

## 21.6 Financial flow accounts

Against a background of rapid expansion of real economic activity and an accelerated pace of inflation, a record volume of funds was channelled through Canadian capital markets in 1973. Total borrowing by non-financial sectors of the economy rose from approximately \$17 billion in 1972 to \$22 billion in 1973. (Non-financial sectors borrow through conventional credit market instruments: consumer credit, bank loans, other loans, short-term debt instruments, mortgages, bonds, stocks and foreign securities.) There was increased reliance on short-term forms of financing by the non-financial business sector in 1973 and short-term rates of interest rose dramatically over the year. Short-term rates, however, did not reach the high levels attained abroad. In contrast to the pressure on the short-term instruments, the volume of bond financing was substantially below the flow for 1972 and long-term rates of interest posted a modest rise in 1973. By the third quarter of the year, the yield curve was twisted with many short-term rates of interest exceeding long-term rates.

Following three years of an expansionary monetary policy initiated in 1970, the authorities moved progressively toward a more restrictive posture in 1973. This less expansionary stance is not immediately recognizable from the growth rates posted by the various measures of the money supply. While money, narrowly defined, grew at a rate of 11.2% in 1973, which was down from the elevated rate of 14.7% in 1972, this still represented a rapid rate of expansion viewed from a longer-run historical perspective. The money supply, broadly defined, continued to rise rapidly in 1973, the rate of expansion of close to 16% was similar to the percentage rate of increase a year earlier. The rapid expansion of the banking system in 1973 appears less of an anomaly and can be placed in a better perspective if the following points are taken into consideration: a substantial increase in the total demand for funds by non-financial borrowers; an increased relative emphasis on short-term forms of financing (particularly loans) away from long-term forms; the rapid rise in short-term interest rates that occurred as the short-term capital market came under increased demand pressure; and the increased tendency of lenders and borrowers to channel credit through the deposit-accepting institution.

During 1973, the Bank of Canada revised the bank rate upwards five times from a low of 4.75% at the beginning of the year to 7.25% by mid-September. With loans and mortgages expanding at a faster rate than total banking assets, the liquid asset ratios of the chartered banks fell progressively over the year and by the end of the year, were at historically low levels.

Some perspective on the magnitude of borrowing in 1973 can be gained by comparing it to the gross national product (GNP). As a percentage of GNP, total borrowing rose markedly in 1971 to approximately 17%. This high proportion was maintained in 1972 and rose somewhat in 1973 to 18.7%. A marked shift in emphasis to private sector borrowing away from public sector borrowing occurred in 1972 and accelerated in 1973. Borrowing by non-financial sectors was concentrated in mortgages, consumer finance and bank loans in 1973.

The substantial increase in mortgage liabilities reflected the continued expansion in residential construction and the sharp increases in prices of new and existing houses and land. Mortgage borrowing as a percentage of total borrowing increased from about 28% in 1972 to over 31% in 1973. In contrast to the situation in the United States, where the housing sector fell off during the year, residential construction activity increased in Canada during 1973 and the flow of funds into the mortgage market was accelerated. Referring to the mortgage component of the annual financial flows matrix for 1973 (Table 21.35), it can be seen that the bulk of the increase was financed by chartered banks and other lending institutions such as trust and mortgage loan companies. This increased pressure on the mortgage market was accompanied by some increase in mortgage lending rates. By year's end the rate applicable to conventional mortgages hovered about 10%, up from slightly over 9% in the early months of the year.

A broadly based expansion in expenditures on consumer durables was mirrored in the financial system by a large increase in the amount of consumer credit outstanding, which reached a level of approximately \$17.7 billion by the end of 1973. The flow of consumer credit was augmented by 34% to \$2.8 billion. The greater part of this increase was financed by the chartered banks, which accounted for over 60% of the flow. Credit unions and caisses populaires and sales finance and consumer loan companies were also important suppliers of additional consumer credit in 1973.

As increased pressure was placed on productive capacity, the pace of business investment spending picked up sharply in 1973. Expenditures on plant and equipment by the business sec-