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Governor.

Bank of Canada.

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Federal Reserve Bank of St. Louis

BANK OF CANADA

ANNUAL REPORT TO MINISTER OF FINANCE AND STATEMENT OF ACCOUNTS

FEBRUARY 8TH, 1946

BANK OF CANADA

INCORPORATED UNDER THE BANK OF CANADA ACT, 1934

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BANK OF CANADA

Ottawa, February 8th, 1946

The Right Hon. J. L. Ilsley,
Minister of Finance,
Ottawa.

Dear Sir,

In accordance with the provisions of the Bank of Canada Act Amendment Act, I am enclosing herewith in duplicate a statement of the Bank's accounts for the fiscal year 1945, signed by the Governor and the Chief Accountant, and certified by the Auditors, in the form prescribed by the by-laws of the Bank.

The major changes which took place in our various asset and liability accounts during the course of the year are indicated in the following table, which shows the effect of these changes on the cash reserves of the chartered banks.

<u>Calendar Year 1945</u>	<u>Changes producing a decrease in chartered banks' cash</u>	<u>Changes producing an increase in chartered banks' cash</u>
	<u>(Millions of Dollars)</u>	
Increase in Dominion and Provincial Government Securities.....		364.8
Increase in Active Note Circulation.....	69.6	
Increase in Dominion Government Deposits.....	144.8	
Decrease in Liabilities payable in Sterling, U. S. A. and Foreign Gold Currencies		15.4
Decrease in Sterling and U.S.A. Dollars	15.4	
Decrease in Other Assets less Other Liabilities.....	7.4	
	<u>237.2</u>	<u>380.2</u>
Deduct.....		<u>237.2</u>
Increase in Chartered Banks' Cash Reserves.....		<u><u>143.0</u></u>

BANK OF CANADA

NOTES IN CIRCULATION

The Bank of Canada note issue as at the end of December last was \$1,129,099,247, up \$93,126,640 from the same date a year before. Of the total amount of our notes outstanding, \$966.2 millions were held by the public, and \$162.9 millions by the chartered banks. As will be seen from the table given in Appendix A, the increase in notes held by the public was less in 1945 than in any year since 1939. This was to be expected since the volume of production and of money payments declined somewhat in the latter part of 1945 from their wartime peak.

RESERVE

The asset account in our statement entitled "Sterling and U.S.A. Dollars" stood at \$156,829,962 on December 31st last. This represented foreign exchange held for the account of foreign clients, and was balanced by a contra item "Liabilities Payable in Sterling, U.S.A. and Foreign Gold Currencies" of the same amount. The change during the year in this item did not, therefore, involve any variation in the cash reserves of the chartered banks.

INVESTMENTS

The Bank's holdings of Dominion and Provincial Government securities were \$1,845,582,637 at the end of December last, having increased \$364,756,768 during the year. Our security purchases were undertaken in part to offset the downward effect on chartered banks' cash reserves of increased public holdings of Bank of Canada notes, and also in order to enlarge the cash reserves of the chartered banks.

On the basis of the Wednesday figures published in our weekly statements, the Bank's total investments averaged \$225 millions more in 1945 than in 1944.

BANK OF CANADA

PROFIT AND LOSS

The net profit from our operations in 1945, after providing for contingencies and reserves, was \$22,766,920.92. Payment of a dividend of \$225,000 on capital stock held by the Minister of Finance left \$22,541,920.92 available, as compared with \$20,087,659.68 in 1944. This increase in profits was attributable to the rise in security holdings mentioned in the previous section.

Under Section 31(c) of the Bank of Canada Act, the whole of the surplus available from our operations was paid to the Receiver General and placed to the credit of the Consolidated Revenue Fund.

BANK RATE

Bank Rate remained unchanged during 1945 at $1\frac{1}{2}$ per cent. As in previous years banks had little occasion to borrow from us.

STAFF

The staff of the Bank numbered 1,166 at December 31st, 1945, an increase on the year of 41. The heavy addition to the work of the Bank during the war years, arising out of the larger public holdings of Government debt, the increase in notes in circulation and other causes, for the most part is of a continuing character. I wish to record my sincere appreciation of the willing co-operation of all members of the staff.

During the year just ended we have had the pleasure of welcoming back a number of those who have been on service with the Armed Forces and are looking forward to the time when those remaining will have returned.

MONETARY EXPANSION

During 1945 the Canadian deposit liabilities of the chartered banks rose by \$804 millions. The increase in their

cash reserves, referred to at the beginning of this Report, was such as to maintain their ratio of cash to deposits. This ratio, on a daily average basis, was 11.4 per cent for the year 1945, and 11.5 per cent for December 1945, as compared with 11.8 per cent and 11.3 per cent respectively in 1944.

