

H. 13

April 20, 1962

No. 56

CAPITAL MARKET DEVELOPMENTS ABROAD

- I. Canada
II. Nine Charts on Financial Markets Abroad

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FEDERAL RESERVE BANK
OF RICHMONDCanada: Money and Capital Markets during March

In March, pressure on the Canadian exchange rate diminished somewhat. The rate firmed moderately just before mid-month, following indications of some relaxation in the official attitude discouraging foreign long-term borrowing by Canadians. Improvement in the exchange rate -- which moved from 95.2 U. S. cents on March 1 to between 95.3-95.4 U. S. cents around mid-March -- lessened the need for support operations on the scale of January and February, when official sales of U. S. dollars totalled (U.S.) \$309 million. The reserve loss of (U.S.) \$37 million reported for March was concentrated largely in the first part of the month. The exchange rate was under some pressure in the beginning of April, however, and remained at around 95-1/4 U. S. cents through the first two weeks, with some indications of official support operations.

The brief upward movement in Canadian short money rates which developed in the final weeks of February was interrupted and reversed in March. After reaching a high of 3.21 per cent on March 1 the Treasury bill rate moved sharply downward and averaged 3.09 per cent in the remaining four auction dates in March as well as through the first week in April. It declined further, to 3.04 per cent, on April 12. The drop in the Treasury bill rate followed the appearance of data indicating that the pace of Canadian business recovery, which was mildly encouraging at year's end, displayed some hesitation in the first two months of the year. During March, yields on Government of Canada bonds drifted downward, continuing the trend of the previous month, while the average yield for 40 provincial and corporate bonds declined from 5.34 per cent on February 28 to 5.25 per cent on March 30. This marks the lowest average yield since February 1959.

Although the latest general economic indicators do not extend beyond February, the view of the authorities on the continued need for relatively easy monetary and fiscal policies in the interests of spurring economic recovery was confirmed in the 1962-63 budget presented on April 10. The budget provides for some tax relief. Consumers will receive a minor concession in the form of an increase of \$50 in the deduction for dependents. In addition, two tax measures are specifically designed to assist the business recovery; they provide (a) for corporate tax rebates for increasing sales, and (b) a 150 per cent deduction from income for increased expenditures on scientific research for industrial purposes. The overall 1962-63 budget forecasts a deficit of \$745 million, compared with a deficit of \$791 million for the fiscal year which ended March 31.

DECONTROLLED AFTER SIX MONTHS

Money market. Canadian short-term interest rates began to move upward in the latter part of February but the movement was reversed in March. The average auction yield on the 3-month Treasury bill reached a high of 3.21 per cent on March 1, but thereafter moved rather sharply downward. Moving within a rather narrow range, the Treasury bill rate averaged 3.09 per cent for all subsequent weekly auction dates in March, as well as through the first week in April. On April 12 the yield declined further, to 3.04 per cent, at which point the bill rate had reverted to the general level prevailing at the beginning of the year. The 6-month bill rate also moved downward during the month, declining from 3.41 per cent on March 1 to 3.29 per cent on March 31 and to 3.24 per cent on April 12. Rates for day-to-day money remained level (at 2-3/4 per cent) for the first three weeks in March but moved upward at the end of the month, resulting in a rise in the monthly average from 2.62 per cent in February to 2.81 per cent in March.

In March, the Canadian chartered banks disposed of \$30 million in Treasury bills, and this reduction of bank holdings of short-term securities was matched by an equivalent increase in the Bank of Canada portfolio. Other changes in security holdings, amounting to approximately \$130 million, reflected absorption by the market of the short-term bond issue delivered on March 1.

The rather pronounced decline in the Canadian Treasury bill rate after March 1 -- with the U. S. Treasury bill rate moving narrowly within a range of 2.68 - 2.73 per cent between March 1 and April 12 -- reduced the spread in favor of the Canadian bill from 53 basis points on March 1 to 37 points at the end of the month and to 31 basis points on April 12. Changes in the relationship of forward to spot rates were more erratic and, as a result, the net incentive to hold the Canadian bill also fluctuated, from 0.40 per cent on March 1 to 0.37 per cent on March 29 and 0.24 per cent on April 12 (See Table and Chart 1).

