



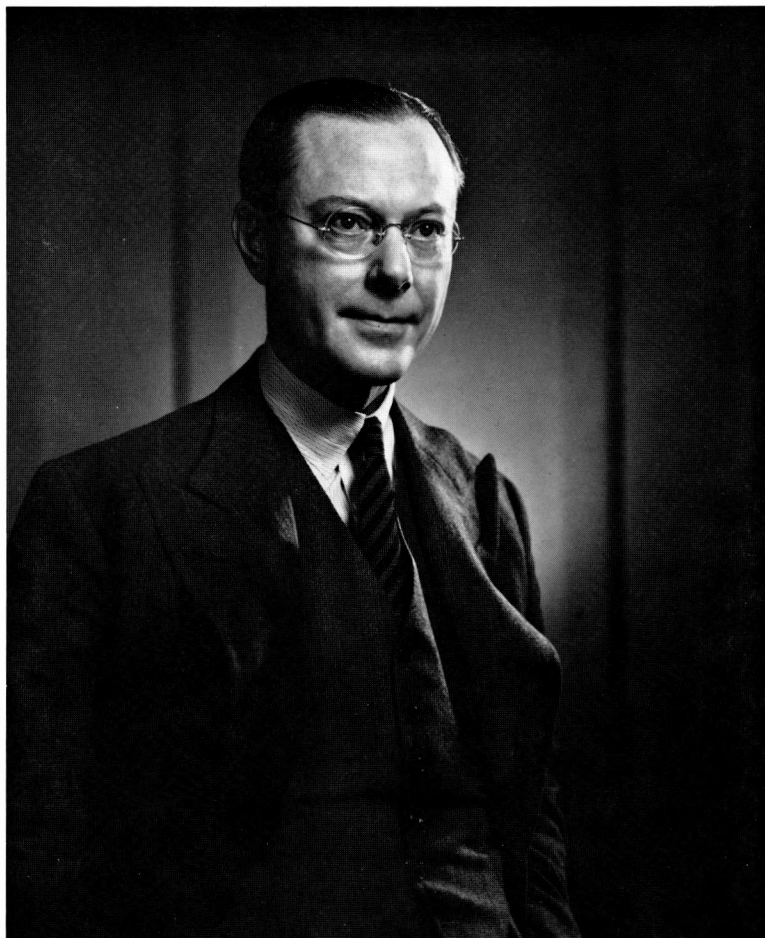
BANK OF CANADA

**ANNUAL REPORT TO
MINISTER OF FINANCE**

AND STATEMENT OF ACCOUNTS

FOR THE YEAR *1954*

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1954



KARSH

Graham Ford Towers, C.M.G.
First Governor

BANK OF CANADA

February 28th, 1955.

THE HON. W. E. HARRIS,
Minister of Finance,
Ottawa.

Dear Sir,

In accordance with the provisions of the Bank of Canada Act, I am enclosing herewith in duplicate a statement of the Bank's accounts for the fiscal year 1954, signed by the Governor and the Chief Accountant and certified by the Auditors, in the form prescribed by the by-laws of the Bank.

On September 10, 1954 Mr. Graham F. Towers completed a period of twenty years as Governor of the Bank. Prior to that time he had expressed to the Directors his wish to retire at the end of the year, and the Board announced in November that they had regretfully agreed to his request. In accepting his resignation the Directors paid tribute to Mr. Towers' outstanding personal qualities and the distinguished service he rendered as first Governor of the Bank.

In 1934 Mr. Towers, then 36 years of age, had attained a position of eminence in commercial banking in Canada. At the request of the Prime Minister he left this career in order to serve the public interest by organizing and heading the new central bank. His position as an outstanding authority in economic and financial matters has been widely recognized both in Canada and abroad. In his farsighted direction of the central bank's operations through the first twenty years of its existence he made a unique contribution to the strength of Canada's financial structure and to the development of the entire Canadian economy. It was evident to all who knew him that Mr. Towers consistently thought in terms of the underlying human and material factors as well as the financial ramifications of the problems which came before him.

Throughout the period of his service he discharged his many and varied responsibilities with single-minded devotion to the public interest and with unflinching distinction.

During these twenty years the world environment to which Canada must adapt her affairs was changing continually and sometimes violently. New and pressing economic problems were constantly arising in Canada for the solution of which there were no reliable guides in past experience either here or in other countries.

When the Bank opened for business in March 1935 the world-wide depression had been subjecting the Canadian economy to great strains for five years. Unemployment was at a high level, production was far below capacity and the burden of fixed interest debt, both public and private, had become a serious problem. The situation called for a policy of monetary expansion to reduce interest rates and facilitate borrowing for new capital and refunding purposes. During this period provincial finances and debts posed some particularly serious problems which ultimately led to an examination of all aspects of federal-provincial relations by the Rowell-Sirois Royal Commission. Preparations were made for the establishment of a Bank of Canada subsidiary, the Central Mortgage Bank, to refund private mortgage debts at lower interest rates, but subsequent events removed the need for such an institution and it never came into operation.

By 1938 it became unhappily necessary to consider possible financial developments in the event of war. If at an early stage Canada were involved and the United States were not, there was obvious danger of an outflow of capital which could have exhausted our foreign exchange reserves. In September 1939, within a week of Canada entering the war, a full-fledged system of foreign exchange control was in operation for which preparations had been made over the previous twelve months.

During the early part of the war speedy mobilization of Canadian resources was the overriding need. At a later stage, with continued expansion of the war effort at a time of full utilization of the nation's physical capacity, problems of restricting and controlling the civilian economy became a major concern of policy. In the industrial field this involved priorities, allocations and rationing. In the financial field it involved the highest level of taxation that was practicable, and an all out effort through the agency of the National War Finance Committee to promote saving. Realization that all these measures taken together were not sufficient to keep prices from rising dangerously even before the United States entered the war led finally to a bold, and in the

event successful, attempt at comprehensive price control, wage control and consumer rationing.

By 1944 preparations were being made in many parts of the world for the post-war reconstruction period. The degree of mobilization was so great that dislocations in the process of demobilization and reconversion in Canada appeared certain to be formidable. Great efforts would also be needed to re-establish international trading arrangements and financial relations which had been disrupted by the war. During this phase Canada took an active part in the preparatory work which ultimately led to the establishment of the International Bank for Reconstruction and Development, the International Monetary Fund and the General Agreement on Tariffs and Trade. In the domestic field preparations were made for setting up the Industrial Development Bank, the Export Credits Insurance Corporation and the Central Mortgage and Housing Corporation. During this period preparations were also being made for the widely-ranging Federal-Provincial Conference on Reconstruction which met in August 1945.