As will be seen from the table in Appendix A, the increase during 1945 in the total volume of money (including both notes and deposits) was \$1,013 millions.

SECURITY MARKETS

Medium and long term government bond prices rose appreciably during 1945 in Canada, the United States and the United Kingdom. Continuing this movement in January 1946, the yield on long term Dominion issues moved below the previous low level of $2\frac{3}{4}$ per cent which was established in the summer of 1936.

Yields on provincial, municipal and corporate bonds also declined and a substantial number of corporate issues were refunded at lower rates. The stock market was strong and in addition to a considerable amount of new financing, a number of blocks of stock in formerly privately owned companies were sold to the public.

A table of new Canadian bond issues of all categories, less retirements, is given in Appendix B. It shows that outstanding issues of the Dominion government have increased by \$11,667 millions over the last five years, while provincial, municipal and corporate bonded debt has been reduced by \$161 millions, \$224 millions and \$267 millions respectively.

As indicated in the table, net new domestic issues taken up by the public in 1945 substantially exceeded the corresponding figure for any previous year. This was accounted for by the record size of the Eighth and Ninth Victory Loans which produced cash applications for \$1,564 millions and \$2,022 millions respectively. These figures are themselves

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a tribute to the effort of all those who took part in the work of the National War Finance Committee, and to the patriotism and good sense of the Canadian people.

GENERAL

During the war Canadian production, and with it employment and income, rose to unprecedented levels. Over-all estimates have recently been compiled by the Dominion Bureau of Statistics and are shown in the following table:—

NATIONAL PRODUCTION*
(Billions of Dollars)

	1938	1941	1944	Prelim. 1945
Salaries, wages and other labour income.....	2.4	3.5	5.1	5.2
Military pay and allowances.....	—	.4	1.1	1.1
Investment income (before corporate taxes)	.7	1.6	1.8	1.6
Net income of individual enterprisers8	1.1	1.9	1.8
Net National Production at Factor Cost	3.9	6.6	9.9	9.7
Indirect Taxes.....	.6	1.1	1.1	1.0
Net National Production at Market Prices	4.5	7.7	11.0	10.7
Depreciation.....	.5	.7	.8	.7
Gross National Production at Market Prices.....	<u>5.0</u>	<u>8.4</u>	<u>11.8</u>	<u>11.4</u>

Production is of course undertaken in response to expenditure, and total production must be equal to the total of all final expenditures including investment in inventories. The following Bureau of Statistics estimates show the main divisions of the over-all expenditure which brought about such high levels of production and income:—

*Source: National Accounts: Income and Expenditure: 1938-1945, prepared by the Dominion Bureau of Statistics and now being published as a Reference Book for the Dominion-Provincial Conference on Reconstruction. Minor adjustments have been made in the Bureau figures to eliminate the residuals arising from errors and omissions. However these adjustments do not affect the broad outline of the picture presented.

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NATIONAL EXPENDITURE*
(Billions of Dollars)

	1938	1941	1944	Prelim. 1945
Net exports of goods and services directly or indirectly financed by government....	—	.9	1.3	} 4.5
Other government expenditure on goods and services.....	.9	1.7	4.1	
Other net exports of goods and services.....	—	-.3	-.3	-4
Gross private investment in Canada (incl. investment in inventories).....	.4	1.1	.5	.8
Personal expenditure on consumers' goods and services.....	3.7	5.0	6.2	6.5
Gross National Expenditure.....	<u>5.0</u>	<u>8.4</u>	<u>11.8</u>	<u>11.4</u>
(= Gross National Production at Market Prices)				

Trends in these components of national expenditure, taken together, will determine whether or not a satisfactorily high level of employment and income can be maintained in the years ahead.

Clearly it is the first two items in the expenditure table, comprising total government outlay, which represented the main driving force behind the very high level of activity which was attained during the war period. Canada's problem now is to expand the other types of expenditure, and particularly domestic private investment and domestic consumption, in order that there will be compensating stimulus as government outlays decline to their post-war level.

At present, government outlays are still comparatively high. Time is required for demobilization, and large payments of war service gratuities and re-establishment credits are in process of being made. Moreover, our exports, which reached unprecedented volume under Mutual Aid, are being maintained at a high level in part by government loans to assist Allied countries to rebuild their damaged economies and to

*See note on page 8.

secure necessary foodstuffs. There is the further factor that civilian expenditures may tend to increase at first more rapidly than supplies can accommodate, because of the considerable accumulation of demand for goods which were scarce or unobtainable during the war—a demand backed by large individual holdings of cash and other liquid assets.

