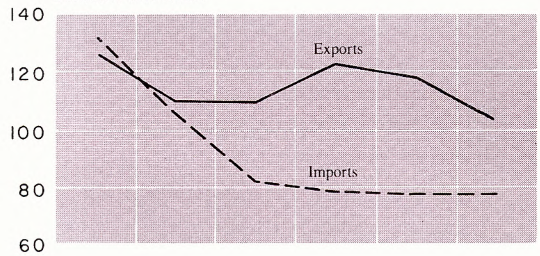
Trade and current account balances

Billions of U.S. dollars



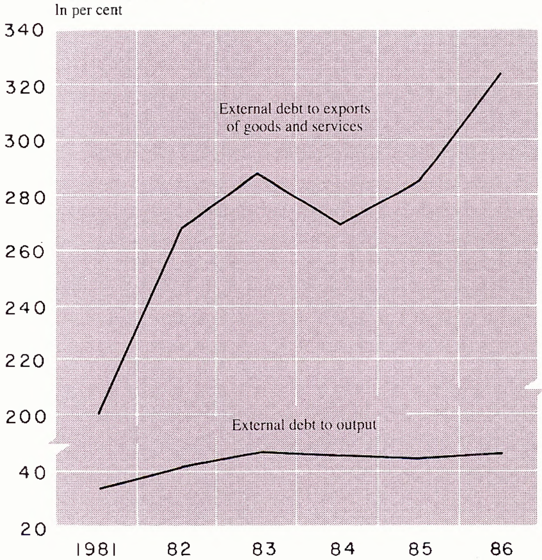
Merchandise trade

Billions of U.S. dollars



External debt ratios

In per cent



(1) Ratios apply to capital importing developing countries only

(2) Argentina, Bolivia, Brazil, Chile, Colombia, Côte d'Ivoire, Ecuador, Mexico, Morocco, Nigeria, Peru, Philippines, Uruguay, Venezuela, Yugoslavia

Source: IMF

while private and official creditors rescheduled repayments due from many of these countries and provided new financing in some cases. The Canadian banks played their part in these arrangements. The largest financial package assembled through these coordinated efforts was that for Mexico.

In 1986, the Bank of Canada, with the concurrence of the Minister of Finance, participated with other countries in arrangements to provide short-term bridge financing to Mexico and Nigeria. In both cases, the financing was related to economic adjustment programs undertaken by these countries in cooperation with the IMF and IBRD. Canada's share in the U.S.$1.1 billion official facility for Mexico was U.S.$45 million, and in the U.S.$250 million facility for Nigeria was U.S.$5 million. Only a small amount of the Mexican drawings remains outstanding, while the Nigerian loan has been repaid.

BANK OF CANADA OPERATIONS

Bank of Canada Advances and Securities Market Operations

The Bank of Canada has two principal liabilities: currency issued to meet the public's demand for banknotes, and the deposits of chartered banks and directly clearing members of the Canadian Payments Association (CPA) that are held at the Bank for reserve and settlement purposes. Normally, the asset counterpart of these liabilities is made up almost entirely of Government of Canada securities. However, in 1985 in response to persistent liquidity problems of certain smaller banks, advances by the Bank to CPA members grew to represent a sizable proportion of the Bank's total assets. During the early part of 1986 outstanding advances to chartered banks and other CPA members continued to increase, from \$3.5 billion at the end of 1985 to a peak of \$5.2 billion at the end of March 1986. Since then repayments have led to a very substantial reduction in advances to CPA members – to a level of \$868 million at year-end. As these repayments were made, the Bank was once again able to increase its overall holdings of Government of Canada securities, and these rose by \$2.6 billion. Holdings of treasury bills increased by \$3.9 billion, while holdings of Government of Canada marketable bonds fell by \$1.3 billion. Other investments of the Bank rose by about \$1 billion during 1986 as the Bank purchased foreign currency assets from the Exchange Fund Account as part of its regular cash management operations. Monthly changes in the Bank's assets and liabilities are shown in Appendix Table I.

The changes in the Bank's outstanding advances over the course of the year were related primarily to loans that had been extended to four banks – the Canadian Commercial Bank and the Northland Bank, which ceased operating in 1985, and the Continental Bank of Canada and the Bank of British Columbia, which have recently sold their assets to other banks. The continuing process of liquidating the assets of the Canadian Commercial Bank and the Northland Bank enabled the repayment of part of the advances that had been made to these institutions. At the end of 1986 Bank of Canada advances to the Canadian Commercial Bank stood at \$481 million, down from \$1,095 million at the end of 1985, while advances to the Northland Bank decreased from \$481 million to \$310 million over the same time period.

On October 31, 1985 a special \$1.4 billion term advance to the Continental Bank of Canada from the Bank of Canada was announced in conjunction with a \$1.5 billion line of credit from the major chartered banks. The term loan with the Bank of Canada, originally scheduled to mature April 30, 1986, was extended on three occasions and was due to expire at the end of

January 1987. In addition to the term advance, the Bank made short-term advances on a day-to-day basis, and total advances to the Continental Bank of Canada reached a peak of $2,848 million in 1986. On October 2, 1986 Lloyds Bank of Canada announced that it had reached an agreement to buy a substantial portion of the assets of the Continental Bank of Canada and to assume most of its liabilities. The liability for outstanding advances from the Bank was transferred to Lloyds Bank of Canada on November 7, 1986, the closing date of this transaction, and was fully repaid by mid-December.

Substantial liquidity advances were also provided to the Bank of British Columbia beginning in February. These advances reached a peak of $975 million in the spring of 1986. In November 1986, the Hongkong Bank of Canada announced its intention to purchase most of the assets of the Bank of British Columbia and to assume the bulk of its liabilities, including the Bank of Canada advances. This purchase was effected on November 27, 1986, and the outstanding advance from the Bank of Canada was repaid before the end of November.

The Bank of Canada also extended credit at various times in 1986 through Purchase and Resale Agreements (PRA) to those investment dealers who are also money market jobbers. These periods centred around February and March, when the overnight costs of financing dealer inventories were high as the Bank sought wide spreads between short-term interest rates in Canada and the United States, and the final weeks of the year when technical factors in the U.S. markets put undesired upward pressure on overnight rates in Canada. The PRA extended towards year-end were for the most part "special" PRA. Special PRA are offered by the Bank on its own initiative and terms, rather than on the initiative of the jobbers. Since the initiative to provide the financing rests with the Bank, such PRA provide the Bank with the scope for a more direct influence on the cost of overnight financing for investment dealers in circumstances where it is considered that the interest cost developing in the market is too high. Details of Bank of Canada advances to CPA members and the amount of PRA outstanding, including Special PRA, are shown in Appendix Table III.

On one occasion in 1986 the Bank undertook a new type of transaction called Special Sale and Repurchase Agreements. Special Sale and Repurchase Agreements are essentially the opposite of Special PRA. That is, they provide the Bank with a direct method of stabilizing the cost of overnight financing against downward rather than upward rate pressure. The Bank arranged $150 million of Special Sale and Repurchase Agreements with chartered banks on August 29, 1986.

The Bank adjusts its portfolio of Government of Canada bills and bonds either through transactions with the market or by adjusting its participation in new issues of marketable bonds and at the weekly treasury bill tenders. During 1986 the Bank managed the very large changes in the composition of its assets primarily through its transactions in treasury bills.