One of the heritages of the war in every country was a large pent-up demand for goods backed by a high level of liquid assets, and world prices rose substantially in the post-war years. This period was also characterized by an unusual degree of uncertainty about the future. The Western European countries had suffered severe physical and economic damage during the war and it soon became apparent that their recovery would be seriously hampered by international tension, and in particular by the "Iron Curtain" which kept the Continent divided. Uncertainty about the extent and speed of European recovery clouded the early post-war outlook for an important part of Canada's traditional export trade. Western European recovery was assisted by United States and Canadian reconstruction loans and, later on, Marshall aid. By the spring of 1950 it seemed that the long struggle against inflation was about over, even allowing for the degree of cold war which existed at the time. However, the outbreak of hostilities in Korea gave rise to a further period of severe upward pressure on world prices. In Canada the inflationary impact was resisted by financial measures rather than by returning to direct controls. The situation was made more difficult by an inward flood of capital of unprecedented proportions. At this time the fixed rate of exchange on the Canadian dollar was suspended in favour of a free market rate, and a little more than a year later foreign exchange control was terminated. Over the whole post-war period, up to 1953, the Canadian economy achieved about as large an increase in employment and output as was physically possible, and a great

increase in its productive capacity, while the rise in prices in Canada was less relative to pre-war than that experienced by any of the Allied countries*.

RECENT ECONOMIC DEVELOPMENTS

At the beginning of 1954 some sections of industry in the United States and Canada were experiencing a recession which had begun some months earlier. This recession grew out of developments during the Korean war, which are a necessary background for comments on the 1953-1954 period.

In the spring of 1950 economic conditions in North America were buoyant. The post-war fight against inflation appeared to have been won. Indeed there had been a brief recession in the United States in 1949 and some slowing in the pace of growth in Canada, but by mid-1950 a normal rate of expansion had been resumed, and both the United States and the Canadian economies were close to being fully employed. This was the situation when the outbreak of hostilities in Korea brought major new complications to the economic scene.

Rapid expansion of the defence programmes of the United States and Canada was accompanied by a wave of inventory accumulation and prices rose sharply, particularly in the case of primary commodities. Tax rates were increased, and monetary and credit restraints and certain direct controls were applied. Production began to respond to the extra demands placed upon it, and as the Korean war settled down to a stalemate the expectations of further inflation largely disappeared. Part of the increase in primary commodity prices was reversed, beginning as early as February 1951. Consumer prices continued to rise for some months as the higher prices for basic commodities worked their way through to the retail level. From the beginning of 1952 on, however, there was approximate stability of consumer prices while, with defence production still rising substantially, both United States and Canada continued to have an unusually high rate of growth in output.

In view of the important role which the defence build-up played in the expansion of United States production there was considerable uncertainty as to the course events might take when defence expenditures began to decline. Some reversal of the tax increases imposed in 1950 and 1951 to pay for defence could be expected, and also a lifting of the monetary and credit restraints,

*Mr. Towers gave a detailed review of post-war monetary policy in a statement made to the Banking and Commerce Committee of the House of Commons on March 18, 1954.

but much would depend upon how well business and consumer confidence could be maintained and how smoothly the nation's production could be shifted from defence goods to other goods. Some feared that the adjustments might turn out to be so substantial and widespread as to become cumulative and start a general downward spiral.

The decline in United States defence expenditure commenced in mid-1953 and at the same time inventories, which had been rising quite sharply, began to be cut back. Business capital expenditures also declined moderately after the third quarter of 1953. Total output of goods and services in the United States fell by about 4 per cent from the second quarter of 1953 to the first quarter of 1954, after allowance for normal seasonal movements.

Notwithstanding the weakening influences mentioned above, the decline did not become cumulative throughout the economy. Expenditure by consumers and by state and local governments increased steadily through 1954 and housing construction rose strongly under the stimulus of easier financing provisions. Total production in the United States leveled out in the first quarter and remained stable over the first nine months of the year. During this period there was a gradual growth of confidence in the business outlook. In the fourth quarter of 1954, as inventory liquidation and the decline in defence expenditure appeared to have run their course, total output began to increase and by the end of the year had climbed about one-half of the way back to its mid-1953 peak.

Canada also experienced a contraction in output in the latter part of 1953 and the causes were similar to those in the United States. However, throughout the period Canada continued to draw some support from the major sources of our post-war economic growth — principally our rapid rate of population growth and of resource development and the sustained world demand for many of our basic commodities — and the contraction in output here came later and was smaller than in the United States. Total production of goods and services other than farms reached its peak in the third quarter of 1953 and, after allowing for normal seasonal movements, had fallen about 2 per cent by the first quarter of 1954. Thereafter non-farm output began to rise again, first slowly, and then more rapidly, and in the final months of the year it appears to have regained and perhaps exceeded its previous peak. Farm output in Canada declined about one-quarter from 1953 to 1954 due to the influence of unfavourable growing conditions on the grain crop.

The immediate cause of much of the decline in non-farm output in Canada was a change in the trend of business inventories. In general Canadian business inventories had grown rapidly, though irregularly, since mid-1950 and were still growing strongly through the first half of 1953. Then inventory accumulation ceased and was soon reversed, largely it would appear because Canadians shared the view which had developed in the United States that a period of adjustment was in prospect. The change in trend of Canadian business inventories from the middle of 1953 to the middle of 1954 appears to have been somewhat greater relative to output than it was in the United States.

There were some other sectors of demand in Canada which declined in the final months of 1953 and the early part of 1954. Business expenditures on construction and equipment were reduced appreciably. Government outlays on defence also declined, by about one-half as much in percentage terms as in the United States. Grain exports in the 1953-54 crop season were reduced by large crops in Europe, and by some liquidation of United Kingdom wheat stocks following the end of state trading in grains in that country. Canadian shipments rose again in the latter part of 1954, but one consequence of the earlier decline in grain exports was that it reduced the amount of grain which the elevators could accept and thus reduced the cash receipts of farmers. Wheat prices declined, and the 1954 harvest was only half that of the previous year. These developments led to lower expenditures by farmers on machinery and on consumer goods and services.

On the other hand, expenditure on new housing continued to expand, assisted by easier financing terms under the National Housing Act and the increased supply of mortgage funds which became available after the chartered banks were empowered to make insured residential mortgage loans. Foreign purchases of Canadian goods other than grains increased on balance, with the rise in shipments to overseas countries being greater than the decline in sales to the United States. Exports of forest products and non-ferrous metals rose substantially; there were reductions in the case of iron and steel, autos and trucks, aircraft and electrical equipment.