It is therefore not surprising that in Canada, and in the United States where similar conditions prevail, business remains very good and a feeling of optimism is widespread. Indeed, in the near future there is more danger of inflation than deflation, unless necessary price and supply controls remain effective until war-created shortages are overcome.

Looking to the future, however, there is no reason for complacency. Most of our real problems of post-war adjustment are still ahead. The backlog of demand will not be large in relation to productive capacity when industry has been fully reconverted and inventories built up to normal levels. When the time lag involved in demobilization is over, government expenditures will fall rapidly. Nor will our foreign lending to finance the purchase of Canadian goods remain indefinitely at the present level. The prevailing optimism on the North American continent is dangerous if it diverts attention from the problems which have to be faced.

The destruction, distortion and disorganization which have taken place on other continents are difficult to exaggerate. The present conditions of life in many countries are almost beyond our comprehension. It seems likely that there will be far greater delayed reactions from World War II than from World War I, unless positive steps are taken to prevent this.

Certainly there is need for the best possible international arrangements, both economic and political. On the economic side there is, I think, general agreement about the desirability of reducing trade barriers and discriminatory practices, of

taking positive measures to expand trade, of avoiding burdensome war debts, of promoting wise foreign investment. The problem, however, is to translate agreement about objectives into effective action on specific issues. It is well to recall that the shortcomings of the past did not result from lack of knowledge of what ought to be done, but from lack of purpose. The danger is that general principles will again be applied to practical problems in a timid way, that the scope of the international arrangements which are actually made will be whittled down to the point where they become ineffective. When it comes to the application of agreed principles, there are liable to be differences of opinion as to what constitutes effective action. For example, the proposed United States loan to the United Kingdom is generally regarded in the United States as fully adequate to meet the needs of the situation. In the United Kingdom many have expressed a contrary view.

However well the complexities and difficulties of the international situation may be handled, it is quite unlikely that perfection will be achieved, or that Canada can expect to avoid serious external threats to her trade, and to her level of employment. This accents the need for the fullest possible encouragement to Canadian enterprise and focusses attention on the outcome of the current Dominion-Provincial discussions which will determine the character of our tax system during the transition period. If mutually satisfactory agreements can be reached which will adapt present taxation arrangements to postwar conditions it will be possible for tax rates to be set in such a way as to encourage business expansion and promote high and stable employment. I need hardly add that the higher the average level of employment and income which can be achieved, the larger will be the tax base of all governments, and the lower the tax rates which will be required, on average, to meet their needs. Agreements of the kind mentioned would also make it possible to

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determine tax rates with an eye to balancing budgets over the business cycle as a whole rather than in each separate year.

Failure to reach satisfactory Dominion-Provincial agreements would mean a return to the pre-war multiplicity of taxes. Whether governments intend it or not, the character of our tax system will have a powerful effect on business enterprise and economic conditions, and reversion to the pre-war tax situation would certainly hamper economic expansion. In view of the very difficult international situation which we must face, such a development would appear to involve risks which this country can ill afford to take.

I am,

Dear Sir,

Yours faithfully,

G. F. TOWERS,

Governor.

BANK OF CANADA

PROFIT AND LOSS ACCOUNT

For the Year Ended 31st December, 1945

PROFIT FOR THE YEAR ENDED 31ST DECEMBER 1945, after making provision for contingencies and reserves	\$22,766,920.92
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APPROPRIATED AS FOLLOWS:

Dividends for the year ended 31st December 1945 at the rate of 4½% per annum—		
No. 22 paid 2nd July 1945	\$ 112,500.00	
No. 23 payable 2nd January 1946	112,500.00	225,000.00

BALANCE, TRANSFERRED TO THE RECEIVER GENERAL OF CANADA FOR CREDIT TO THE CONSOLI- DATED REVENUE FUND . . .	<u><u>\$22,541,920.92</u></u>
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BANK OF CANADA
STATEMENT OF ASSETS AND LIABILITIES
as at 31st December, 1945

LIABILITIES

CAPITAL:	
Authorized—100,000 shares par value of \$50.00 each . . .	<u>\$ 5,000,000.00</u>
Issued and Paid Up . . .	5,000,000.00
REST FUND	10,050,366.82
NOTES IN CIRCULATION	1,129,099,247.41
DEPOSITS:	
Dominion Government . . .	175,838,825.88
Chartered Banks	521,209,382.77
Other	<u>29,770,378.77</u>
	726,818,587.42
LIABILITIES PAYABLE IN STERLING, U.S.A. AND FOREIGN GOLD CURRENCIES:	
Deposits	156,829,962.33
DIVIDEND DECLARED:	
Payable 2nd January 1946 . .	112,500.00
ALL OTHER LIABILITIES	3,975,965.44

\$2,031,886,629.42

AUDITORS' REPORT

We have examined the above statement of assets and liabilities of the Bank of Canada as at 31st December 1945 and have received all the information and explanations we have required. We report that, in our opinion, it is properly drawn up so as to exhibit a true and correct view of the state of the Bank's affairs as at that date, according to the best of our information, the explanations given to us and as shown by the books of the Bank.