The Bank was at times also a net seller of bills to the market, especially at the beginning of February, when its actions were designed to produce upward pressure on short-term interest rates in support of the dollar and then in the period from late February through to May to moderate the decline in short-term interest rates as the dollar strengthened. The Bank was subsequently able to replace these bills and added a further $3.9 billion of bills to its portfolio at the regular weekly auctions. The acquisition of bills by the Bank at the auctions was particularly large during the period of heavy sales to the market and towards the end of the year when large repayments of advances by banks took place. Normally the size of new treasury bill tenders is reduced during November and December when Government balances are high following the Canada Savings Bond campaign. With this year's more modest outcome for the campaign, the bill auctions in late November and December were larger than in recent years and the Bank's purchases were readily accommodated. The Bank also added to its holdings of marketable bonds at most of the new issues, yet sales to the market more than offset these purchases and over the year the bond portfolio was reduced by $1.3 billion. Most of the Bank's bond sales were concentrated in the first quarter of 1986. The Bank's net securities transaetions with the market and with the Government and other client accounts are shown on a monthly basis in Appendix Table IV.

The Bank, as fiscal agent, is a party to the Government of Canada's banking arrangements. At the beginning of April 1986 new arrangements between the Government and the finaneial institutions were put in place. The system was changed from one in which the Government held a certain amount of interest-free balanees with directly clearing members of the CPA as eompensation for cheque clearing and other banking services, to one in which specific charges are levied for individual banking services. Under this fee-for-service system, the Government earns a basic rate of interest on all its demand balances, which are allocated to eligible institutions by formula, and places its remaining balances through competitive tender. The Government is thereby in a position to earn a higher rate of interest on that portion of its balances that it determines is surplus to its needs for short periods of time. The first auction was held on April 1, 1986, and auctions are now held on a routine basis, usually once a week, depending upon the availability of surplus funds. Terms have ranged from three days to 28 days but are typically seven days, and tender amounts have varied from $200 million to $2.4 billion. The size, term and frequency of these auctions are decided by the Government with the Bank's advice, and all directly clearing members of the CPA are eligible to bid.

The revisions to the Government's banking arrangements were followed by a change in the way the Bank carries out the final settlement of the daily clearings, a change that has substantially increased the efficiency of the payments system. On July 16, 1986 the Bank, in response to a request from the CPA, instituted a proeedure to eliminate the effect of the normal one-day lag in the settlement of the daily clearing of cheques and other payment items among banks and other deposit-taking institutions. With this system the daily clearing results are entered on the books of the Bank of Canada so as to ensure that the dating of settlements coincides with the date of exchange of clearing items. With this change it is no longer necessary for financial institutions to monitor and analyze the patterns of receipts and disbursements of clients in an effort to estimate and charge for the average cost associated with payment items in transit (''float'') before they are settled. Similarly, it is no longer necessary for the major clients of the financial institutions to devote resources to adjusting the timing or routing of payments to minimize float charges.

Debt Management

As fiscal agent for the Government, the Bank of Canada manages Government of Canada borrowing operations in domestic markets and assists with borrowings in foreign markets. In 1986 the Government's net domestic borrowing totalled about $17 billion, over $12 billion less than the amount borrowed in 1985. The amount raised from the general public, not including the banks, fell from $30.6 billion in 1985 to $11.6 billion last year.

Contributing to this substantial reduction in borrowing were a decline of about $8 billion in the Government of Canada's financing requirements and a rundown in Government cash balances of $2.3 billion. In addition, foreign exchange transactions over the year generated $2.3 billion in Canadian funds.

This reduced borrowing requirement allowed somewhat more scope to pursue a debt management policy of limiting the portion of financing done through longer-term borrowing at fixed rates and lessening the reliance on Canada Savings Bonds. The average term to maturity of Canada's domestic marketable debt, comprising all unmatured issues of marketable bonds and treasury bills, declined from five years six months to five years one month in 1986. This was a result of the reduction in new bond issues with maturities of ten years or longer and an increased proportion of borrowing through treasury bills.

Although the increase in the value of marketable Government of Canada bonds outstanding was less than in the previous year, there were 19 new issues in both 1985 and 1986. These issues raised $11.3 billion on a net basis after allowing for the redemption of about $3 billion of maturing bonds. Almost two thirds of the new bonds issued were for terms to maturity of less than ten years. This relatively high percentage of shorter-term borrowing was accompanied by a greater use of the auction technique to market new issues with terms in the two- to five-year area. The now well-established program of quarterly auctions of two-year bonds raised net new funds of $675 million while $2 billion was raised through four additional auctions of short- and mid-term bonds. In 1985 net financing through marketable Canada bonds amounted to $13.4 billion. Details of the 1986 marketable debt program are provided in Appendix Table V.

Treasury bills outstanding at year-end were $69.7 billion, an increase of $10.3 billion over the year and $20 billion since 1984. The market for treasury bills has become a very flexible and major source of funds for the Government. While in most weeks there was an increase in the amount of bills auctioned through the regular three- and six-month issues and bi-weekly one-year issues, the magnitude of these increases and the size of the gross issues themselves have varied widely depending on the Government's current needs. For example, around the beginning of 1986 when Government balances were high due to the large Canada Savings Bond campaign, the amount of treasury bills outstanding was reduced by as much as $950 million a week and by almost $6 billion over the two-month period from December 1985 to February 1986. The borrowing program was then increased to provide a net source of funds to replace balances lost through large Canada Savings Bond redemptions, and by mid-February the net weekly increment was $800 million. The aggressive use of the treasury bill program has meant that the Government is now able to maintain lower cash balances and lower financing costs.

As in past years the Government also offered special short-term cash management bills in October and early November to build up balances for and during the first week in November. This is the period when there are large outflows of funds related to interest payments and redemptions of Canada Savings Bonds, while receipts from the sale of the new issue are typically not received until after the end of the sales period. This mismatch of cash flows has become quite large as a result of the large increase in the amount of Canada Savings Bonds maturing in recent years. In 1986 there were three $750 million and one $500 million special cash management bill issues compared with three $500 million issues in 1985.

The amount of Canada Savings Bonds outstanding reached an all-time high of over $50 billion after the 1985 sales campaign. In the beginning of 1986 there was a flurry of early encashments of the 1985 series and the pace of redemptions picked up markedly in February as the rate of interest paid on competing instruments beeame more attractive. On February 17, 1986 the Government announced that the rate of interest on all series of Canada Savings Bonds currently paying less than 10 per cent would be raised to 10 per cent for the four-month period March 1 to June 30, 1986. After this adjustment the rate of redemptions dropped off significantly and by July competitive rate pressures had eased sufficiently so that redemptions were not abnormally large in the July to October period.

The 1986–87 Series of Canada Savings Bonds, the forty-first issue, provides for a rate of 7¾ per cent for the first year beginning November 1, 1986 and a minimum rate of 5¾ per cent for the remaining six years to maturity. Total sales for the campaign amounted to $9.2 billion including about $1.8 billion sold under the Payroll Savings Plan. After allowing for redemptions of the 1977 and 1979 series, which matured, as well as October and November redemptions of other series, net sales amounted to some $5.4 billion. However, Canada Savings Bond redemptions for the January to October period more than exceeded this net total, and for 1986 as a whole the amount of savings bonds outstanding declined by $4.4 billion.

The following table shows changes in Government of Canada Canadian dollar securities outstanding during 1985 and 1986 in total and by major categories of holders.

New foreign borrowing operations over the year consisted of three bond issues in Europe, totalling an equivalent of U.S.$1.9 billion, and a new short-term note program in the United States denominated in U.S. dollars. In addition, drawings were made at times on standby lines with banks. The equivalent of about U.S.$700 million was repaid, including the prepayment of the equivalent of U.S.$380 million in yen loans and a U.S.$300 million bond maturity. Details of these borrowings and bond retirements are shown in Appendix Table V.