Yields on short-term Canadian finance paper were unchanged during March, at a level slightly below the previous month. With U. S. rates showing only small variations which moved, on balance, marginally higher, the spread in favor of Canadian paper fell from 31 basis points on February 23 to 16 basis points on March 30. Yields for 30- to 89-day paper for leading acceptance houses in Canada and the United States were as follows, on the dates shown (in per cent per annum):

	<u>Canada</u>	<u>U. S.</u>	<u>Spread</u>
January 5	3.25	2.75-2.88	0.56
February 9	3.00	2.60-2.75	0.32
February 23	3.00-3.25	2.75-2.88	0.31
March 30	2.88-3.00	2.78	0.16

Bond market. The downward trend in yields on Canadian Government bonds with maturities of 3 years and over which was evident in February continued during March and into early April. The following comparison shows yields on selected maturities over recent months.

<u>Maturity</u>	<u>January 31</u>	<u>February 28</u>	<u>March 28</u>	<u>April 11</u>
May 1964	3.75	3.67	3.58	3.58
Jan. 1975-78	4.98	4.96	4.86	4.80
Sept. 1983	5.04	5.00	4.94	4.89

The generally more pronounced decline in yields on U. S. Government bonds during March resulted in some widening of yield spreads in favor of Canadian bonds. The widening was most pronounced in the case of the intermediate-term issue, only moderately so for medium and long-term maturities (see Table).

The continued decline in yields in the provincial and corporate bond sectors during March reflected the influence of heavy institutional buying, which may have included purchases which were postponed during December and January, when bond prices were falling. At the same time, the supply of new issues has been limited, with the volume of both provincial and corporate bond financing below last year's levels. During March, yields on provincial and corporate bonds declined to 5.25 per cent on March 30, reaching the lowest level since February 1959. As reported by McLeod, Young, Weir and Company, recent average bond yields were (in per cent per annum):

	<u>1962</u>		
	<u>Jan. 31</u>	<u>Feb. 28</u>	<u>Mar. 30</u>
10 Provincial	5.43	5.31	5.20
10 Municipal	5.65	5.54	5.44
10 Public utilities	5.25	5.23	5.18
10 Industrials	5.31	5.28	5.18
40 Bond yield average	5.41	5.34	5.25

According to A. E. Ames & Co., \$796 million of new securities (exclusive of regular short-term financing) were issued in the period ending March 26; this compares with new issues totalling \$921 million in the comparable period in 1961. The decline in volume so far this year was accounted for largely by smaller amounts of provincial and corporate financing. Of the amount of new issues through March 26, \$3 million in corporate bonds were sold on the U. S. market.

Debt management program. On April 11 the Minister of Finance announced details of the third issue this year in the Government's program of spacing borrowing at more frequent intervals in moderate amounts. The offering announced on April 11 consisted of an exchange of \$100 million of 3 per cent bonds maturing May 1, 1962 for an addition, in like amount, to the \$175 million outstanding 2-3/4 per cent bonds due June 1, 1963. The financing also included a new mid-term issue of \$100 million of 3-3/4 bonds due October 1, 1967. The exchange refunding, part of which will be offered for cash, will be used to retire the \$100 million issue falling due on May 1, while the advance refunding through issue of new medium-term bonds will reduce the maturities falling due on June 15 and August 1 by \$140 and \$285 million, respectively.

Fiscal 1962-63 budget. Amid signs that the mildly encouraging business expansion at the end of the year had given way to some hesitation in the pace of Canadian recovery in the first two months of the year, the 1962-63 budget presented on April 10 confirmed the Government's intentions of continuing expansionary fiscal policies. "The encouragement of economic growth," in the words of Finance Minister Fleming, "is the central purpose of this budget." The budget, accordingly, repeats the pattern of deficits which has characterized budget accounts in all five previous fiscal years; for fiscal 1962-63 the deficit is forecast at \$745 million, as compared with the \$791 million deficit for 1961-62. The new budget contains no significant new revenue measures or major tax cuts. Consumers will receive a minor concession in the form of an increase of \$50 in the income tax deduction allowable for dependents. In addition, two tax incentive devices in this year's budget are designed to encourage higher levels of general business activity and investment. Enterprises will be allowed a 50 per cent deduction in corporate taxes on all earnings from new sales up to \$50,000 and a 25 per cent deduction for new sales above this amount. Secondly, firms will be permitted a deduction of 150 per cent for increased expenditures for scientific research for industrial purposes.

