Market crash of '87 returns

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TORONTO - David Laidler says that if the central bank does not start pumping money into the economy soon, it will set off a deflationary spiral.

Mr. Laidler is no wild-eyed prophet of doom. He is scholar-in-residence at the C.D. Howe Institute, a strong supporter of the Bank of Canada. Although he supports the bank, Mr. Laidler says it must change its strategy of fighting money growth.

High interest rates and tight money have scared away borrowers, Mr. Laidler argues. But the way our credit system works, borrowing is what creates money.

"Scare off too many borrowers and money growth begins to collapse: further downward pressure on prices and output ensues, and a deflationary spiral - just as damaging as an inflationary one - is soon in full swing," he says.

Now this may seem strange to those who have aruged that the money supply has been growing too quickly. Indeed it has until recently. In an eery way, the Crash of '87 is coming back to haunt us.

TOO MUCH MONEY

Throughout 1986 and early in 1987, Canadian and U.S. central bankers kept the system flush with money. When they tried to tighten in October, 1987, they precipitated the stock market crash. The crash was so devastating that central bankers flooded the market with money again. In so doing, they laid the groundwork for a wave of inflation later.

Until a few months ago, the money supply was burgeoning. But money growth has since ground to a halt. M-1, cash in circulation and bank deposits, fell at an annualized rate of 11.5 per cent over the past six months, Mr. Laidler notes. M-1 is the most interest-sensitive measure of money supply. M-2 which includes certain term deposits, grew at a meagre 2.5 per cent rate.

Over the past three months, both measures have shrunk, M-1 by 17 per cent and M-2 by 1.5 per cent. "These figures are far too low to be compatible with zero inflation," Mr. Laidler says. "They offer an early warning that a downward spiral of the 1981-82 variety is in the making."

He urges the central bank to increase liquidity available to the banking system. Otherwise recent money supply numbers will be a "route marker on the way into a much deeper, and by then unavoidable, depression."

Will John Crow, governor of the Bank of Canada, take Mr. Laidler's advice? Will Finance Minister Michael Wilson agree that the money supply is shrinking too fast?

LOWER RATES

If they do, and if liquidity is pumped into the banking system, short-term interest rates will fall. The danger is that long-term rates would do the opposite and rise. As it is now, short-term rates are higher than long-term ones.

Looking back, one can see what the Bank of Canada did wrong. Monetary policy works with a lag, so easy money spells inflation down the road. By being free with money in 1986 and 1987, the bank fuelled a boom in the housing market in 1988 and 1989. Credit demand swelled, led by skyrocketing mortgage loans.

Farmers support boycott

OTTAWA - The Canadian Federation of Agriculture is reacting postively to indications from the federal government that it is sympathetic to farmers who could lose millions of dollars as a result of the United Nations trade boycott against Iraq.

Last year, Iraq was Canada's fourth largest customers for wheat. In 1988-89, Iraq purchased wheat and barley exports worth about $300 million to Canadian grain producers. CFA President Don Knoerr said the trade embargo could represent a significant loss to farmers who are already facing economic difficulties because of high interest rates, low world prices for grains and oilseeds and high input costs.

"I'm encouraged that both Prime Minister Brian Mulroney and Mr. Mazankowski are carefully considering the difficulties faced by farmers and I am anxiously waiting to hear of a favorable compensation package," Knoerr said.

Knoerr noted a precedent exists for supporting farmers during trade embargoes. "We're hopeful the government will act quickly again to assist the country's food producers," he said.

The government paid about $80 million to producers shortly after it agreed in 1980 not to increase Canada's market share in the Soviet Union. The government took that decision following the imposition of a grain embargo by the United States.