Early in the year the Government borrowed actively in external markets as the weaker Canadian dollar resulted in increased use of the

Summary of Changes in Government of Canada Securities Outstanding During 1985 and 1986

Billions of dollars (par value)	**1985**	**1986**
Treasury bills	+ 9.7	+10.3
Marketable bonds	+13.3	+11.3
Canada Savings Bonds	+ 6.2	− 4.4
Total	+29.2	+17.2
Held by:		
Bank of Canada		
Treasury bills	+ 0.5	+ 3.9
Marketable bonds	− 2.0	− 1.3
Total	− 1.5	+ 2.6
Chartered Banks		
Treasury bills	− 0.3	+ 2.5
Marketable bonds	+ 0.3	0.0
Total	0.0	+ 2.5
Government Accounts		
Treasury bills	0.0	− 0.1
Marketable bonds	+ 0.2	+ 0.6
Total	+ 0.2	+ 0.5
General Public		
Treasury bills	+ 9.6	+ 4.0
Marketable bonds	+14.8	+12.0
Canada Savings Bonds	+ 6.2	− 4.4
Total	+30.6	+11.6
Memo:		
Government of Canada Cash Balances	+ 2.3	− 2.3

Exchange Fund Account. Two new borrowings were arranged in Europe for delivery in February, and extensive use was made of U.S. dollar standby credit lines with Canadian and international banks. The European borrowings eonsisted of an 80 billion yen (equivalent to U.S.$415 million) issue of five-year bonds and a U.S.$1 billion issue of ten-year bonds. The fixed rate Euro-yen liability was swapped into a floating-rate U.S. dollar liability. Drawings outstanding under the standby credit faeilities totalled U.S.$2,850 million at the end of February. As the Canadian dollar strengthened, these short-term loans were allowed to run off and by the end of July the balance outstanding was nil.

A second Euro-yen borrowing was undertaken in July. The issue consisted of 80 billion yen 5⅝ per cent bonds maturing in seven years. The proceeds were used in part to prepay two yen-syndicated loans originally arranged with Japanese banks and insurance companies in 1979. The balances on these loans, which totalled about 60 billion yen, carried rates of interest of 7.1 per cent and 7.5 per eent. The 20 billion yen liability remaining from the new issue was swapped into floating-rate debt denominated in U.S. dollars.

Modest use of the standby credit facility with the Canadian banks was made in August, but by the end of September these drawings were repaid, and no drawings were undertaken during the last three months of the year.

In early October a short-term note program was launched in the U.S. money market to provide Canada with a low-cost source of short-term U.S. funds on an ongoing basis. Under this program, administered by the Bank on behalf of the Government, Canada issues obligations in the United States known as ''Canada Bills'', which have a term to maturity of not more than 270 days. At year-end the amount of Canada Bills outstanding was U.S.$934 million.

Renegotiation of the standby credit agreement with U.S. and other foreign international banks was completed in November. The amendments include a lower commitment fee, lower costs of borrowing and an extension of the maturity date of the facility to 1994.

Foreign Exchange Operations

During the first quarter of 1986 the Canadian dollar was under considerable downward pressure. It touched a record low of U.S.$0.6913 on February 4. This decline was largely reversed over the next few days by forceful intervention in both the foreign exchange market and the domestic securities market. These actions were supported by the announcement by the Minister of Finance that the Canadian government would undertake further borrowings abroad to bolster exchange reserves. Another sizable decline in the value of the dollar occurred at the end of February and continued into early March, but the dollar again recovered rapidly. In subsequent quarters the Canadian dollar traded in a relatively narrow range centred just above U.S.$0.72. Over the year as a whole the Canadian dollar rose by 1.3 per cent against the U.S. dollar, while on a trade-weighted basis against the major currencies it fell by 2.0 per cent.

In early 1987 the Canadian dollar rose strongly against the U.S. dollar and was trading above U.S.$0.7450 at the end of January. On a trade-weighted basis the increase was less, given the further decline of both the Canadian and U.S. dollars against overseas currencies.

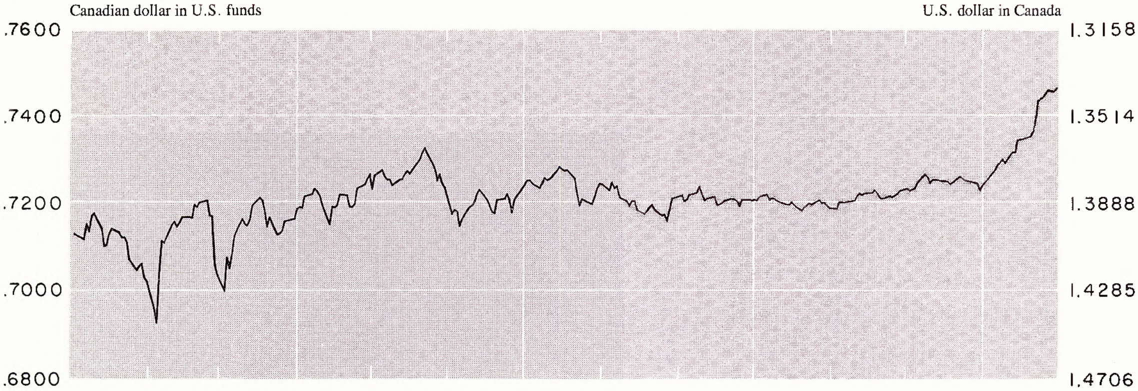
Foreign exchange market operations by the Bank of Canada, as agent for the Exchange Fund Account of the Minister of Finance, continued to be oriented towards promoting orderly market conditions by dampening excessive movements in the exchange rate. In the circumstances, there were significant purchases and sales of foreign exchange for stabilization purposes. Largely reflecting the dollar's pronounced weakness early in the year, official sales of foreign exchange in 1986 exceeded official purchases.

Canada's holdings of foreign exchange reserves were supplemented as needed by drawings on Canada's standby credit facilities with both Canadian and foreign banks. These facilities, along with net longer-term external borrowings of the equivalent of almost U.S.$1.2 billion, were used to replenish the Exchange Fund Account during 1986. More recently the issuance of Canada Bills, obligations denominated in U.S. dollars, has provided Canada with an additional source of short-term funds. As in previous years, other changes in the composition of reserves reflected transactions in SDRS with the IMF and other IMF members and modest sales of gold from the Account for U.S. dollars.

Canada's holdings of official international reserves were the equivalent of U.S.$3,275.6 million at the end of 1985 and U.S.$4,095.6 million at the end of 1986.

Exchange Rate

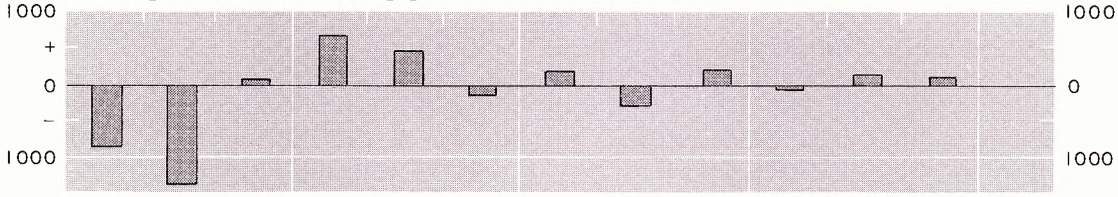
Spot closing rates, daily



Changes in Official Reserves

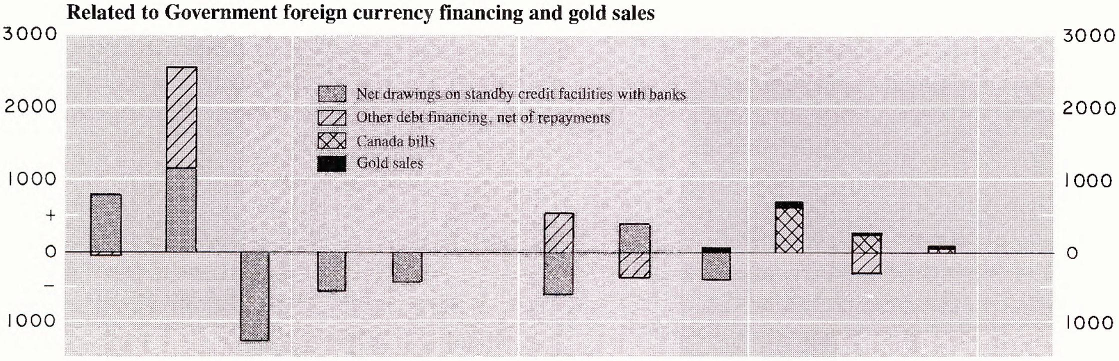
Millions of U.S. dollars, monthly

Excluding official external financing, gold sales and revaluation effects[1]