Bank loans and money supply. As before, Canadian monetary conditions remained relatively easy and, despite some temporary tightness toward the end of the month, the average liquid asset ratio of the chartered banks was 18.0 per cent -- unchanged from February -- and still 3 percentage points above the required minimum. On a seasonally adjusted basis, it is estimated that total money supply rose in March, after declining in the previous month. General bank loans also continued to move upward. On the basis of data which are partly estimated, total Canadian money supply would appear to have risen by 2.3 per cent since the beginning of this year, as compared with an increase of 1.5 per cent in the first three months of 1961. On the same basis, general bank loans rose by 7.1 per cent in the first three months of this year, as compared with a more modest increase -- of 2 per cent -- in the first quarter of 1961, before a genuine improvement in the pace of Canadian business recovery had become evident.

Foreign trade. Despite an encouraging export performance through the third quarter of last year, the lower foreign exchange value of the Canadian dollar was relatively ineffective in promoting the recent development of sales abroad, while imports continued their general rising tendency. Nevertheless, preliminary balance of payments statistics indicate that Canada experienced an improvement in its external accounts for the year as a whole. The 1960 trade deficit (\$145 million) was reversed, yielding a trade surplus of \$179 million in 1961, the first export surplus in many years. The deficit on nontrade transactions rose from \$1,072 to \$1,168 million between 1960 and 1961. Dividend and interest payments increased markedly -- by \$84 million to a total of \$575 million last year -- while capital inflow (official and private) amounting to over \$600 million was about 30 per cent less than the \$873 million total recorded in 1960. The resulting current account deficit, according to preliminary estimates, works out at \$989 million, which is about 20 per cent less than in 1960 (\$1,217 million) and the lowest level since 1955, when the deficit was \$698 million.

In January, the latest month for which data are available on a seasonally adjusted basis, Canadian foreign trade was in approximate balance. Exports were valued at \$504.7 million, a decline of 6.7 per cent from the revised figure for December (\$541 million), while imports, amounting to \$507.5 million, were 2.7 per cent below the revised total of \$521.8 for December.

	1961				1962	
	II	III	Oct.	Nov.	Dec.	Jan.
Exports	473.5	514.4	505.9	509.0	541.0	504.7
Imports	443.2	495.5	523.5	517.7	521.8	507.5
Trade balance	+ 30.3	+ 18.9	- 17.6	- 8.7	+ 19.2	- 2.8

Foreign exchange. The Canadian dollar opened under pressure, at an approximate level of 95.2 U. S. cents, at the beginning of March. The rate displayed a somewhat firmer tone just before mid-month, following indications of some relaxation of the official attitude discouraging foreign borrowing by Canadian users of investment capital. The exchange rate regained the 95-1/2 cent level briefly in the third week in March but closed at 95.3 U. S. cents on March 30 and has remained at around 95-1/4 U. S. cents through the first two weeks in April. The improvement in the exchange rate during part of March reduced the need for support operations on the scale of the two previous months -- when official sales of U. S. dollars amounted to \$309 million -- and the reserve loss of \$37 million in March was apparently concentrated largely in the first part of the months.

	End of month				
	1960	1961	1962		
	Dec.	Dec.	Jan.	Feb.	Mar.
Gold	885.3	946.2	949.6	962.4	n.a.
U. S. dollars	943.9	1,109.6	972.3	784.3	n.a.
Total	1,928.2	2,055.8	1,921.9	1,746.7	1,709.4
Change during period		- 23.0	- 133.9	- 175.2	- 37.3

Relationships between the spot and forward rates for the Canadian dollar moved erratically during March and early April (see Table). The forward Canadian dollar stood at a continued small discount in the first week in March, moved to a premium when the rate firmed at mid-month, was on a flat basis over the end of the month and has currently moved again to a slight discount. Consequently, the net incentive to hold Canadian bills (covered for exchange risk) also changed erratically during this period, but it was still generally below levels which operate to induce any movement of funds into Canada (see Table). From statistics available through the end of February, there does not appear to have been any significant activity in non-Canadian currency assets and liabilities of the Canadian chartered banks for that month.

The Canadian exchange rate is currently under continued pressure, which suggests that the authorities are still engaging in support operations. In a review of exchange rate developments in the course of his budget presentation on April 10, Finance Minister Fleming re-stated the official view that the reversal of exchange rate policy of last June -- to which he attributed qualified success so far -- was intended to correct the overvaluation induced by the earlier capital inflow. He denied any intention of acting aggressively to lower the exchange rate but characterized the policy followed as one of responding to and moderating market pressures without engaging in actions prejudicial to the interests of other countries. At the same time, he indicated, "the government has not hesitated, and will not hesitate in the future, to deploy a substantial volume of funds, on one side of the market or the other, in order to prevent sudden or erratic movements in our exchange rate." The Finance Minister's references to Canada's relations with the International Monetary Fund were brief and generally non-committal; he acknowledged the Fund's desire for the "ultimate objective of having Canada declare a fixed exchange rate" but also noted that the Fund "has not been disposed to press us into any hasty action which might prove to be premature or impossible to maintain."