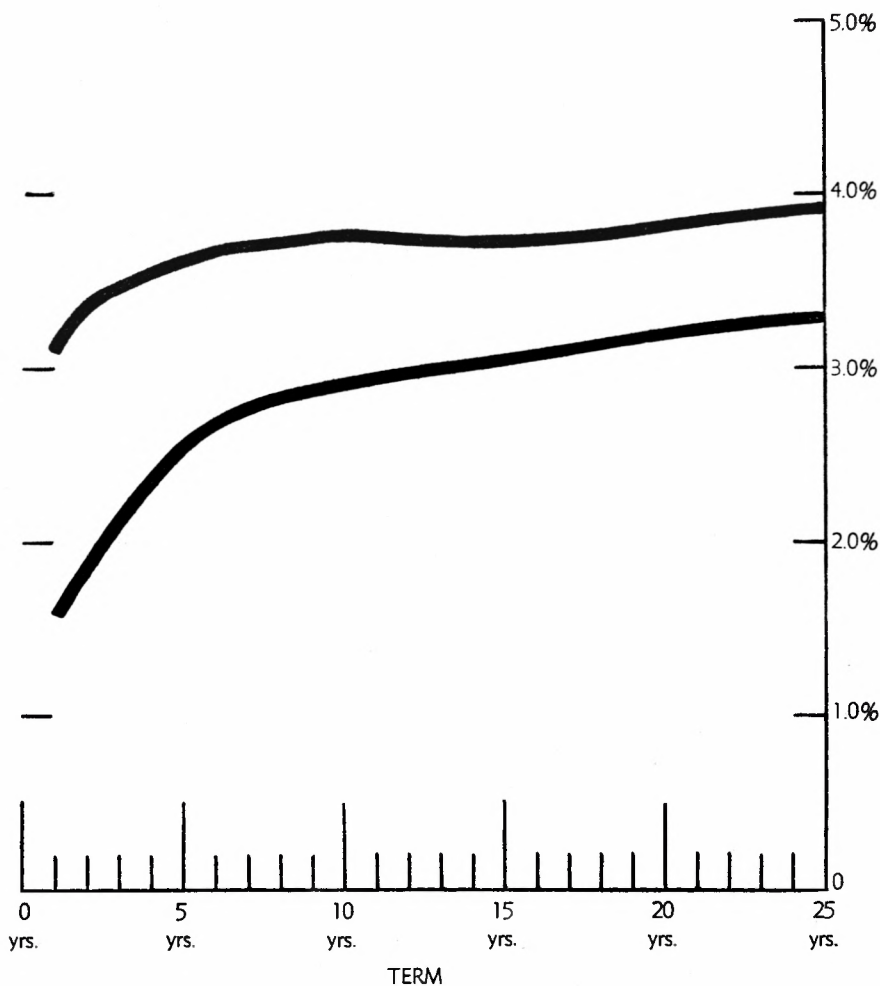
Total expenditure on consumer goods and services continued to expand through 1954, at a somewhat lower rate than in previous years. The decline in consumer expenditure by farmers as a group and by those in industry who were affected by unemployment was less than the increase in expenditure on the part of the much more numerous group whose incomes continued to rise, and total spendable income was enlarged by the tax reduction which

came into effect in July 1953. Expenditures on non-durable goods and services continued generally upward, but purchases of durable goods declined somewhat from the very high levels reached in 1953.



As a result of these conflicting tendencies, total demand was sufficient to prevent more than a minor and temporary decline in total non-farm output from its 1953 peak, but it did not keep pace with the growth of the labour force and according to the labour force survey in December, 1954 there were 247,000 persons without jobs and seeking work, 57,000 more than a year before. There were fairly sharp reductions in output and employment in a number of industries, though in Canada as in the United States the recession was not at any stage a general phenomenon. Declining output in some industries was accompanied by stability in others and by expansion, sometimes rapid expansion, in still others. Activity in the forest products, mining and service industries continued to grow. The construction of homes and municipal facilities rose appreciably through this period. There was also a moderate expansion of output in many sectors of manufacturing, although there were marked declines in textiles, iron and steel, and most of the industries producing durable goods.

In the field of foreign trade one effect of the easing in total demand in Canada was a considerable reduction in imports. After allowing for normal seasonal movements commodity imports fell by more than 10 per cent from their peak in the third quarter of 1953 to the first quarter of 1954, since when there has been a moderate increase. A considerable part of the decline in imports appears to have been associated with the sharp inventory swing in certain industries and the downward trend in private investment in equipment. The overall reduction in imports from 1953 to 1954 was somewhat greater than the decline in exports and the current account deficit in Canada's balance of international payments appears to have declined from its level of \$439 million in 1953.

In 1954, as in 1953, domestic prices were generally stable with relatively few large changes. Except in the case of wheat the movement of world prices appears to have had little influence in either direction. Farm prices as a group were lower, while movements of other basic commodity prices were generally small and divergent; textile and iron and steel prices tended downward and lumber and non-ferrous metal prices strengthened. The consumer price index followed the previous year's movements at a fractionally higher level. Rents and most service costs were appreciably higher, while prices for clothing and many household durables were lower.

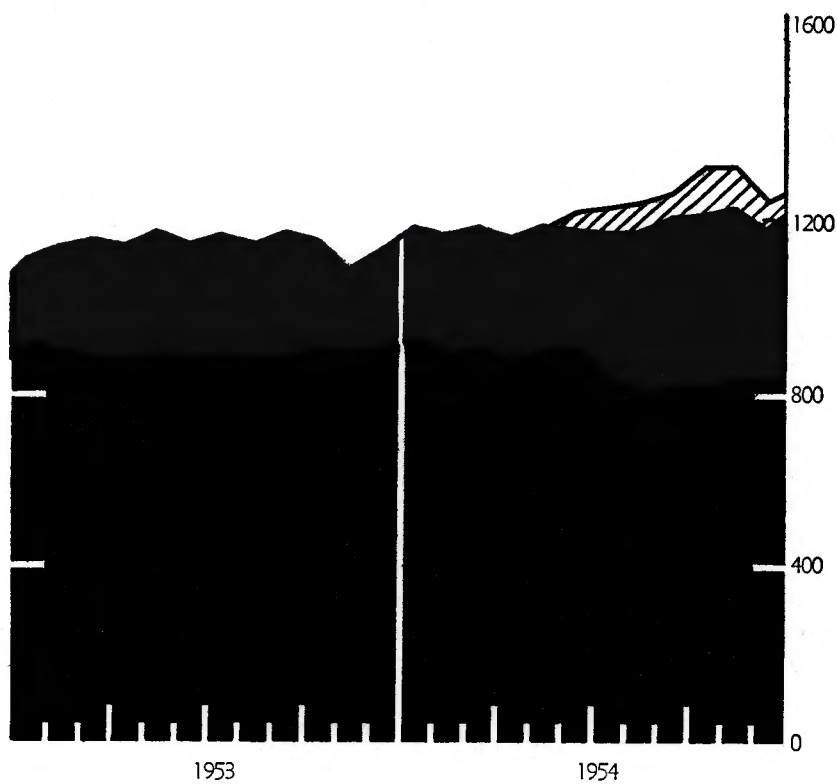


**GOVERNMENT OF CANADA BOND YIELDS
THEORETICAL YIELD CURVES**




 As at September 30, 1953
 As at December 31, 1954

In Western Europe, including the United Kingdom, the trend of activity since mid-1950 has been quite different from that experienced in North America. Western European output showed little increase in 1950 and 1951 and declined slightly in 1952, but growth was resumed by the end of that year and continued at a fairly high rate through 1953 and 1954. Economic activity in Europe was not adversely affected by the 1953-54 recession in the United States as many had feared; on the contrary, the strength of European demand afforded some support to output elsewhere and it seems to have had a firming effect on primary commodity prices through the period. Liberalization of restrictions against imports from Canada and the United States made further progress. The recent expansion in Western Europe has been based on rising output for domestic use by the countries concerned and their trading partners in the non-dollar area and there was some decline in exports to dollar countries in 1954. United States aid and United States defence expenditures in Western Europe were sufficient, however, to enable these countries to increase their gold and dollar reserves appreciably during the past two years.