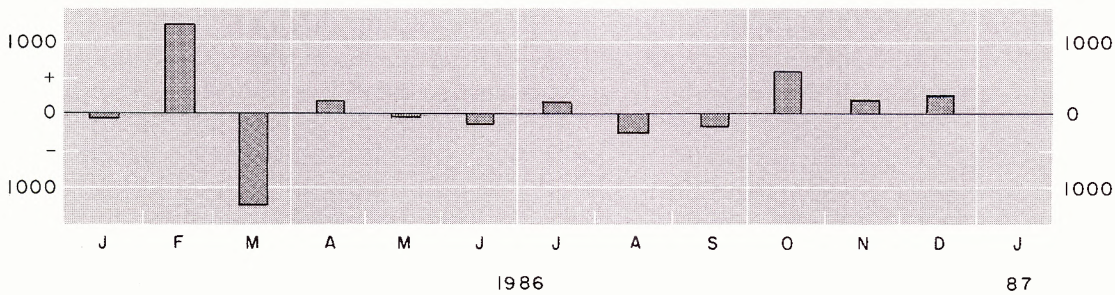


[1] The U.S. dollar value of SDR-denominated assets (gold, the IMF position and SDRs) rises when the exchange rate of the U.S. dollar declines in terms of SDRs, and decreases when the opposite occurs.

Related to Government foreign currency financing and gold sales



Total net change



Last date plotted: exchange rate January 30, 1987
official reserves December 1986

In addition to the activities diseussed in previous seetions of this Report, the Bank has a number of operational responsibilities that involve the processing of large volumes of material and data. In partieular, the Bank is responsible for the issue of banknotes and acts as fiscal agent for the Government of Canada in servicing its debt. Notwithstanding an increasing reliance on automated proeessing systems to support an expanding workload, about one half of the Bank's staff is directly involved in carrying out these functions.

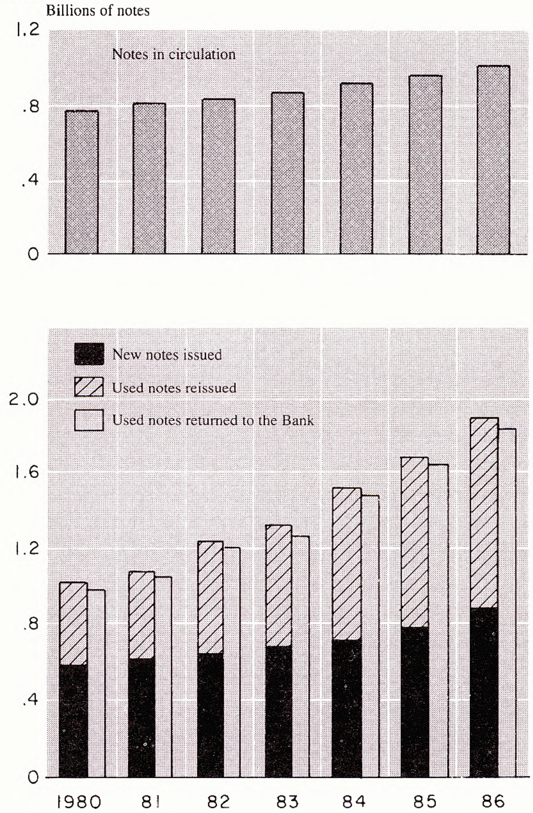
The Bank also provides banking serviees to the Government and operates deposit accounts for members of the Canadian Payments Association, foreign central banks and international institutions. As well, the Bank is the custodian of unclaimed balances originally deposited with chartered banks and transferred to the Bank after these aeeounts have been inaetive for ten years.

Note Issue

Banknotes are issued by the Bank through financial institutions to meet the public's demand for additional notes and to replace used notes that are no longer suitable for circulation. Notes issued comprise new notes and reissues of used notes still fit for circulation that have been returned to the Bank by institutions with surplus holdings.

The number of banknotes in circulation has been rising by about 5 per cent a year in recent years, but the volume of banknotes processed by the Bank of Canada has been increasing much more rapidly. For example, the number of notes issued increased in total by over 10 per cent in both 1985 and 1986, with similar increases in the number of used notes returned to the Bank by financial institutions. This high turnover of notes between financial institutions and the Bank has resulted in part from the expanding number of automatic banking machines, over 4,000 of which are in use in Canada. As in other countries, easier access to banknotes appears to have prompted the public to rely more heavily on cash as a means of payment. This has led to a greater demand for banknotes from the Bank of Canada by financial institutions to stock their automatic

Banknotes



banking machines and to a higher volume of notes returned to the Bank by institutions that receive more notes deposited by their customers than they require. An upgrading of the quality of notes for use in automatic banking machines has also increased the turnover of notes, with more used notes being withdrawn from circulation and more new notes being issued by the Bank.

To cope with the increased processing requirements for used banknotes and to maintain standards for the quality of used notes reissued, the Bank has a program underway to equip its Agencies with high-speed note-handling equipment that counts, authenticates and verifies denominations of used notes and sorts those to be reissued and those to be destroyed. By the end of 1986 such equipment had been installed in all but one of the Bank's nine Agencies.

During 1986 the Bank introduced the first two denominations of a new series of banknotes. The new $5 note was made available to main offices of chartered banks and other financial institutions from the Bank's Agencies on April 28 and the new $2 note was made available on September 2. By the end of 1986, 105 million new-series $5 notes had been issued, comprising three quarters of the total number of new $5 notes issued during the year, and 44 million new-series $2 notes had been issued, over one third of the total.

Other denominations of the new series of notes will follow over a number of years. The new series incorporates additional security features against counterfeiting, changes to facilitate more efficient use of the high-speed note-handling machines and features to assist the blind and visually impaired to distinguish among denominations of notes.

The Bank will not redesign the $1 note as part of the new series. This decision was taken following the Government of Canada's announcement that a new $1 circulating coin will be introduced in mid-1987. The Bank plans to cease issuing the $1 note in 1989. However, it should be emphasized that all Bank of Canada notes remain legal tender for their full face value even when they are no longer in general circulation.

Debt Service

The number of certificates issued for Government of Canada bonds and treasury bills declined in 1986, owing primarily to a substantially smaller Canada Savings Bond campaign compared with the previous year. However, the number of certificates redeemed continued to increase, as did the number of interest payments made directly by the Bank to holders of outstanding Government debt.

Canada Savings Bonds comprise over 80 per cent of the total number of certificates processed in connection with new issues and redemptions of Government of Canada securities and an equally high percentage of interest payments to holders of outstanding debt. As a result of the autumn sales campaign and November maturities, the work related to Canada Savings Bonds is subject to an annual peak that the Bank meets with temporary staff.

In 1986, in addition to its usual notifications to holders of maturing regular-interest Canada Savings Bonds and fully registered marketable Government bonds, the Bank also sent notices to the 68,000 remaining holders of matured compound-interest Canada Savings Bonds advising them that their bonds had ceased to bear interest and should be redeemed. This change led to a substantial increase in the number of inquiries from the public regarding matured bonds and in the number of replacements of missing bonds.

Unclaimed Bank Balances

The Bank processed 5,600 inquiries concerning unclaimed bank balances in 1986, an increase of 15 per cent following increases of over 30 per cent in each of the previous two years. In late 1983, to facilitate recovery of unclaimed balances by their owners, copies of the central records of all accounts held by the Bank were placed in each Agency. These records are updated annually and are directly accessible to the public without charge. In 1986 payments were made in respect of 2,500 claims, an increase of some 50 per cent from the previous year.