Stock exchange. In the first half of March industrial stock prices continued the slight upward movement initiated in February, but thereafter declined moderately through the first week in April. The weekly average for the index of industrial stock prices on April 6 was 1.8 per cent below March 9, while the New York Standard & Poor industrial index registered a drop of 2.7 per cent during the same period (see Chart).

Avg. for week ending	DBS Industrials	N.Y. Standard & Poor Industrials
1962 - Feb. 9	345.1	74.33
23	344.2	74.35
Mar. 9	342.1	73.94
30	345.3	73.69
Apr. 6	339.7	72.59

Canada: Treasury Bill Yields and Exchange Rates

<u>3-mo. Treas. bill arbitrage calculation</u>						Spot Can. \$ (U.S. cents)	<u>Finance paper^{d/}</u>	
Canada <u>a/</u>	U.S. <u>a/</u>	Differ- ence	3-mo. Can. \$ <u>b/</u>	In favor Can. bill ^{c/}	30-89 days		90-179 days	
1961-High	3.34	2.66	0.68	0.45	0.89	101.72	--	--
Low	2.26	2.17	-0.13	-0.56	-0.20	95.91	--	--
1962-Feb. 15	3.06	2.84	0.22	-0.26	-0.04	95.34	3	3-1/4
22	3.17	2.69	0.48	-0.26	0.22	95.30	3 to	3-1/4
Mar. 1	3.21	2.68	0.53	-0.13	0.40	95.22	--	--
8	3.08	2.75	0.33	-0.20	0.13	95.22	2-7/8 to 3	3-1/8-1/4
15	3.08	2.73	0.35	+0.07	0.42	95.33	2-7/8 to 3	3-1/8-1/4
22	3.10	2.69	0.41	+0.13	0.54	95.31	2-7/8 to 3	3-1/8-1/4
29	3.12	2.75	0.37	0	0.37	95.28	2-7/8 to 3	3-1/4
Apr. 5	3.09	2.72	0.37	0	0.37	95.23	--	--
12	3.04	2.73	0.31	-0.07	0.24	95.30	--	--

a/ Thursday quotations.b/ Spread between spot and 3-month forward rate in per cent per annum. Discount equals (-).c/ Net of difference in bill yield less discount on 3-month Canadian dollar.d/ Friday quotations.Selected Government of Canada Security Yields

	<u>6-mo. Treas. bills</u>		<u>Intermediate</u>		<u>Long-term bonds</u>			
	<u>Spread</u>		<u>bonds (8 yr.)</u>		<u>(20 year)</u>		<u>(35 year)</u>	
	Canada <u>a/</u>	U.S. <u>b/</u>	Canada <u>c/</u>	U.S. <u>d/</u>	Canada <u>e/</u>	U.S. <u>f/</u>	Canada <u>g/</u>	U.S. <u>h/</u>
1961 - High	3.63	1.15	4.75	1.16	5.19	1.40	5.23	1.59
Low	2.35	-0.11	4.17	0.04	4.80	0.78	4.92	1.14
Feb. 28	3.41	0.55	4.15	0.17	4.90	0.77	4.92	1.13
Mar. 7	3.24	0.36	4.11	0.17	4.88	0.78	4.92	1.14
14	3.25	0.35	4.09	0.26	4.87	0.83	4.92	1.17
21	3.26	0.42	4.09	0.38	4.86	0.84	4.92	1.18
28	3.29	0.41	4.11	0.32	4.82	0.82	4.91	1.18
Apr. 4	3.30	0.49	4.12	0.53	4.82	0.92	4.91	1.23
11	3.24	0.39	4.13	0.45	4.77	0.85	4.88	1.18

a/ Average yield at weekly tender on Thursday.b/ Spread between Canadian auction rate and composite market yield of U. S. bill on close of business Thursday.c/ Government of Canada 2-3/4 per cent of June 1967-68.d/ Spread over U. S. Government 2-1/2 per cent of 1963-68.e/ Government of Canada 3-1/4 per cent of October 1979.f/ Spread over U. S. Government 3-1/4 per cent of 1978-83.g/ Government of Canada 3-3/4 per cent of September 1996 - March 1998.h/ Spread over U. S. Government of 1995.

