# Banking, finance and insurance

# Chapter 21

## Banking

21.1

### Bank of Canada

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Canada's central bank, the Bank of Canada, began operations on March 11, 1935, under the terms of the Bank of Canada Act, 1934, which charged it with the responsibility for regulating "credit and currency in the best interests of the economic life of the nation" and conferred on it specific powers for discharging this responsibility. Through the exercise of these powers, the Bank of Canada influences the level of short-term interest rates and thus the growth of the money supply, narrowly defined as the public's holdings of chartered bank demand deposits and currency. Revisions to the act were made in 1936, 1938, 1954 and 1967, and are included in RSC 1970, c.B-2.

The provisions of the Bank of Canada Act enable the central bank to determine the total amount of cash reserves available to the chartered banks as a group and in that way to influence the level of short-term interest rates. The Bank Act, which regulates the chartered banks, requires that each chartered bank maintain a stipulated minimum average amount of cash reserves, calculated as a percentage of its Canadian dollar deposit liabilities, in the form of deposits at the Bank of Canada and holdings of Bank of Canada notes. The minimum cash reserve requirement, which came into effect under the legislation beginning February 1, 1968, is 12% of demand deposits and 4% of other deposits. Effective January 1969, the chartered banks have been required to maintain this minimum cash reserve ratio on a half-monthly rather than on a monthly basis. The ability of the chartered banks as a group to expand their total assets and deposit liabilities is therefore limited by the total amount of cash reserves available.

A decrease in cash reserves tends to cause short-term interest rates to rise, making it more costly for the public to hold non-interest-bearing deposits and currency. An increase in cash reserves would put downward pressure on interest rates and indirectly induce the public to hold more money. Control of interest rates thus provides some control over the growth of the money supply.

There are two methods by which the Bank of Canada can alter the level of cash reserves of the chartered banks. The technique employed more often is the transfer of government deposits between the central bank and the chartered banks. The second method is the purchase or sale of government securities.

The transfer of government deposits from the Bank of Canada to the chartered banks or the payment by the central bank for the securities purchased 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. The more direct method of increasing bank reserves is the transfer of government deposits to the chartered banks. Such transfers, which the bank is authorized to make as the fiscal agent of the federal government, do not involve any immediate effect on security prices and yields in financial markets.

If the Bank of Canada wishes to decrease the reserves of the chartered banks, it may either transfer government deposits from accounts at the chartered banks to the government's account at the central bank or sell government securities in the market.

In using the powers at its disposal, the Bank of Canada attempts to bring about monetary conditions appropriate to both domestic and external conditions. The basic principle it relies upon to do this is that the money supply should grow along a path capable of accommodating the maximum rate of real growth consistent with continued movement toward the goal of price stability. In November 1975 the governor of the Bank of Canada announced an explicit target range for a monetary aggregate, narrowly defined as the public's holdings of chartered bank demand deposits and currency. It was