E. J. HOWSON, F.C.A., of the firm of Thorne, Mulholland, Howson & McPherson	MAURICE SAMSON, C.A., of the firm of Chartré, Samson, Beauvais, Gauthier & Cie
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ASSETS

RESERVE:	
Sterling and U.S.A. dollars, at market value	\$ 156,829,962.33
SUBSIDIARY COIN	339,157.29
INVESTMENTS:	
Dominion, Dominion guar- anteed and Provincial Government short term securities — at values not exceeding market	\$1,157,312,458.85
Other Dominion, Dominion guaranteed and Provincial Government securities — at values not exceeding market	688,270,177.71
Other securities — at cost . .	<u>10,000,000.00</u>
	1,855,582,636.56
BANK PREMISES:	
Land, Buildings and Equip- ment—at cost less amounts written off	1,884,018.28
ALL OTHER ASSETS	17,250,854.96

\$2,031,886,629.42

NOTE: In accordance with Section 12 of the Industrial Development Bank Act, the Bank of Canada has subscribed for 250,000 shares of the par value of \$100. each of the Industrial Development Bank of which 100,000 shares had been purchased as at 31st December 1945.

G. F. TOWERS,
Governor.

H. R. EXTENCE,
Chief Accountant.

Ottawa, Canada, 28th January 1946.

APPENDIX A
CHANGES IN THE VOLUME OF MONEY AND RELATED BANK ASSETS
(Millions of Dollars)

VOLUME OF MONEY: Increase (+) or Decrease (-)

CALENDAR YEAR	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	Volume of Money as at Dec. 31, 1945
NOTES HELD BY PUBLIC											
Bank of Canada Notes.....	+ 29	+ 24	+ 7	+ 44	+ 99	+ 118	+ 193	+ 179	+ 145	+ 70	966
Chartered Bank Notes.....	- 8	- 7	- 8	- 4	- 5	- 9	- 10	- 18	- 9	- 8	25
TOTAL.....	+ 21	+ 17	- 1	+ 40	+ 94	+ 109	+ 183	+ 161	+ 136	+ 62	991
DEPOSITS WITH CHARTERED BANKS											
Public Demand.....	+ 41	+ 17	+ 35	+ 119	+ 178	+ 238	+ 231	+ 197	+ 166	+ 201	2,063
Public Notice.....	+ 62	+ 35	+ 77	+ 81	- 100	+ 28	+ 4	+ 275	+ 475	+ 442	2,865
Other Canadian Deposits ⁽¹⁾	+ 11	+ 12	—	+ 152	- 123	+ 38	+ 264	+ 276	+ 149	+ 161	1,021
Dom. Govt. and "Other"											
Deposits with Bank of Canada ⁽²⁾	+ 3	- 6	+ 5	+ 44	- 42	+ 61	- 5	- 26	+ 6	+ 147	206
TOTAL VOLUME OF MONEY ..	+ 138	+ 75	+ 116	+ 436	+ 7	+ 474	+ 677	+ 883	+ 932	+1,013	7,146

RELATED BANK ASSETS: Increase (+) or Decrease (-)

CALENDAR YEAR	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	Related Bank Assets as at Dec. 31st, 1945
Gold held by Bank of Canada ⁽³⁾	- 1	—	+ 6	+ 40	- 226	—	—	—	—	—	—
Exchange held by Bank of Canada ⁽³⁾⁽⁵⁾	+ 5	+ 6	+ 13	+ 36	- 26	+ 162	- 200	—	- 1	—	—
Securities held by Bank of Canada	+ 46	+ 26	- 1	+ 46	+ 344	+ 33	+ 408	+ 244	+ 230	+ 365	1,856
Securities held by Chartered Banks ⁽⁴⁾	+ 228	+ 16	+ 37	+ 184	- 95	+ 204	+ 469 ⁽⁶⁾	+ 609 ⁽⁶⁾	+ 639 ⁽⁶⁾	+ 395 ⁽⁶⁾	3,796 ⁽⁶⁾
Canadian Loans of Chartered Banks	- 123	+ 33	+ 67	+ 136	+ 7	+ 53	- 2 ⁽⁷⁾	+ 6 ⁽⁷⁾	+ 98 ⁽⁷⁾	+ 223 ⁽⁷⁾	1,526 ⁽⁷⁾
TOTAL.....	+ 155	+ 81	+ 122	+ 442	+ 4	+ 452	+ 675	+ 859	+ 966	+ 983	7,178