**Canada: Changes in Distribution of Holdings of Canadian
Government Direct and Guaranteed Securities**
(millions of Canadian dollars, par value)

	<u>Bank of Canada</u>		<u>Government Total</u>	<u>Chartered banks</u>		<u>General public</u>		
	<u>Treas. bills</u>	<u>Bonds</u>		<u>Treas. bills</u>	<u>Bonds</u>	<u>Savings bonds</u>	<u>Treas. bills</u>	<u>Bonds</u>
1961-Mar.	- 47	-120	- 25	- 36	+ 50	- 18	+ 30	+ 6
April	+ 9	+ 59	- 2	- 70	- 52	- 37	+ 64	- 12
May	+ 17	- 22	- 1	+ 63	+ 24	- 33	- 80	+ 1
June	- 74	+ 43	+ 5	+ 33	+ 62	- 22	- 7	+ 37
July	+ 69	+ 21	+ 16	+ 16	+ 11	- 23	- 95	- 37
Aug.	0	+ 21	+ 32	+107	+148	- 29	- 87	- 35
Sept.	+ 16	+ 44	+ 9	- 58	+ 72	- 24	+ 40	+ 42
Oct.	-105	+ 14	- 39	+109	+ 4	+ 4	- 3	- 31
Nov.	- 9	+ 3	-125	- 42	+ 56	+720	+ 48	- 67
Dec.	- 3	+ 32	+ 21	- 48	+111	+ 24	+ 47	- 77
1962-Jan.	- 69	- 1	+ 88	+ 48	+ 57	- 10	- 20	- 19
Feb.	- 42	- 44	- 19	- 8	- 4	- 4	+ 69	- 34
Mar.	+ 30	+ 51	- 51	- 30	+ 43	- 13	- 18	+ 87

Source: Bank of Canada, Weekly Financial Statistics.

Canadian banks: Non-Canadian Currency Assets and Liabilities
(in billions of Canadian dollars)

	<u>Deposits</u>			<u>Assets</u>				
	<u>Banks</u>	<u>Others</u>	<u>Total</u>	<u>Deposits with banks</u>	<u>Call loans</u>	<u>Securi- ties</u>	<u>Other loans</u>	<u>Total</u>
<u>End of year</u>								
1957	.3	1.5	1.8	.4	.6	.4	.5	1.9
1958	.4	1.7	2.1	.3	.6	.5	.7	2.1
1959	.5	1.9	2.4	.4	.7	.5	.8	2.4
1960	.7	2.0	2.7	.5	.8	.6	.8	2.7
1961	.7	2.8	3.5	1.0	.8	.7	1.1	3.6
<u>End of Quarter</u>								
1961: I	.6	2.3	2.8	.6	.7	.8	.7	2.8
II	.6	2.8	3.3	.8	1.0	.7	.8	3.3
III	.6	2.9	3.5	.9	.8	.9	.9	3.5
IV	.7	2.8	3.5	1.0	.8	.7	1.1	3.6
<u>End of month</u>								
1961: Sept.	.6	3.0	3.5	.9	.8	.9	.9	3.5
Oct.	.7	3.0	3.7	1.0	.9	.8	.9	3.6
Nov.	.7	3.2	3.9	1.0	.9	1.0	1.0	3.9
Dec.	.7	2.8	3.5	1.0	.8	.7	1.1	3.6
1962: Jan.	.8	3.0	3.8	.9	.8	1.1	1.0	3.8
Feb.	.8	3.1	3.9	.9	.8	1.2	1.0	3.9

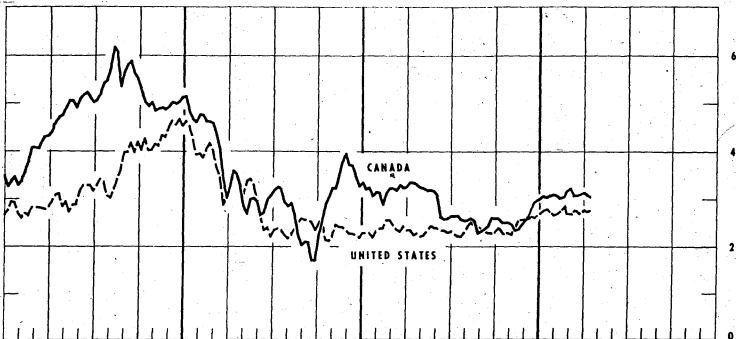
Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