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	Advances to CPA members	All other assets (net)	Note circulation	Canadian dollar deposit liabilities			
						Chartered banks	Other CPA members	Government of Canada	Other
1986									
January	− 212	+ 88	− 236	− 3	−1,820	+1,387	+173	− 112	+10
February	−1,346	+ 201	+ 173	−234	− 31	− 849	−239	− 66	−21
March	+ 161	− 262	+1,822	−126	+ 340	− 94	− 99	+1,472	−26
April	−1,325	+ 295	− 367	+380	+ 138	+ 99	+301	−1,592	+36
May	+1,422	− 281	− 381	+252	+ 222	+ 328	− 28	+ 497	− 7
June	− 274	+ 71	− 19	−110	+ 740	− 356	−187	− 502	−28
July	+ 901	− 86	− 409	−198	− 67	+ 51	− 34	+ 265	− 9
August	− 411	+ 82	+ 93	− 8	+ 113	− 86	− 80	− 261	+70
September	+1,429	− 80	+ 71	− 46	− 156	+ 402	+ 21	+1,137	−31
October	+ 743	− 8	− 766	−165	− 72	− 594	− 1	+ 483	−12
November	+1,112	− 10	−1,607	+109	+ 211	+ 304	− 29	− 946	+64
December	+ 344	+1,049	− 974	+393	+1,621	− 349	+237	− 640	−57
Annual change	+2,544	+1,060	−2,601	+243	+1,239	+ 245	+ 36	− 265	− 9

APPENDIX TABLE II

Chartered Bank Cash Reserves and Clearing Balances of Other Directly Clearing Members of the Canadian Payments Association

Millions of dollars unless otherwise indicated

		Chartered bank cash reserves			
		Total minimum cash requirements	Average holdings of statutory coin and Bank of Canada notes	Required minimum Bank of Canada deposits	Average holdings of Bank of Canada deposits
1986					
January	**1–15**	5,977	2,909	3,068	3,103
	16–31				3,149
February	**1–15**	5,834	3,288	2,545	2,612
	16–28				2,595
March	**1–15**	5,288	2,796	2,492	2,555
	16–31				2,612
April	**1–15**	5,374	2,751	2,624	2,700
	16–30				2,734
May	**1–15**	5,359	2,819	2,540	2,578
	16–31				2,601
June	**1–15**	5,355	2,887	2,468	2,504
	16–30				2,508
July	**1–15**	5,352	2,970	2,382	2,392
	16–31				2,413
August	**1–15**	5,436	3,034	2,403	2,435
	16–31				2,456
September	**1–15**	5,352	3,057	2,294	2,315
	16–30				2,332
October	**1–15**	5,367	3,098	2,268	2,291
	16–31				2,369
November	**1–15**	5,380	3,024	2,356	2,429
	16–30				2,416
December	**1–15**	5,479	3,135	2,344	2,403
	16–31				2,434

Chartered bank cash reserves			Clearing balances of other directly clearing members of the Canadian Payments Association	
Sum of reservable day weights in period	Cumulative excess reserves at end of period	Average excess reserve ratios	Average holdings of Bank of Canada deposits	Number of clearing days in month
15	526	.024	125	22
16	1,291	.056		
14	936	.047	106	20
14	690	.034		
14	891	.046	125	20
17	2,048	.087		
15	1,147	.055	146	22
15	1,654	.079		
15	566	.027	124	21
15	916	.044		
14	499	.026	102	21
17	688	.029		
15	151	.007	104	22
16	492	.022		
17	549	.023	94	21
15	804	.038		
14	289	.015	90	21
15	558	.027		
15	335	.016	81	22
18	1,820	.072		
14	1,026	.053	92	19
14	842	.043		
15	894	.042	124	21
17	1,538	.064		

APPENDIX TABLE III

Bank of Canada Advances to Members of the Canadian Payments Association and PRA Outstanding

Millions of dollars unless otherwise indicated

		Advances to chartered banks		Purchase and Resale Agreements		Advances to directly clearing non-bank members of the CPA	
		Number of days outstanding	Average amount outstanding[1]	Number of days outstanding	Average amount outstanding[1]	Number of days outstanding	Average amount outstanding[2]
1986							
January	1–15	10	4,053.8	5	112.9	7	15.4
	16–31	12	3,847.6	8	186.7		
February	1–15	10	3,970.9	8	303.9	9	15.7
	16–28	10	3,843.6	10	494.6		
March	1–15	10	4,457.4	10	556.3	10	29.3
	16–31	10	4,657.8	10	572.4		
April	1–15	11	4,845.9	11	536.8	7	23.7
	16–30	11	4,838.5	6	371.8		
May	1–15	11	4,733.2	3	26.0	8	16.0
	16–31	10	4,568.2	7	173.7		
June	1–15	10	4,355.4	2	21.0	10	15.6
	16–30	11	4,251.1	2	12.2		
July	1–15	10	4,168.9	7	145.0	7	15.2
	16–31	12	4,031.8	8	104.1		
August	1–15	11	3,928.1	1	0.6	11	17.6
	16–31	10	3,796.2	–	–		
September	1–15	10	3,839.7	2	24.0	10	20.4
	16–30	11	3,852.3	2	73.9		
October	1–15	10	3,661.6	4	61.5	6	7.9
	16–31	12	3,379.7	1	47.5		
November	1–15	9	2,971.2	1	11.7	9	36.7
	16–30	10	1,923.0	3	65.5		
December	1–15	11	1,071.6	8	249.8	9	13.8
	16–31	10	832.3	6	104.5		

(1) Advances to chartered banks and Purchase and Resale Agreements summed and divided by number of reservable days in the averaging period

(2) Advances to non-bank members of the Canadian Payments Association summed and divided by number of clearing days in the month

APPENDIX TABLE IV

Bank of Canada Net Transactions in Government of Canada Securities and Bankers' Acceptances

Delivered basis, par value in millions of dollars

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

	Treasury bills	Bonds				Bankers' acceptances	Total of bills, bonds and bankers' acceptances	Securities under PRA
		3 years and under	3–5 years	5–10 years	Over 10 years			
1986								
January	− 227.0	–	–	–	−185.0	–	− 412.0	+105.2
February	− 2,802.0	− 50.0	−285.0	−105.0	−405.0	–	− 3,647.0	+537.2
March	− 1,226.0	− 65.0	− 30.5	− 89.0	−190.0	–	− 1,600.5	− 19.3
April	− 2,375.0	–	–	−185.0	−200.0	–	− 2,760.0	−699.8
May	− 1,777.0	–	–	–	–	–	− 1,777.0	+283.0
June	− 1,100.0	–	–	–	–	–	− 1,100.0	−283.0
July	− 140.0	–	–	–	− 14.0	–	− 154.0	+ 74.3
August	− 505.0	–	–	–	–	–	− 505.0	− 74.3
September	− 35.0	–	–	–	–	–	− 35.0	+648.8
October	–	–	− 5.9	–	–	–	− 5.9	− 78.8
November	− 235.0	–	–	–	–	–	− 235.0	−155.4
December	–	− 0.2	–	+ 0.2	–	–	–	−414.6
Total	−10,422.0	−115.2	−321.4	−378.8	−994.0	–	−12,231.4	− 76.7

(Continued)

APPENDIX TABLE IV (Continued)

Bank of Canada Net Transactions in Government of Canada Securities and Bankers' Acceptances