MONETARY CONDITIONS • From mid-1950 to mid-1953 monetary policy operated to prevent excessive expansion of credit during a period when the total demand for goods and services threatened to exceed the growing production of the economy. This situation changed in the latter part of 1953, and Bank of Canada policy since then has been directed towards easier monetary conditions and the positive encouragement of enterprise so far as the availability of credit is concerned. The cash reserves of the chartered banks have been more than sufficient to enable the banks to meet the demand for loans, which leveled off and showed no increase in December 1954 over December 1953. The banks were in a position therefore to make large purchases of Government securities in the market which added substantially to the amount of money held by the public. In addition, in 1954 the Government had an overall excess of disbursements over receipts which resulted in a reduction of its cash balances and an increase in the money holdings of the public. The result of these developments, reinforced by the influence of declining United States interest rates, was a considerable reduction of interest rates in Canada and a rise in security prices. These changes in the capital market made it easier for those who wished to undertake expenditures to obtain funds either by borrowing or by converting securities into cash.



CHARTERED BANKS: SELECTED LIQUID ASSETS
 Average of Wednesday Figures
 (millions of dollars)

-  Day-to-day loans
-  Treasury bills
-  Cash reserves

BANK CASH • The 1954 revision of the Bank Act changed the minimum required cash reserves of the chartered banks from a fixed daily ratio of 5 per cent of their Canadian deposit liabilities to a daily average of 8 per cent during each calendar month. An amendment to the Bank of Canada Act gave the central bank power to raise the minimum by 1 per cent in any month but not to exceed the figure of 12 per cent. No action has been taken under this authority. Under the former regime the banks in practice worked to a figure of 10 per cent, which gave them a usable reserve of 5 per cent above the fixed minimum. With the adoption of the monthly average of 8 per cent, effective July 1st, the banks soon began to work to lower ratios, and by December the average for the banks as a group was 8.7 per cent, with several banks keeping close to the 8 per cent minimum. Total holdings by the chartered banks of Bank of Canada notes and deposits with the Bank of Canada were \$812 million in December 1954 compared with \$903 million a year earlier.

MONEY MARKET LOANS • The introduction in mid-June of what are known as day-to-day loans was an important development affecting both banking practices and the short-term securities market or "money market". These loans are made by chartered banks against the pledge of treasury bills and Government of Canada bonds maturing within three years. The borrowers are those bond dealers who are prepared to act as jobbers in the short-term market and who have entered into purchase and resale arrangements with the Bank of Canada. Day-to-day loans may be called for payment at any time and the willingness of the Bank of Canada to purchase securities under resale agreements provides an underlying assurance of liquidity.

From January 1953 to June 1954 the Bank of Canada had made a considerable amount of funds available for the financing of dealers' inventories of treasury bills and short-term Government bonds through purchase and resale agreements. The total provided in this way reached a maximum of \$73 million in June. Subsequently, day-to-day loans from the chartered banks provided this financing in amounts which, as at the close of business on Wednesdays, varied between a low of \$44 million and a high of \$135 million, and Bank of Canada facilities were infrequently used.

In addition to providing a source of funds to finance dealers' inventories of short-term Government securities, day-to-day loans

afford a convenient and efficient means whereby the chartered banks may adjust surplus or inadequate cash reserve positions. A bank desiring to replenish its cash reserves may call part or all of its day-to-day loans and present the borrower's cheque through the Clearing House for credit to its account with the Bank of Canada the following day*. When the day-to-day loan rate is below Bank Rate, as has consistently been the case, the borrower whose loan is called has a strong incentive to obtain the funds required to repay the loan from another chartered bank which has surplus cash, rather than from the Bank of Canada under a purchase and resale agreement. One of the effects of the call and the new loan is to transfer deposits at the Bank of Canada from the lending to the calling bank. If the borrower is not successful in obtaining a day-to-day loan from another bank and obtains the funds from the Bank of Canada, the initial effect is to increase the total cash reserves available in the system, as the calling bank receives an addition to its cash without a corresponding decrease in any other bank's cash.

INSURED MORTGAGE LOANS • The revised National Housing Act which became effective on March 22, 1954 authorized the chartered banks to finance housing construction by investing in mortgages insured under the Act. This power was subsequently incorporated in the 1954 revision of the Bank Act. Insured mortgage loans are made by approved lending institutions, including life insurance companies, trust companies and loan companies, as well as the chartered banks and savings banks, and are insured for 98 per cent of the principal amount. The typical insurance premium is 2 per cent of the loan, collected in advance from the borrower. The maximum authorized rate of interest on these loans in 1954 was $5\frac{1}{2}$ per cent and it is understood that none were made at less than this rate.

Prior to March 1954 the banks had, with only minor exceptions, been prohibited from lending on the security of mortgages on real estate. By the year-end they had made insured mortgage loan commitments on 17,000 housing units amounting to about

* A bank can obtain additional cash on the same day by borrowing from the Bank of Canada. In the case of sales of treasury bills, Government of Canada bonds maturing within 5 years, and longer-term Government of Canada bonds, market practices respecting delivery and payment dates have the result that cash is received on the second, third and fourth days, respectively, after the day of the sale.

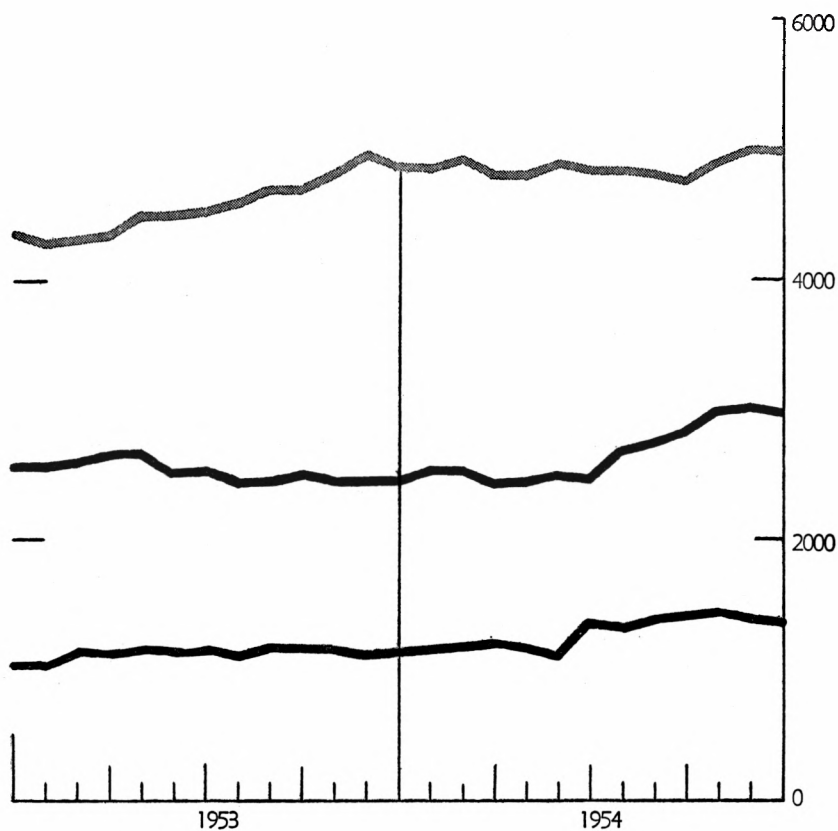
\$160 million; net disbursements on such loans were \$74 million. In the second half of the year about 40 per cent of all insured loans were being made by banks.

