CHAPTER XXVI.—CURRENCY AND BANKING; MISCELLANEOUS COMMERCIAL FINANCE

CONSPECTUS

Note.—*The interpretation of the symbols used in the tables throughout the Year Book will be found facing p. 1 of this volume.*

PART I.—CURRENCY AND BANKING*

A historical sketch of currency and banking in Canada appears in the 1938 Year Book, pp. 900-905.

Section 1.—The Bank of Canada

The Bank of Canada was incorporated under the Bank of Canada Act 1934 and commenced operations on Mar. 11, 1935.

The Bank of Canada is Canada's central bank and as such its main function is to regulate the total volume of money and credit. The normal way in which this function is performed is through changes in the cash reserves of the chartered banks. Each chartered bank is required by the Bank Act to maintain, on the average during each calendar month, an amount of cash reserves, in the form of Bank of Canada notes and deposits with the Bank of Canada, equal to not less than 8 p.c. of its Canadian dollar deposit liabilities. (Prior to July 1, 1954, each chartered bank was required to maintain at all times, cash reserves equal to not less than 5 p.c. of its Canadian dollar deposit liabilities; in practice the chartered banks normally attempted to maintain a ratio of about 10 p.c.) An increase in cash reserves encourages banks to expand their assets (mainly by purchasing securities and making loans), with a resultant similar increase in their deposit liabilities; a decrease in cash reserves tends to discourage expansion and may result in some contraction. Therefore, by taking steps to alter the volume of cash reserves available to the chartered banks, the Bank of Canada is able to influence the total of chartered bank assets and the total of their Canadian dollar deposit liabilities. The deposit liabilities of the banks, except for those payable to the Government, are of course assets of the general public and, together with currency, comprise their most liquid assets. (*See* Table 7, p. 1142, for Canadian dollar currency and bank deposits held by the general public.)

Open market operations in Government of Canada securities constitute the chief means by which the Bank of Canada influences the volume of chartered bank reserves. When the Bank of Canada purchases a security it issues a cheque in settlement which, after it is cashed at, or deposited with, a chartered bank by the recipient, is in turn deposited by that chartered bank in its account with the Bank of Canada, thereby increasing its cash reserves. Conversely, when the Bank of Canada sells a security the cheque which

* Except where otherwise indicated, this material has been revised by the Research Division of the Bank of Canada.