Delivered basis, par value in millions of dollars

Net transactions with government and other client accounts: Purchases (+) of new issues less matured holdings – Bills	Bonds	Net purchases from (+) or net sales to (−) government accounts and client accounts – Bills	Bonds	Net change in holdings of Government of Canada securities and bankers' acceptances: Bills	Bonds	Bankers' acceptances	Total
+ 455.8	–	− 350.1	+ 1.3	− 31.1	− 168.7	–	− 199.8
+ 1,950.7	+ 85.0	− 279.5	–	− 621.1	− 732.5	–	− 1,353.6
+ 1,889.1	− 87.3	− 22.3	+ 7.5	+ 657.0	− 489.8	–	+ 167.2
+ 2,435.5	+ 200.0	− 528.8	+ 1.5	− 1,161.1	− 190.5	–	− 1,351.6
+ 3,145.9	+ 75.0	− 268.6	+ 1.3	+ 1,383.3	+ 76.3	–	+ 1,459.6
+ 1,364.5	–	− 287.3	+ 10.4	− 305.8	+ 10.4	–	− 295.4
+ 1,112.9	+ 150.0	− 287.7	–	+ 759.5	+ 136.0	–	+ 895.5
+ 340.4	+ 5.0	− 181.1	+ 1.0	− 420.0	+ 6.0	–	− 414.0
+ 963.9	+ 75.0	− 197.8	+ 4.3	+ 1,363.8	+ 95.4	–	+ 1,459.2
+ 824.2	− 49.7	+ 88.2	–	+ 849.7	− 71.7	–	+ 778.0
+ 1,438.9	–	+ 94.6	–	+ 1,143.1	–	–	+ 1,143.1
+ 948.1	+ 37.9	− 244.0	+ 0.3	+ 289.5	+ 38.2	–	+ 327.7
+ 16,869.9	+ 490.9	− 2,464.4	+ 27.6	+ 3,906.8	− 1,290.9	–	+ 2,615.9

APPENDIX TABLE V

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

Date in 1986		Issues offered/ retired	Term to maturity	Yield to maturity	Millions of dollars par value: Amount delivered	Millions of dollars par value: Amount retired
Issues payable in Canadian dollars – direct and guaranteed						
Feb.	1	12½% Feb. 1, 1986				6[1]
Feb.	6	9¾% Dec. 15, 1988	2 yrs. 10 mos. 9 days	9.82	175[2]	
		9¾% May 1, 1991	5 yrs. 2 mos. 23 days	9.92	300	
		10¼% Mar. 1, 1996	10 yrs. 23 days	10.24	350	
					825	
Feb.	26	10% Feb. 26, 1990	4 yrs.	10.12	500	
Mar.	6	10½% Mar. 6, 1986				350[3]
		9¾% Mar. 6, 1988	2 yrs.	9.98	550	
Mar.	15	10% Mar. 15, 1986				625[4]
		9¾% Dec. 15, 1988	2 yrs. 9 mos.	9.92	175[5]	
		9¾% May 1, 1991	5 yrs. 1 mo. 17 days	9.71	325[6]	
		9¾% Mar. 1, 2010	23 yrs. 11 mos. 17 days	9.77	325	
					825	
Apr.	10					173[7]
		9¼% Apr. 15, 1989	3 yrs. 5 days	9.24	125[8]	
		9¼% Mar. 1, 1991	4 yrs. 10 mos. 21 days	9.18	175[9]	
		9¼% May 1, 1996	10 yrs. 21 days	9.28	475	
		9½% June 1, 2010	24 yrs. 1 mo. 21 days	9.44	325	
					1,100	
Apr.	28	8½% July 1, 1989	3 yrs. 2 mos. 3 days	8.62	125	
		8½% July 1, 1991	5 yrs. 2 mos. 3 days	8.64	225	
		8¾% June 1, 1996	10 yrs. 1 mo. 3 days	8.82	425	
		8¾% Oct. 1, 2010	24 yrs. 5 mos. 3 days	8.88	325	
					1,100	
May	1	14½% May 1, 1986				9[10]
May	22	8½% July 1, 1989	3 yrs. 1 mo. 10 days	8.30	175[11]	
		8½% July 1, 1991	5 yrs. 1 mo. 10 days	8.52	325[12]	
		8¾% June 1, 1996	10 yrs. 10 days	8.82	400[13]	
					900	
June	1	15¼% June 1, 1986				5[14]
June	6	13% June 6, 1986				375[15]
		8½% June 6, 1988	2 yrs.	8.60	550	
June	12	8½% July 1, 1991	5 yrs. 19 days	8.90	500[16]	
July	1	14¾% July 1, 1986				5[17]
July	3	8½% July 1, 1989	2 yrs. 11 mos. 29 days	8.88	150[18]	
		8½% July 1, 1991	4 yrs. 11 mos. 29 days	8.97	350[19]	
		9% Mar. 1, 2011	24 yrs. 7 mos. 29 days	9.21	325	
					825	

(Continued)

APPENDIX TABLE V (Continued)

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

Date in 1986		Issues offered/ retired	Term to maturity	Yield to maturity	Millions of dollars par value: Amount delivered	Millions of dollars par value: Amount retired
Issues payable in Canadian dollars – direct and guaranteed						
July	24	8½% July 1, 1989	2 yrs. 11 mos. 8 days	8.59	175[20]	
		8½% July 1, 1991	4 yrs. 11 mos. 8 days	8.65	300[21]	
		8¾% June 1, 1996	9 yrs. 10 mos. 8 days	8.76	350[22]	
					825	
Aug.	11	9% Aug. 1, 1990	3 yrs. 11 mos. 21 days	9.04	500	
Sept.	2	8½% July 1, 1989	2 yrs. 9 mos. 29 days	8.81	100[23]	
		8¾% Dec. 15, 1991	5 yrs. 3 mos. 13 days	8.83	400	
		9% Mar. 1, 2011	24 yrs. 5 mos. 29 days	8.99	325[24]	
					825	
Sept.	5	12¼% Sept. 5, 1986				400[25]
		8¾% Sept. 5, 1988	2 yrs.	8.87	550	
Oct.	1	8% Oct. 1, 1986				410[26]
		18% Oct. 1, 1986				7[27]
		8½% July 1, 1989	2 yrs. 9 mos.	8.90	125[28]	
		8¾% Dec. 15, 1991	5 yrs. 2 mos. 14 days	9.01	400[29]	
		8¾% June 1, 1996	9 yrs. 8 mos.	9.06	375[30]	
					900	
Oct.	23	8½% July 1, 1989	2 yrs. 8 mos. 9 days	9.00	250[31]	
		8¾% Dec. 15, 1991	5 yrs. 1 mo. 23 days	9.02	300[32]	
		9% Mar. 1, 2011	24 yrs. 4 mos. 9 days	9.24	300[33]	
					850	
Nov.	12	8¾% Dec. 15, 1991	5 yrs. 1 mo. 3 days	9.03	500[34]	
Dec.	5	10¾% Dec. 5, 1986				450[35]
		8½% Dec. 5, 1988	2 yrs.	8.73	600	
Dec.	15	10% Dec. 15, 1986				200[36]
		8½% July 1, 1989	2 yrs. 6 mos. 17 days	8.43	75[37]	
		8¾% Feb. 1, 1994	7 yrs. 1 mo. 17 days	8.72	250	
		8¾% June 1, 1996	9 yrs. 5 mos. 17 days	8.76	425[38]	
		9% Mar. 1, 2011	24 yrs. 2 mos. 17 days	8.95	350[39]	
					1,100	
		Total bonds payable in Canadian dollars			14,325[40]	3,014[40]
		Total treasury bills*			178,350	168,050
Issues payable in foreign currencies – direct						
Feb.	20	Yen 80,000 million 6⅛% bonds due Feb. 20, 1991	5 yrs.		614[41][42]	
Feb.	27	U.S. $1,000 million 9% bonds due Feb. 27, 1996	10 yrs.		1,410[43]	
Mar.	20					8[44]