The chartered banks' participation in residential mortgage lending has enlarged their role in the financing of investment in Canada and improved the general structure and flexibility of the capital market. To some extent the participation of the banks makes possible a larger total volume of institutional lending for new housing; to the extent that bank lending displaces loans that would otherwise have been made by other institutions, the equivalent funds are available in the hands of such institutions for lending in other sections of the capital market. An important new feature in the mortgage lending field is that the chartered banks with their widespread branch office system are in a position to lend on home mortgages not only in the larger urban areas but also in the smaller cities and towns which other institutional lenders had not been able to serve.




CHARTERED BANKS • Major Canadian Assets and Deposit Liabilities

(Monthly overages of Wednesday figures in millions of dollars)

	Total Dec. 1954	Change from Dec. 1953
Bank of Canada deposits and notes	812	-91
Day-to-day loans	81	+ 81
Treasury bills	350	+116
Sub-total	1,243	+106
Government of Canada bonds	2,946	+449
Other Canadian securities	776	+ 6
Insured residential mortgages	63	+ 63
Loans in Canada (ex. day-to-day loans)	4,167	+ 45
Total of foregoing assets	9,195	+669
Canadian deposit liabilities	9,481	+639



CHARTERED BANKS: MAJOR CANADIAN ASSETS
month-end
 (millions of dollars)

-  Loans in Canada (ex. day-to-day loans), insured mortgages, and provincial, municipal and corporate securities
-  Government of Canada securities (excluding treasury bills)
-  Cash, day-to-day loans and treasury bills

With inventories declining and consumer credit rising only moderately the increase over the past year in the amount of loans outstanding has been small, and in order to make full use of their cash reserves the banks have purchased Government securities in the market on a substantial scale. As a result of these and other changes in the banks' assets their Canadian deposit liabilities rose by 7 per cent during 1954.

The decline in the chartered banks' holdings of cash (Bank of Canada notes and deposits with the Bank of Canada) which is shown in the table on page 13 is not an indication that the banks were in a tight cash position during 1954. In the first part of the year they were able to be active buyers of treasury bills without reducing their average reserve ratios below 10 per cent in any month. When the arrangements for introducing day-to-day loans were completed in June the banks were able to make \$86 million of such loans in the first week. During the second half of the year they continued to make substantial amounts available for day-to-day loans, added further to their holdings of treasury bills, and were net buyers of Government bonds on a large scale. The total of their most liquid assets—cash, day-to-day loans and treasury bills—rose by \$106 million, or 9 per cent, from December 1953 to December 1954.

For a detailed classification of changes in chartered bank loans it is necessary to use December 31st data rather than the December averages of Wednesday figures which appear in the foregoing table. Changes in loans in 1953 and 1954 are summarized on the following page.

Loans to industry and merchandisers, which rose sharply in 1953 as shown in this table, declined during 1954, a reflection of the change from increasing to decreasing business inventories. Similarly the level of loans to both merchandisers and instalment finance companies was affected by the marked slowing down in the growth of outstanding consumer credit during the past year. It is estimated on a preliminary basis that the increase in consumer credit outstanding was of the order of \$125 million in 1954 as compared to an increase of \$314 million in 1953. The level of bank loans to instalment finance companies was also affected by the fact that these companies made greater use of non-bank sources of finance during the past year.

The 1954 revision of the Bank Act for the first time authorized the chartered banks when making personal loans to take security on motor vehicles and other consumer durable goods. Little use was made of this authority during 1954.

Personal loans other than against securities continued to rise in 1954 but at a somewhat lower rate than in 1953. Loans to grain dealers, which depend mainly on the volume of grain in commercial channels, had risen to a high level following the large crops of 1952 and 1953 and showed little change during 1954. Loans to farmers also showed little increase; purchases of farm machinery and equipment were substantially less in 1954 than in the previous year.

Estimated Changes in Chartered Bank Loans ⁽¹⁾ in Canada

(millions of dollars)

	Dec. 31/52 to Dec. 31/53	Dec. 31/53 to Dec. 31/54
Industry	+151	-47
Merchandisers	+101	-22
Instalment finance companies	+ 21	-45
Personal (other than on securities)	+ 66	+43
Grain dealers and exporters	+134	+13
Farmers	+ 25	+ 5
Government ⁽²⁾ and other public services	- 5	+14
For the purchase of Canada Savings Bonds	+ 19	-18
On securities ⁽³⁾	+ 18	-14
All other	+ 56	+60
	<u>+587</u>	<u>-11⁽⁴⁾</u>

(1) Excluding day-to-day loans.

(2) Excluding Government of Canada.

(3) Including personal loans on the security of stocks and bonds.

(4) After the revision of the Bank Act month-end adjustments to loans for items in transit were discontinued; if the December 31, 1954 figure for total loans had been strictly comparable with that of December 31, 1953 the change would have been approximately +15 to +25.

LIQUID ASSETS OF THE GENERAL PUBLIC • The total amount of currency, bank deposits and Government of Canada securities held by the general public rose by much the same order of magnitude in 1954 (\$236 million) as in 1953 (\$264 million) but the sources and composition of the increases were quite different.

**General Public Holdings of Currency, Bank Deposits and
Government of Canada Securities⁽¹⁾**

(millions of dollars)

	<u>Total as at</u> <u>Dec. 31/54</u>	<u>Change During</u>	
		<u>1953</u>	<u>1954</u>
Liquid Assets			
Currency (notes and coin)	1,458	+ 52	+ 29
Bank deposits	8,689	— 9	+773
Government of Canada securities	8,717	+221	—566
Total	<u>18,864</u>	<u>+264</u>	<u>+236</u>
Factors accounting for change in total liquid assets			
Government of Canada operations ⁽²⁾		—220	+231
Chartered bank operations		+466	+ 19
All other (net)		+ 18	— 14
		<u>+264</u>	<u>+236</u>

(1) Includes all holdings other than those of the banking system and the Government of Canada (including the Unemployment Insurance Fund and other Government accounts).

(2) Operations other than funded debt transactions of the Government including the Unemployment Insurance Fund and other Government accounts. (+) denotes an overall excess of disbursements over receipts, which produces an increase in the liquid asset holdings of the general public of a corresponding amount, the composition of the increase depending on the nature of Government financing. (—) denotes an excess of receipts over disbursements which has the opposite effect.

In 1953 the increase in public holdings of liquid assets arose principally from the sharp increase in bank loans. The Government (including the Unemployment Insurance Fund and other Government accounts) had an overall surplus of receipts over disbursements which had the effect of offsetting about half the increase in liquid asset holdings arising from the banks' activities.