- (1) Variations in this item are accounted for mainly by Dominion Government deposits.
(2) Excluding deposits of chartered banks and deposits in foreign currencies shown under Item 5 of Liabilities on Bank of Canada Statement. See also footnote (5).
(3) In May 1940, under the Exchange Fund Order and the Foreign Exchange Acquisition Order, the Bank of Canada sold gold and exchange amounting to \$253.5 millions to the Foreign Exchange Control Board and acquired additional government securities; at the same time the Bank's minimum gold reserve requirement was temporarily discontinued.

- (4) Excluding foreign government securities.
(5) Excluding exchange equal to the amount of deposits in foreign currencies shown under Item 5 of Liabilities on Bank of Canada Statement. See also footnote (2).
(6) Including security holdings connected with instalment purchases of Victory Bonds, changes in which amounted to +51, +21, +14 and +91 in the years 1942 to 1945, respectively.
(7) Including loans connected with instalment purchases of Victory Bonds, changes in which amounted to +115, +74, -4 and +49 in the years 1942 to 1945, respectively.

APPENDIX B
ESTIMATED
NET NEW BOND ISSUES (+) OR RETIREMENTS (-)
 (Par Values in Millions of Canadian Dollars)

Calendar Year	Dominion & C.N.R.*	Provinces	Municipalities**	Private Corporations	Total
PAYABLE IN CANADA ONLY					
1936	+ 170	+66	-13	+182	+ 405
1937	+ 25	+82	- 9	+ 75	+ 173
1938	+ 91	+59	- 9	+ 31	+ 172
1939	+ 74	+51	-24	+ 96	+ 197
1940	+ 444	+75	-14	- 22	+ 483
1941	+ 730	-	-32	- 33	+ 665
1942	+1,830	+ 7	-47	- 12	+1,778
1943	+2,606	+ 7	-40	- 27	+2,546
1944	+2,692	-39	-16	- 18	+2,619
1945	+3,545	-11	-28	+ 48	+3,554
PAYABLE ABROAD, ONLY OR OPTIONALLY					
1936	- 39	-27	-14	-141	-221
1937	- 14	-24	-16	- 87	-141
1938	- 21	-11	-21	- 42	- 95
1939	- 96	+29	-15	-129	-211
1940	-144	-15	-16	- 35	-210
1941	-193	-18	-14	- 31	-256
1942	-292	-41	-14	- 64	-411
1943	-148	-25	-13	- 35	-221
1944	- 68	-27	-11	- 17	-123
1945	- 46	-14	- 9	- 78	-147
TOTAL					
1936	+ 131	+39	-27	+41	+ 184
1937	+ 11	+58	-25	-12	+ 32
1938	+ 70	+48	-30	-11	+ 77
1939	- 22	+80	-39	-33	- 14
1940	+ 300	+60	-30	-57	+ 273
1941	+ 537	-18	-46	-64	+ 409
1942	+1,538	-34	-61	-76	+1,367
1943	+2,458	-18	-53	-62	+2,325
1944	+2,624	-66	-27	-35	+2,496
1945	+3,499	-25	-37	-30	+3,407

*Includes War Savings Certificates, but excludes Treasury Bills, Deposit Certificates and short-term issues sold directly to the Bank of Canada and the chartered banks, of which the amount outstanding increased by 12, nil, 5, 200, 315, 290, 633, 535, 248 and - 695 in the calendar years 1936 to 1945 respectively.

**The division of net municipal retirements between the domestic and the foreign category is a rough approximation only.

February 26, 1946.

Dear Governor Towers:

This is to thank you again for your thoughtfulness in sending me the Annual Report of the Bank of Canada to the Minister of Finance. I wish we could be as prompt as you in preparing and issuing our annual report, which, of course, is much longer, but I am sure not more understandable or as effectively presented as yours always are.

I hope I may have the pleasure of seeing you when you are next in Washington.

With kindest personal regards,

Sincerely yours,

The Honorable G. P. Towers,
Governor,
Bank of Canada,
Ottawa.

ET:b