Date in 1986		Issues offered/ retired	Term to maturity	Yield to maturity	Millions of dollars par value Amount delivered	Amount retired
Issues payable in Canadian dollars – direct and guaranteed						
Apr.	15					1[45]
July	23	Yen 80,000 million 5⅝% bonds due July 23, 1993	7 yrs.		709[41][46]	
Oct.	15					1[45]
Nov.	3	U.S. $300 million 16¼% bonds due Nov. 3, 1986				416[47]
		Total bonds payable in foreign currencies			2,733	426
		Total Canada Bills**			1,528	238

* Includes 10-day, 24-day, 31-day, 38-day, three-month, six-month and one-year treasury bills.
** Canada Bills are short-term U.S.-dollar-denominated notes issued for terms not exceeding 270 days.
(1) Maturity of 12½% bonds issued Feb. 1, 1981
(2) In addition to $125 million of 9¾% bonds due Dec. 15, 1988 already outstanding
(3) Maturity of 10½% bonds issued Mar. 6, 1984
(4) Maturity of 10% bonds issued Feb. 22, 1983, Mar. 15, 1983, Apr. 27, 1983, Oct. 15, 1983, Nov. 8, 1983
(5) In addition to $300 million of 9¾% bonds due Dec. 15, 1988 already outstanding
(6) In addition to $300 million of 9¾% bonds due May 1, 1991 already outstanding
(7) Cancellation of $22.5 million of 9½% Oct. 1, 2003 bonds, $19.1 million of 10% Oct. 1, 1995 bonds, $18.1 million of 9% Oct. 15, 1999 bonds, $29.3 million of 9½% June 15, 1994 bonds, $30.0 million of 9¼% May 15, 1997 bonds, $7.5 million of 8¾% Feb. 1, 2002 bonds, $32.5 million of 9½% Oct. 1, 2001 bonds, and $12.5 million of 9¾% Dec. 15, 2000 bonds
(8) In addition to $150 million of 9¼% bonds due Apr. 15, 1989 already outstanding
(9) In addition to $375 million of 9¼% bonds due Mar. 1, 1991 already outstanding
(10) Maturity of 14½% bonds issued May 1, 1981
(11) In addition to $125 million of 8½% bonds due July 1, 1989 already outstanding
(12) In addition to $225 million of 8½% bonds due July 1, 1991 already outstanding
(13) In addition to $425 million of 8¾% bonds due June 1, 1996 already outstanding
(14) Maturity of 15¼% bonds issued June 1, 1981, July 31, 1981
(15) Maturity of 13% bonds issued June 6, 1984
(16) In addition to $550 million of 8½% bonds due July 1, 1991 already outstanding
(17) Maturity of 14¾% bonds issued July 1, 1981
(18) In addition to $300 million of 8½% bonds due July 1, 1989 already outstanding
(19) In addition to $1,050 million of 8½% bonds due July 1, 1991 already outstanding
(20) In addition to $450 million of 8½% bonds due July 1, 1989 already outstanding
(21) In addition to $1,400 million of 8½% bonds due July 1, 1991 already outstanding
(22) In addition to $825 million of 8¾% bonds due June 1, 1996 already outstanding
(23) In addition to $625 million of 8½% bonds due July 1, 1989 already outstanding
(24) In addition to $325 million of 9% bonds due Mar. 1, 2011 already outstanding
(25) Maturity of 12¼% bonds issued Sept. 5, 1984
(26) Maturity of 8% bonds issued Apr. 1, 1977
(27) Maturity of 18% bonds issued Oct. 15, 1981
(28) In addition to $725 million of 8½% bonds due July 1, 1989 already outstanding

(Continued)

APPENDIX TABLE V (Continued)

(29) In addition to \$400 million of 8¾% bonds due Dec. 15, 1991 already outstanding
(30) In addition to \$1,175 million of 8¾% bonds due June 1, 1996 already outstanding
(31) In addition to \$850 million of 8½% bonds due July 1, 1989 already outstanding
(32) In addition to \$800 million of 8¾% bonds due Dec. 15, 1991 already outstanding
(33) In addition to \$650 million of 9% bonds due Mar. 1, 2011 already outstanding
(34) In addition to \$1,100 million of 8¾% bonds due Dec. 15, 1991 already outstanding
(35) Maturity of 10¾% bonds issued Dec. 5, 1984
(36) Maturity of 10% bonds issued Dec. 15, 1983, Feb. 1, 1984
(37) In addition to \$1,100 million of 8½% bonds due July 1, 1989 already outstanding
(38) In addition to \$1,550 million of 8¾% bonds due June 1, 1996 already outstanding
(39) In addition to \$950 million of 9% bonds due Mar. 1, 2011 already outstanding
(40) Excludes CNR bonds
(41) Issued in the Euro-Yen market
(42) Swapped into a variable rate U.S. dollar liability based on 6-month LIBOR minus about 55 basis points.
(43) Issued in the Euro-U.S. market
(44) Cancellation of SFr 12.0 million of 3⅝% Mar. 20, 1989 bonds
(45) Partial redemption at par of U.S. \$0.8 million 5% issue due Oct. 15, 1987 for sinking fund
(46) Yen 20,000 million was swapped into a variable rate U.S. dollar liability based on 6-month LIBOR minus about 54 basis points.
(47) Maturity of U.S. \$300 million 16¼% bonds issued Nov. 3, 1981

BANK OF CANADA Statement of Revenue and Expense

Year Ended December 31, 1986
(with comparative figures for 1985)

	1986	1985
	(thousands of dollars)	
REVENUE		
Revenue from investments and other sources net of interest paid on deposits of $6,601 ($4,552 in 1985)	$2,092,189	$2,027,447
EXPENSE		
Salaries[1]	$ 62,234	$ 57,018
Contributions to pension and insurance funds[2]	7,040	8,073
Other staff expenses[3]	1,411	1,564
Directors' fees	109	70
Auditors' fees and expenses	740	380
Taxes – municipal and business	8,161	7,496
Banknote costs	32,561	33,007
Data processing and computer costs	5,745	5,142
Premises maintenance – net of rental income[4]	14,805	12,585
Printing of publications	541	459
Other printing and stationery	2,119	1,831
Postage and express	2,158	2,106
Telecommunications	1,574	1,817
Travel and staff transfers	2,009	2,112
Other expenses	2,067	1,770
	143,274	135,430
Depreciation on buildings and equipment	12,449	11,986
	155,723	147,416
NET REVENUE PAYABLE TO RECEIVER GENERAL FOR CANADA	$1,936,466	$1,880,031

(1) Salaries include overtime and are for Bank staff other than those engaged in premises maintenance. The number of employee years worked by such staff (including temporary, part-time and overtime work) was 2,289 in 1986 compared with 2,215 in 1985.
(2) Contributions to pension and insurance funds for Bank staff other than those engaged in premises maintenance.
(3) Other staff expenses include retirement allowances and educational training costs.
(4) Premises maintenance comprises building and equipment maintenance expenses including related staff costs.