Distribution of Outstanding Direct and Guaranteed Securities of the Government of Canada

(millions of dollars)

Holder	As at	Change in	
	Dec. 31/54	1953	1954
Bank of Canada			
Treasury bills	168	+ 92	-206
Other issues	2,054	- 48	+158
Total	2,222	+ 43	- 48
Chartered Banks			
Treasury bills	360	+106	+116
Other issues	2,953	-130	+437
Total	3,313	- 24	+553
Government Accounts			
Unemployment Insurance Fund			
Treasury bills	40	-	+ 40
Other issues	852	+ 60	- 67
Other Accounts			
Treasury bills	1	+ 5	- 4
Other issues	311	+148	- 79
Total	1,204	+213	-110
General Public			
Treasury bills	211	- 4	+186
Other market issues	6,412	-157	-1,214
Non-market issues	2,094	+382	+462
Total	8,717	+221	-566
of which			
Non-residents	720 ⁽¹⁾	-120	-115 ⁽¹⁾
Resident life insurance companies	850 ⁽¹⁾	- 49	-110 ⁽¹⁾
All other holders ⁽²⁾	7,147 ⁽¹⁾	+390	-341 ⁽¹⁾
Total Outstanding			
Treasury bills	780	+200	+130
Other market issues	12,582	-129	-763
Non-market issues	2,094	+382	+462
Total	15,456	+453	-171

(1) Preliminary estimates.

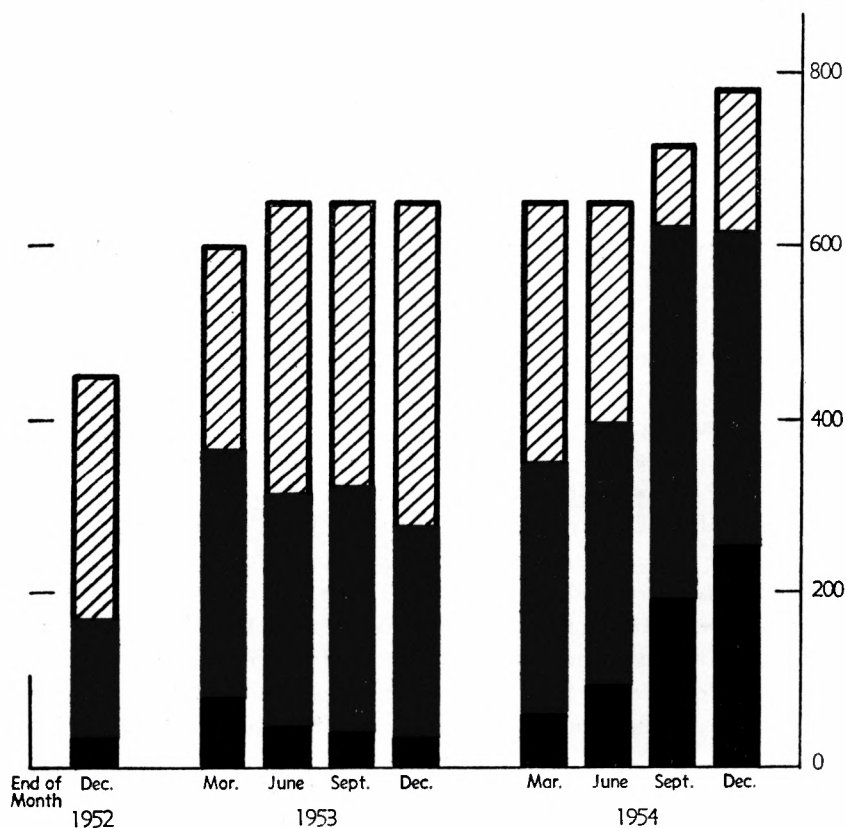
(2) Includes all non-market issues.

In 1954, by contrast, total disbursements were considerably greater than total receipts so that the operations of the Government produced an appreciable net increase in the public's holdings of liquid assets while the operations of the chartered banks had little net effect.

A number of factors were involved in the large change from 1953 to 1954 in the overall position of the Government of Canada. In calendar 1953 budgetary revenue and budgetary expenditure were in balance but in 1954 revenue declined more than expenditure. More money was required in 1954 to finance non-budgetary transactions, including the purchase of foreign exchange by the Exchange Fund. In addition, whereas in 1953 the receipts of the Unemployment Insurance Fund had exceeded payments, there was a net outflow of funds from this account in 1954.




There was a substantial shift during 1954 in the general public's holdings from Government securities to bank deposits. This was facilitated by several large redemptions of Government securities which put cash into the hands of the public, but the greater part of the reduction in the general public's holdings of Government securities was effected by market sales to the chartered banks, particularly in the second half of the year. Non-residents (chiefly non-resident United States life insurance companies) are estimated to have reduced their holdings of Government securities by \$115 million, about the same as in 1953. Net sales by resident life insurance companies at \$110 million were more than twice as great as in 1953, the funds so raised being used to finance a larger volume of new investments on their part, particularly in mortgage loans. The net sales of other members of the general public were \$341 million, the result of an increase of \$471 million in their holdings of Canada Savings Bonds, a decrease of \$9 million in War Savings Certificates, now completely retired, and a decrease of \$803 million in their holdings of Government market issues.

Of the total increase during the year of \$773 million in the bank deposits of the general public, \$462 million went into personal savings deposits, \$119 million into corporate notice deposits, and \$192 million into all other deposits.



**GOVERNMENT OF CANADA TREASURY BILLS:
DISTRIBUTION OF HOLDINGS**

(millions of dollars)

-  Bank of Canada
-  Chartered banks
-  All other

SECURITIES MARKETS • Yields on Government of Canada bonds declined in the last quarter of 1953 following with some lag the general trend of interest rates in the United States. In the first quarter of 1954 Canadian rates declined more rapidly than United States rates and the spread between longer-term rates in the two countries, which had been relatively high since 1951, was greatly reduced. After the end of March there was little decline in long-term yields but there was a further appreciable decrease in short-term rates.

Government of Canada Bond Yields

(based on theoretical maturities)

Term to maturity	Yield at		
	Sept. 30 1953	Mar. 31 1954	Dec. 31 1954
One year	3.12	2.00	1.60
Two years	3.38	2.23	1.89
Five years	3.65	2.93	2.59
Ten years	3.79	3.01	2.93
Fifteen years	3.75	3.06	3.06
Twenty years	3.84	3.29	3.21
Twenty-five years	3.93	3.38	3.30

As part of the general development of the short-term money market in 1954 there was a very substantial increase in the amount of treasury bills held outside the banking system and Government accounts. The demand for treasury bills was strong throughout the year, and average yields at tenders of the three-months treasury bills fell from 1.88 per cent in December 1953 to 1.08 per cent in December 1954. The comparable yields for nine-months bills were 2.65 per cent and 1.37 per cent.

Day-to-day loans were introduced in June at an interest rate of $1\frac{1}{2}$ per cent, dropped to 1 per cent in July, and after some intervening fluctuations stood at $\frac{3}{4}$ per cent at the end of the year.

