dollar deposit liabilities on a monthly average basis. The ability of the chartered banks as a group to expand their total assets and deposit liabilities therefore depends on the level of total cash reserves. An increase in cash reserves will encourage the banks to expand their total assets (which consist chiefly of loans and marketable securities) with a concomitant increase in deposit liabilities; a decrease in cash reserves will bring about a decline in their total assets and deposit liabilities as they seek to restore their cash reserve ratios.

The chief method by which the Bank of Canada can affect the level of cash reserves of the chartered banks and through them the total of chartered bank deposits, is by purchases and sales of government securities. Payment by the central bank for the securities it purchases in the market adds to the cash reserves of the chartered banks as a group and puts them in a position to expand their assets and deposit liabilities. Conversely, payment to the central bank for securities it sells causes a reduction in reserves of the chartered banks and makes it necessary for them to reduce their assets and deposit liabilities.

The influence that the Bank of Canada has on credit conditions and hence on economic behaviour stems from its ability to determine broadly the level of total holdings of currency and chartered bank deposits. The trend of total holdings of these forms of money can have an influence on liquidity generally, including effects on interest rates and bond prices and the availability of credit, and on expectations regarding future financial and economic trends, all of which have some effect on decisions to spend or to save. However, many factors other than changes in the money supply also have important influences on financial and economic developments, such as: the state of economic conditions and prospects outside Canada; the competitive strength of Canadian business enterprises both at home and abroad; the character of the investment decisions and price and wage policies in domestic industries; the skills and degree of mobility of labour; and the nature of public policies at all levels of government with regard to such matters as expenditure, taxation, subsidies and the regulation of industry. In forming its judgments, the Bank of Canada is bound by criteria laid down by Act of Parliament in the preamble to the Bank of Canada Act of 1934. Its operations must be based, not on any simple mechanical formula, but rather on continuous observation and appraisal of the constantly changing state of the economy as reflected in the complex pattern of economic and financial developments.

Although the Bank of Canada has the power to determine the combined total of currency and chartered bank deposits, it has no means of determining how much of this total is held in the form of currency and how much in the form of chartered bank deposits. That depends on the wishes of the public, since deposits can be converted freely into notes and coin and back again. Nor does the Bank have any direct control over the growth of other forms of money or of close substitutes for money as a store of wealth in liquid form, of which there are many varieties in Canada—mainly deposit balances in savings institutions other than chartered banks and short-term securities issued by governments and corporations.

The cash reserve system in Canada, which is similar to that in a number of other countries, while placing the central bank in a position where it can determine within broad limits the total amount of chartered bank assets and deposits, leaves the allocation of bank credit and other forms of credit to the private sector of the economy. Each chartered bank can attempt to gain as large a share as possible of the total cash reserves by competing for deposits. Each bank determines how its assets will be distributed, for example, between various kinds of securities and loans to various types of borrowers. The Bank of Canada has no power to direct banks or other lenders to make funds available to certain groups or in certain regions on the same terms or on different terms than to other groups or in other regions. The influence of the central bank—based in essence on its power to expand or contract chartered bank cash reserves through its market purchases or sales of securities—is both indirect and impersonal and is brought to bear on financial conditions generally through the chartered banks and the numerous inter-connected channels of the capital market.