(See accompanying notes to the financial statements)

BANK OF CANADA Statement of Assets and Liabilities

as at December 31, 1986
(with comparative figures for 1985)

ASSETS	1986	1985
	(thousands of dollars)	
Deposits payable in foreign currencies:		
U.S.A. dollars	$ 314,896	$ 533,581
Other currencies	8,159	35,723
	323,055	569,304
Advances to members of the Canadian Payments Association (note 2)	867,531	3,468,756
Investments — at amortized values (note 3):		
Treasury bills of Canada	7,803,859	3,983,915
Other securities issued or guaranteed by Canada maturing within three years	2,969,430	3,459,594
Other securities issued or guaranteed by Canada not maturing within three years	7,437,840	8,223,748
Other investments	1,024,157	2,633
	19,235,286	15,669,890
Bank premises (note 4)	138,472	118,471
Cheques drawn on members of the Canadian Payments Association (note 8)	—	767,344
Accrued interest on investments	323,363	345,224
Collections and payments in process of settlement:		
Government of Canada (net) (note 8)	—	145,771
Other assets	57,008	49,830
	$20,944,715	$21,134,590

(See accompanying notes to the financial statements)

LIABILITIES	1986	1985
	(thousands of dollars)	
Capital paid up (note 5)	$ 5,000	$ 5,000
Rest fund (note 6)	25,000	25,000
Notes in circulation	17,911,360	16,671,992
Deposits:		
Government of Canada	48,647	313,416
Chartered banks	2,446,039	2,201,122
Other members of the Canadian Payments Association	241,211	205,528
Other deposits	159,132	168,238
	2,895,029	2,888,304
Liabilities payable in foreign currencies:		
Government of Canada	86,992	371,943
Other	27	27
	87,019	371,970
Bank of Canada cheques outstanding (note 8)	11,351	935,793
Other liabilities (note 7)	9,956	236,531
	$20,944,715	$21,134,590

Governor, **G. K. BOUEY** Chief Accountant, **J. E. H. CONDER**

Auditors' Report We have examined the statement of assets and liabilities of the Bank of Canada as at December 31, 1986 and the statement of revenue 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, 1986 and the results of its operations for the year then ended in accordance with the accompanying summary of significant accounting policies, applied on a basis consistent with that of the preceding year.

ARTHUR ANDERSEN & CO. **ERNST & WHINNEY**

Ottawa, Canada, January 15, 1987.

BANK OF CANADA Notes to the Financial Statements
December 31, 1986

1. Significant Accounting Policies

The financial statements of the Bank conform to the disclosure and accounting requirements of the Bank of Canada Act and the Bank's by-laws. The significant accounting policies of the Bank are:

a. Revenues and Expenses

Revenues and expenses are accounted for on the accrual basis except for interest on advances to a bank ordered to be wound up where interest is recorded as received.

b. Investments

Investments, consisting mainly of Government of Canada treasury bills and bonds, are recorded at cost adjusted for amortization of purchase discounts and premiums. The amortization as well as gains and losses on disposition are included in revenue.

c. Translation of Foreign Currencies

Assets and liabilities in foreign currencies are translated to Canadian dollars at the rates of exchange prevailing at the year-end. Gains and losses from translation of, and transactions in, foreign currencies are included in revenue.

d. Bank Premises

Bank premises, consisting of land, buildings and equipment, are recorded at cost less accumulated depreciation. Depreciation is calculated on the declining balance method using the following annual rates:

Buildings	5%
Computer equipment	35%
Other equipment	20%

2. Advances to Members of the Canadian Payments Association

Advances as at December 31, 1986 include a total of $790,831,007 ($1,575,555,885 in 1985) provided to the Canadian Commercial Bank and the Northland Bank for which winding-up orders have been issued by the courts. The liquidators appointed by the courts were also appointed as agents of the Bank of Canada for the purpose of realizing on the loan portfolios held as security against the respective advances.

To ensure the maximum return on the realization of the loan portfolios, the liquidations may extend over several years. On the basis of the information available at December 31, 1986, it is the opinion of the Bank of Canada that its advances will be fully repaid from the proceeds of the liquidations.

3. Investments

Included are securities of the Government of Canada held under Purchase and Resale Agreements (PRA). As at December 31, 1986 there were no securities held under PRA ($75,145,489 in 1985).

4. Bank Premises

	(thousands of dollars) 1986			1985
	Cost	Accumulated depreciation	Net	Net
Land and buildings	$138,572	$53,820	$ 84,752	$ 63,200
Computer equipment	26,436	17,678	8,758	9,721
Other equipment	34,964	20,411	14,553	13,112
	199,972	91,909	108,063	86,033
Projects in progress	30,409		30,409	32,438
	$230,381	$91,909	$138,472	$118,471

5. Capital

The authorized capital of the Bank is $5,000,000 divided into 100,000 shares of the par value of $50 each. The shares are fully paid and in accordance with the Bank of Canada Act have been issued to the Minister of Finance, who is holding them on behalf of Canada.

6. Rest Fund

The rest fund was established by the Bank of Canada Act and represents the general reserve of the Bank. In accordance with the Act, the rest fund was accumulated out of net revenue until it reached the stipulated maximum amount of $25,000,000 in 1955. Subsequently all net revenues have been paid to the Receiver General for Canada.

7. Other Liabilities

As at December 31, 1986, all net revenue for 1986 had been paid to the Receiver General for Canada. (In 1985, $230,031,132 was paid subsequent to year-end.)

8. Settlement of Daily Clearing of Cheques and Other Payment Items

In response to a request from the Canadian Payments Association, the Bank of Canada took steps during 1986 to eliminate the effect of the one-day lag in the settlement of the daily clearing of cheques and other payment items among banks and other deposit-taking institutions. This change resulted in the elimination or substantial reduction in payment items in process of settlement, as reflected in the relevant categories in the Statement of Assets and Liabilities. The corresponding figures for 1985 reflect a one-day lag in settlement.

9. Contingent Liabilities

The Bank has agreed with the Bank for International Settlements to participate in an international initiative to provide credit facilities to the International Monetary Fund. The Bank's potential liability under this agreement, which expires in June 1988, is limited to the placing of deposits with the Bank for International Settlements, if required, to finance loans made under the facility. Pursuant to the agreement, the Bank is contingently liable in the amount of SDR 176,407,186 ($297,884,147 at the December 31, 1986 exchange rate).

During 1986 the Bank of Canada also participated in an international initiative to provide short-term credit facilities to the Banco de Mexico through the Bank for International Settlements. Under this arrangement, the Bank's potential liability is limited to the placing of deposits with the Bank for International Settlements in the event that repayments due under the credit facility are not met. As at December 31, 1986, the Bank of Canada's contingent liability on the principal amount outstanding under this arrangement was U.S.$16,356,635 ($22,580,334 at the December 31, 1986 exchange rate); a repayment by the Banco de Mexico on January 5, 1987 reduced the Bank of Canada's potential liability to U.S.$10,160,923 ($13,961,108 at the January 5, 1987 exchange rate).

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K. W. Kaine, *Deputy Chief*

Comptroller's Department
J. E. H. Conder, *Comptroller and Chief Accountant*
J. Cosier, *Deputy Comptroller*
E. W. Chinn, *Senior Adviser and Coordinator, Office of Systems and Methods*

Audit Department
J. M. E. Morin, *Auditor*
M. Muzyka, *Deputy Auditor*

(1) Also Chairman of the Board of Directors of the Canadian Payments Association
(2) On leave of absence as Interim General Manager of the Canadian Payments Association
(3) Also Alternate Chairman of the Board of Directors of the Canadian Payments Association

Regional Representatives and Agencies

Securities Department

TORONTO	D. R. CAMERON, *Chief, Toronto Division*
MONTREAL	J. CLÉMENT, *Chief, Montreal Division*
VANCOUVER	R. C. WHITE, *Representative*

International Department

TORONTO	T. H. WILLIAMS, *Foreign Exchange Representative*
MONTREAL	G. HOOJA, *Foreign Exchange Adviser*

Department of Banking Operations

HALIFAX	R. E. BURGESS, *Agent*
SAINT JOHN, N.B.	K. T. MCGILL, *Agent*
MONTREAL	R. MARCOTTE, *Agent*
	J. G. M. SABOURIN, *Assistant Agent*
OTTAWA	R. DUPONT, *Agent*
TORONTO	C. R. TOUSAW, *Agent and Banking Operations Adviser*
	P. W. CLIFFEN, *Deputy Agent*
	W. H. WATSON, *Assistant Agent*
WINNIPEG	A. H. POTTER, *Agent*
REGINA	G. L. PAGE, *Agent*
CALGARY	A. G. KEITH, *Agent and Regional Financial Representative*
	C. P. DESAUTELS, *Deputy Agent*
VANCOUVER	G. H. SMITH, *Agent*