Provincial governments, municipalities and corporations all raised much greater amounts of money on the Canadian market in 1954. Net new issues by these borrowers at \$799 million were 60 per cent higher than in 1953. Corporate stock issues, on the other hand, declined about 22 per cent. Net borrowings abroad by each of these categories of borrowers were substantially reduced, particularly after the first quarter of the year. On balance, total new funds raised in all markets by security issues showed a rise of about 12 per cent over the previous year.

**Estimated Net New Issues⁽¹⁾ of Provincial, Municipal
and Corporate Securities**
(millions of dollars)

	Payable in Canadian Dollars Only		Payable Wholly or Optionally Abroad		Total	
	1953	1954	1953	1954	1953	1954
Provincial Bonds ⁽²⁾	119	236	112	55	231	291
Municipal Bonds	185	237	55	11	240	248
Corporate Bonds ⁽³⁾	198	326	101	83	299	409
Total Bonds	502	799	268	149	770	948
Corporate Stocks					236	184 ⁽⁴⁾
Total					1,006	1,132

(1) New issues less retirements.

(2) Including municipal and other issues guaranteed by provinces.

(3) Including CNR unguaranteed bond retirements.

(4) Excluding the issues of United States investment funds.

INTERNATIONAL CAPITAL ACCOUNT • Recent trends in the movement of capital into and out of Canada are shown on the the opposite page by a grouping of quarterly estimates up to the latest quarter available.

The inflow of capital for direct investment in Canada during the middle months of 1954 was somewhat lower than a year earlier, reflecting both the completion of certain large projects and the limitation on oil exploration and development imposed by adverse weather conditions. Receipts from sales of new security issues to non-residents rose substantially in the latter part of 1953, remained high for several months, and then fell sharply after March 1954. At the same time retirements of Canadian securities in non-resident hands were rising and in the six months following March 1954 exceeded new issues. Mainly due to the operations of newly-formed United States investment funds net purchases by non-residents of outstanding Canadian shares increased during 1954, and for the year as a whole are estimated to have been about \$120 million, about \$100 million greater than in the previous year. Non-residents continued through 1953 and 1954 to be substantial net sellers of outstanding Government of Canada direct and guaranteed securities while the trade in bonds of other

Canadian issuers tended to be close to balance. The "other capital movements (net)" in the table are mainly movements of short-term capital in the form of changes in commercial accounts receivable and payable and in privately-held foreign currency balances.

Capital Account: Canadian Balance of Payments

(millions of dollars)

	Six Months Totals		
	Apr./53 to Sep./53 inc.	Oct./53 to Mar./54 inc.	Apr./54 to Sep./54 inc.
Capitol Inflows (+) or Outflows (—)			
Direct investment in Canada ⁽¹⁾	+187	+183	+145
Direct investment abroad ⁽¹⁾	— 20	— 38	— 45
Canadian securities:			
New issues	+ 75	+305	+109
Retirements—Govt. repatriation ⁽²⁾	— 73	—	— 21
—Other	— 24	— 40	— 97
Trade in outstanding shares	+ 11	+ 14	+ 54
Trade in other outstanding securities	— 51	+ 1	— 32
Transactions in foreign securities (net)	+ 1	— 2	— 18
Loan repayments by foreign governments	+ 57	+ 33	+ 29
Increase (+) in Canadian dollar holdings			
of non-residents	— 51	— 26	+ 28
Decrease (+) in official holdings of gold			
and foreign exchange	+ 56	— 38	— 75
Other capital movements (net)	+ 36	—168	+ 80
Total	+204	+224	+157

(1) Exclusive of undistributed profits.

(2) Negotiated repurchases of U.S. pay issues by the Government of Canada in May 1953 and September 1954.

The Canadian dollar continued to be in strong demand on foreign exchange markets during 1954. The average market rate for the United States dollar in Canadian funds was 98.34 cents in 1953 and 97.32 cents in 1954. The closing rates for the year-ends were 97 3/8 cents and 96 19/32 cents, respectively. Official Canadian holdings of gold and United States dollars rose by \$124 million during the year from \$1,819 million U.S. to \$1,943 million U.S.

New Issues and Retirements of Government of Canada Direct and Guaranteed Market Bonds, 1954*

Date of Delivery or Redemption	Type of Security	Amount of		Coupon Rate	Date of Maturity	Earliest Call Date	Issue Price	Yield
		New Issue	Retirement					
Feb. 1	CNR—Govt. Gtd.	200		3 $\frac{3}{4}$	Feb. 1/74	Feb. 1/72	99.50	3.78
Feb. 1	CNR—Govt. Gtd.		50	5	Feb. 1/54	N/C		
Mar. 1	Second Victory Loan		470	3	Mar. 1/54	Mar. 1/52		
June 1	Govt. Loan	300		3 $\frac{1}{4}$	June 1/76	June 1/74	99.00	3.31
June 1	Govt. Loan	550		2 $\frac{1}{4}$	Dec. 15/56	N/C	99.70	2.37
June 1	Third Victory Loan		847	3	Nov. 1/56	Nov. 1/53		
July 1	Govt. Loan		100	2	July 1/54	N/C		
July 23	Govt. Loan	200		1 $\frac{1}{2}$	Nov. 15/54	N/C	99.97	1.59
Oct. 1	Govt. Loan	400		3 $\frac{1}{4}$	Oct. 1/79	N/C	100.00	3.25
Oct. 1	Govt. Loan	700		2	Oct. 1/57	N/C	99.75	2.09
Oct. 1	Fourth Victory Loan		1,111	3	May 1/57	May 1/54		
Nov. 15	Govt. Loan		200	1 $\frac{1}{2}$	Nov. 15/54	N/C		
Dec. 1	Govt. Loan		88	3	June 1/58	June 1/53		
Dec. 15	CNR—Govt. Gtd.	250		2 $\frac{3}{4}$	Feb. 1/63	Feb. 1/61	99.00	2.89
Dec. 15	Govt. Loan		395	2	Dec. 15/54	N/C		
Dec. 15	Govt. Loan		150	2	Dec. 15/54	N/C		
-	All other retirements		6					
		<u>2,600</u>	<u>3,417</u>					

* Excluding operations involving Treasury Bills, Treasury Notes, Canada Savings Bonds and War Savings Certificates.

PUBLIC DEBT OPERATIONS • During 1954 the Bank as fiscal agent for the Government undertook an unusually large number of operations in connection with the public debt. These operations may be summarized as follows:

Changes in Government of Canada Funded Debt in 1954
(millions of dollars)

	<u>New Issues</u>	<u>Retire- ments</u>	<u>Net Change</u>
Market bonds—direct	2,150	3,364	-1,214
—guaranteed	450	53	+397
Canada Savings Bonds	800	329	+471
War Savings Certificates	nil	9	- 9
Sub-total	<u>3,400</u>	<u>3,755</u>	-355
Treasury bills			+130
Matured and outstanding debt			+ 55
Change in funded debt			<u><u>-171*</u></u>

* The net debt retirement of \$171 million and the Government's net disbursement of \$231 million shown in the table on page 17 were matched by reductions of \$292 million in Government bank balances and \$110 million in the security holdings of Government accounts.

