



B A C K G R O U N D E R S

Canada's Money Supply

Some people ask why the Bank of Canada can't directly increase or decrease the money supply at will, since it regulates the supply of paper currency in circulation.

The answer is that the bank notes issued by the Bank represent only a small portion of all the money circulating in the economy at any one time. The bulk of the money supply consists of deposits that the public holds at financial institutions. The amount of money in circulation can be measured in a number of ways. Some of these different measures, which are called monetary aggregates, are described below.

Narrow measures of money

M1+ (gross):

Currency outside banks plus all chequable deposits held at chartered banks, trust and mortgage loan companies, credit unions and caisses populaires (excluding deposits of these institutions); plus continuity adjustments (to "smooth" a time series when there are structural breaks).

M1++ (gross):

M1+ (gross) plus all non-chequable deposits (other than fixed-term deposits) held at chartered banks, trust and mortgage loan companies, credit unions and caisses populaires; less interbank deposits; plus continuity adjustments.

Broad measures of money

M2 (gross):

Currency outside banks plus bank personal deposits, bank non-personal demand and notice deposits; less interbank deposits; plus continuity adjustments.

M3 (gross):

M2 (gross) plus bank non-personal term deposits and foreign-currency deposits of residents; less interbank deposits; plus continuity adjustments.

M2+ (gross):

M2 (gross) plus deposits at trust and mortgage loan companies and at government savings institutions; deposits and shares at credit unions and caisses populaires; life insurance company individual annuities; money market mutual funds; plus continuity adjustments and other adjustments (see "Notes to the tables," E1.)

M2++ (gross):

M2+(gross) plus Canada Savings Bonds and other retail debt instruments; plus non-money market mutual funds.

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Interest rates influence money supply

Commercial banks and other financial institutions provide most of the assets used as money through loans made to individuals and businesses. In that sense, financial institutions create, or can create money.

The Bank of Canada manages the rate of money growth indirectly through its influence on short-term interest rates, or through the reserves provided to large deposit-taking institutions. When short-term interest rates change, they tend to carry other interest rates—such as mortgage rates and other lending rates from commercial banks—along with them. When interest rates rise, consumers and businesses tend to hold less money, to borrow less, and to pay back existing loans. The result is a slowing in the growth of M1+ and in the other broader monetary aggregates.

Bank monitors money supply growth

The Bank monitors several different indicators to ensure that it achieves its inflation target. Among these indicators, monetary aggregates have been found to provide useful information about changes in the economy.

The Bank's economic research indicates that the growth of M1+ provides useful information about the future level of production in the economy. The growth of the broader monetary aggregates is a leading indicator of the rate of inflation.

The objective of the Bank of Canada's monetary policy is to support a level of spending on Canadian goods and services that is consistent with the Bank's goal of price stability, defined as keeping inflation within the inflation-control target range. By monitoring the rate at which the supply of money and credit is growing, along with other indicators, the Bank seeks to ensure that total spending on goods and services in the economy is consistent with achieving that goal.

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