The rise in guaranteed debt shown above was due to a change in the financing operations of the Canadian National Railways. The CNR, which for some years obtained its borrowed funds direct from the Government, in 1954 made two public issues, guaranteed by the Government, totalling \$450 million. The proceeds were used in part to meet a \$50 million CNR maturity and to reduce outstanding advances from the Government.

Further details of the new issues and retirements of market bonds are shown in the table on the facing page. The Second Victory Loan was retired on March 1st mainly from cash balances carried forward from 1953 Canada Savings Bond sales. On March 27th notice was given of the call of the 3 per cent Third and Fourth Victory Loans for redemption on June 1st and October 1st; the two loans were refunded in May and September. The \$200 million issue of July 23rd was sold to the chartered banks and the Bank of Canada; it was retired on November 15th out of the proceeds of the ninth series of Canada Savings Bonds. The two maturities of December 15th were retired mainly from the proceeds of the Canada Savings Bond issue and from the new

CNR issue in December to the extent that the proceeds of the latter were used to repay advances from the Government.

The ninth series of Canada Savings Bonds bearing an interest rate of $3\frac{1}{4}$ per cent went on sale in October and November. Total sales of the ninth series amounted to \$800 million as compared with \$900 million of the eighth series in 1953. The volume of encashments of all series was much lower in 1954 than in the previous year and the outstanding amount of Canada Savings Bonds rose by a net amount of \$471 million as compared to a net increase of \$414 million in 1953. The total amount outstanding at December 31st, 1954 was \$2,094 million, or 13 per cent of the total direct and guaranteed funded debt. During the year the remaining \$9 million of War Savings Certificates matured.

In April the amount of nine-months treasury bills sold at the weekly tender was increased from \$5 million to \$10 million and the amount of three-months bills was reduced from \$35 million to \$30 million. The effect of this change was to increase the total amount of bills outstanding by \$130 million in the second half of the year.

NOTES IN CIRCULATION • Bank of Canada note circulation at December 31st, 1954 was \$1,623 million, an increase over the year of \$24 million, as compared with an increase of \$38 million in 1953. Of the total amount outstanding on December 31st, 1954 some \$261 million was held by the chartered banks and \$1,362 million by other holders. The increase in notes held by other than chartered banks in 1954 was \$27 million.

On September 7th the chartered banks began the distribution of notes of the 1954 issue, the first new issue since 1937. The old notes are being withdrawn in the ordinary manner as they become unfit for further use. By the end of the year the Bank had placed in circulation notes of the 1954 issue to the extent of 25 per cent by number of the total notes outstanding.

BANK RATE • The Bank's minimum rate for advances remained unchanged at 2 per cent during 1954.

PROFIT AND LOSS • Net earnings from the Bank's operations in 1954 before providing for contingencies and reserves were \$44,877,399 as compared with \$47,592,807 in the previous year.

Substantial increases in the market prices of the Bank's investments made it possible to reverse in part earlier appropriations to investment reserves. After such adjustments, net profits were \$51,877,399 as compared with \$44,092,807 in 1953. A dividend of \$112,500 was paid on January 2nd on the capital stock held by the Minister of Finance; further payments of this nature were eliminated by the 1954 revision of the Bank of Canada Act. The amount of \$10,352,980 was allocated to the Rest Fund pursuant to statutory amendments in 1954, which provided that the Rest Fund be raised to \$25,000,000 by allocating one-fifth of the annual surplus each year until that level is reached. The residue of the surplus, amounting to \$41,411,919, was paid to the Receiver General of Canada to be placed to the credit of the Consolidated Revenue Fund. The comparable figure in 1953 was \$43,867,807.

STAFF • The staff of the Bank numbered 729 on December 31, 1954 compared with 737 a year earlier. The very large new issues and retirements of Government securities, the inauguration of the new issue of notes, and the revision of the Bank Act and the Bank of Canada Act entailed an unusually heavy volume of work during 1954. This was carried out efficiently and with a full regard for their responsibilities on the part of department heads, agents and all members of the staff.

Yours very truly,

J. E. COYNE, *Governor*

FINANCIAL STATEMENT



BANK OF CANADA • STATEMENT

ASSETS

Foreign Exchange:

Pounds Sterling and U.S.A.

Dollars — at market value \$ 54,173,614

Other currencies — at

market value	136,170	\$	54,309,784
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Cheques on other Banks	56,454,904
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Investments — at values not exceeding market:

Treasury bills of Canada	\$168,459,754
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Other securities issued or guaranteed by Canada maturing within two years	1,193,005,623
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Other securities issued or guaranteed by Canada not maturing within two years	860,566,387
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Debentures issued by Industrial Development

Bank	10,579,080
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Other securities 12,048,090

Accrued interest	13,991,389	2,258,650,323
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Industrial Development Bank:

Total share capital at cost	25,000,000
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Bank Premises: Land, buildings and equipment — at cost

less amounts written off	.	.	.	4,855,426
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Other Assets: 1,577,303

\$2,400,847,740

OF ASSETS AND LIABILITIES

● AS AT DECEMBER 31st, 1954

LIABILITIES

Capital Paid Up: Authorized and issued—100,000 shares par value \$50 each	\$ 5,000,000
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Rest Fund	20,403,347
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Notes in Circulation	1,623,456,907
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Deposits

Government of Canada	\$ 97,720,600	
Chartered Banks	529,584,526	
Other	30,501,790	657,806,916

Liabilities payable in Pounds Sterling, U.S.A. Dollars and other foreign currencies:

To Government of Canada	\$ 55,745,132	
To others	7,357,897	63,103,029

Other Liabilities: (including

Bank of Canada cheques outstanding \$28,130,042)	31,077,541
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<u>\$2,400,847,740</u>

AUDITORS' REPORT • We have made an examination of the statement of assets and liabilities of the Bank of Canada as at December 31, 1954 and have received all the information and explanations we have required. We report that, in our opinion, it correctly sets forth the position of the Bank at December 31, 1954 according to the best of our information and as shown by the books of the Bank.

J. GRANT GLASSCO, F.C.A.,
of Clarkson, Gordon & Co.

MAURICE SAMSON, C.A.
of Chartré, Samson, Beauvais, Belair & Cie.

Ottawa, January 20, 1955.

PROFIT AND LOSS ACCOUNT

For the year ended December 31, 1954

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PROFIT FOR THE YEAR ENDED DECEMBER 31,

1954 after making provision for contingencies

and reserves \$ 51,877,399

APPROPRIATED AS FOLLOWS:

Dividend No. 40 paid July 2, 1954 \$ 112,500

Allocation to the Rest Fund . 10,352,980 10,465,480

BALANCE TRANSFERRED TO THE RECEIVER

GENERAL OF CANADA for credit to the Con-

solidated Revenue Fund \$ 41,411,919

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•

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E. FRICKER, *Chief Accountant*

E. METCALFE, *Auditor*

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L. P. J. ROY, *Deputy Secretary*

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MISS M. K. ROWLAND, *Personnel Officer*

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Public Debt Division: F. M. PETERS, *Chief*

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G. S. WATTS, *Special Assistant*

G. E. FREEMAN, *Assistant Chief*

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A. CLARK, *Montreal Representative*

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W. A. CAMERON, *Deputy Chief*

P. WATT, *Toronto Representative*

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