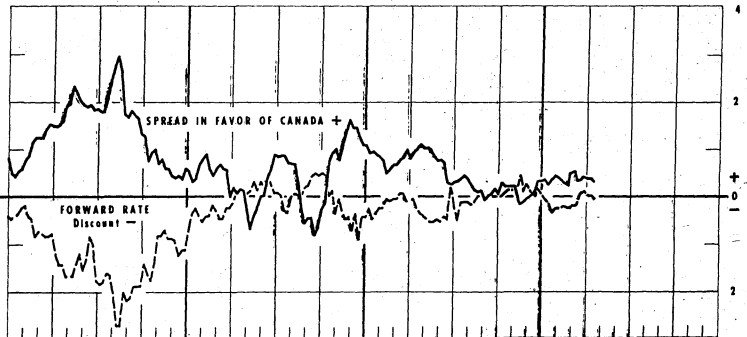
Thursday figures

THREE-MONTH TREASURY BILL RATES

Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

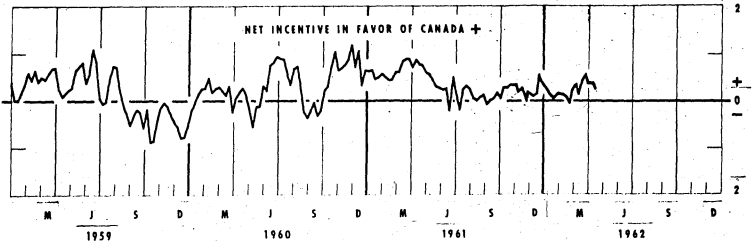
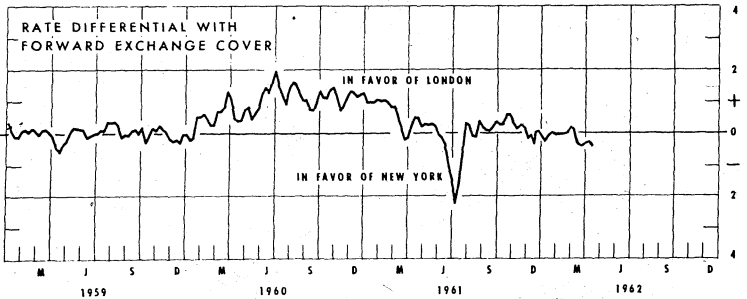
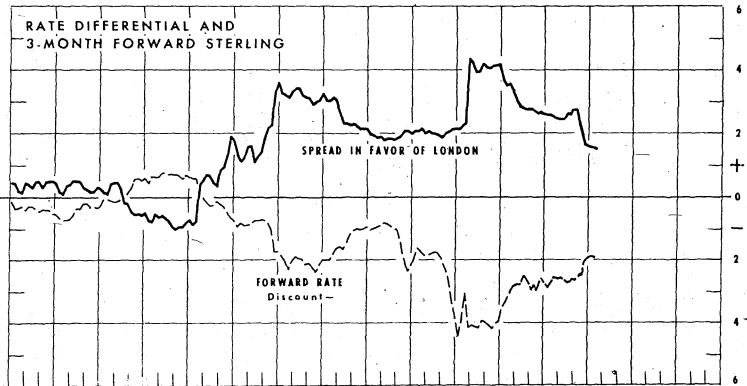
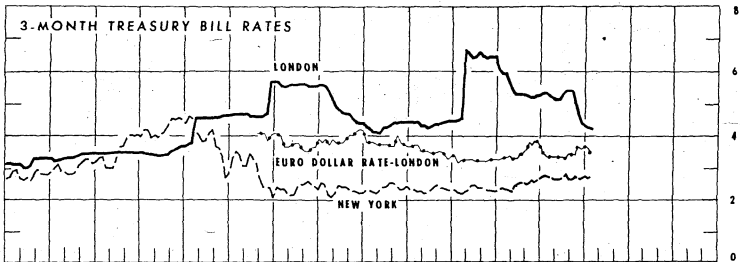


Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

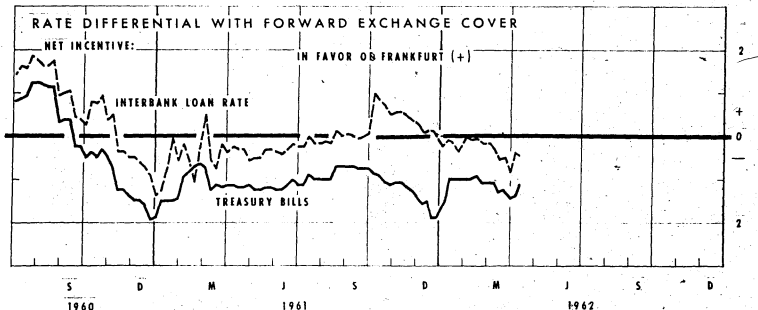
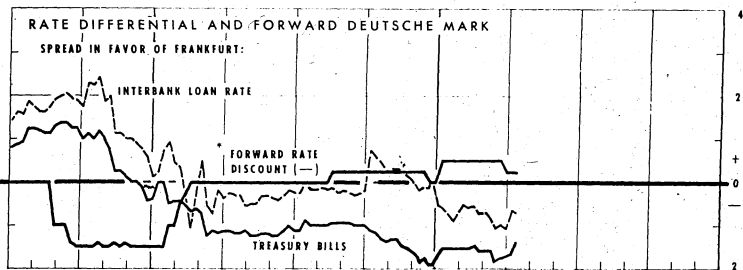
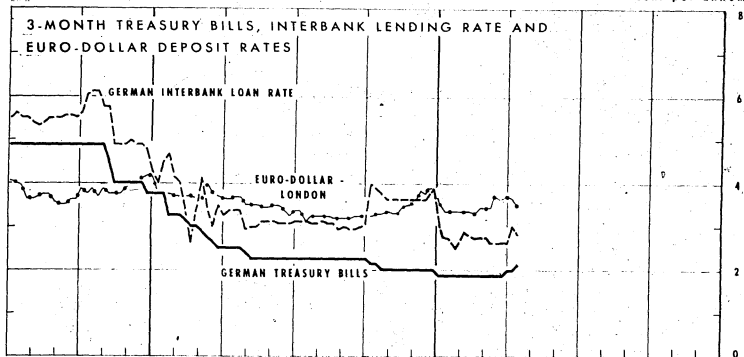
Per cent per annum



INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum



Note: Special forward rate available to German commercial banks

Chart 4

INTEREST ARBITRAGE, FRANKFURT / LONDON

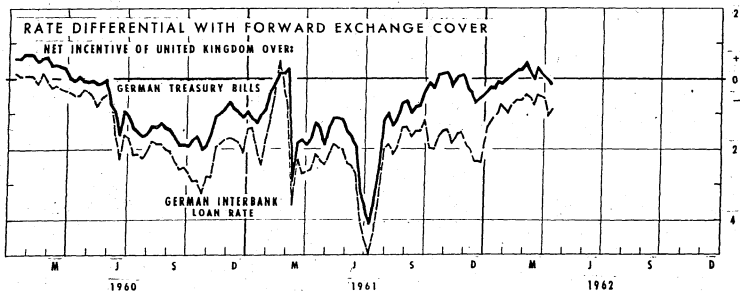
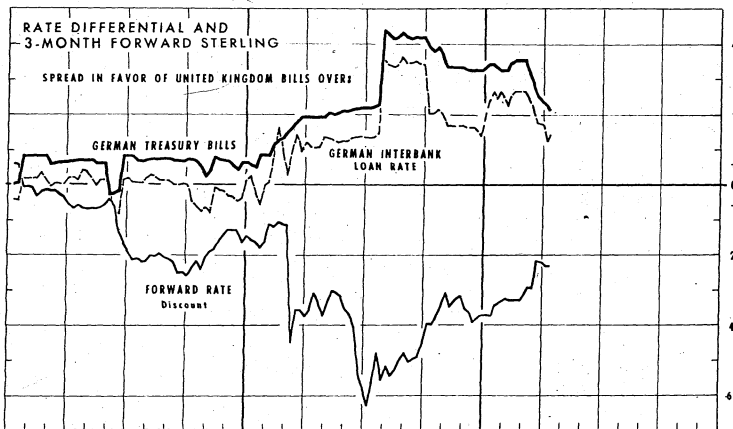
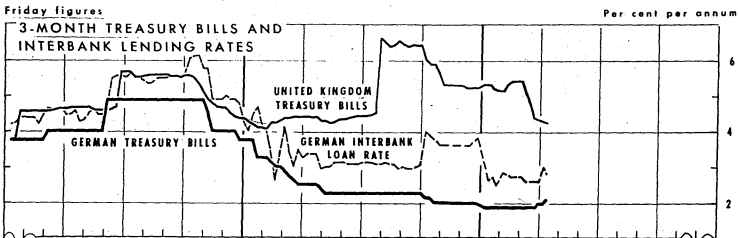
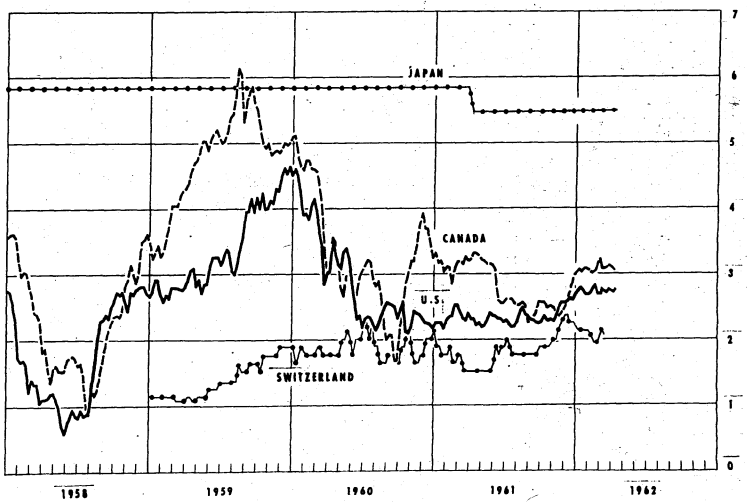
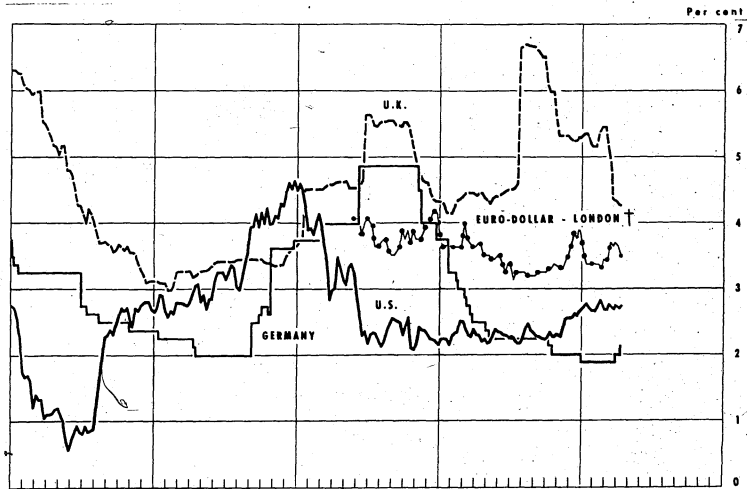


Chart 5
SHORT-TERM INTEREST RATES *



* 3-month treasury bill rates for all countries except Japan (3-month interbank deposit rate) and Switzerland (3-month deposit rate).
 † 3-month rate for U.S. dollar deposits in London

Chart 6

LONG-TERM BOND YIELDS

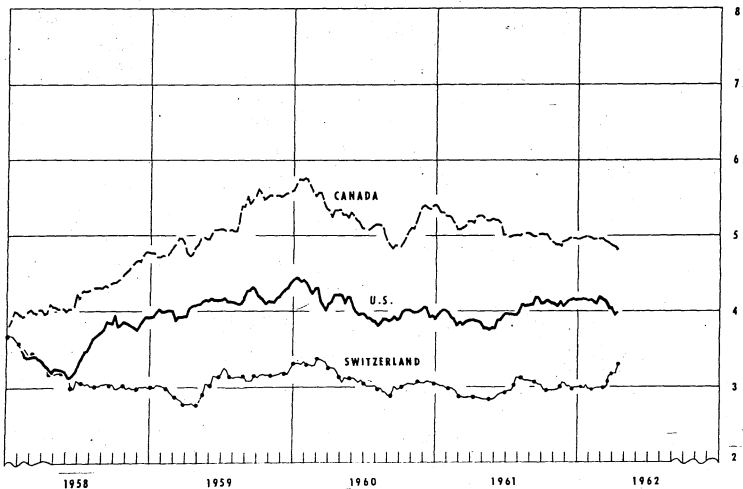
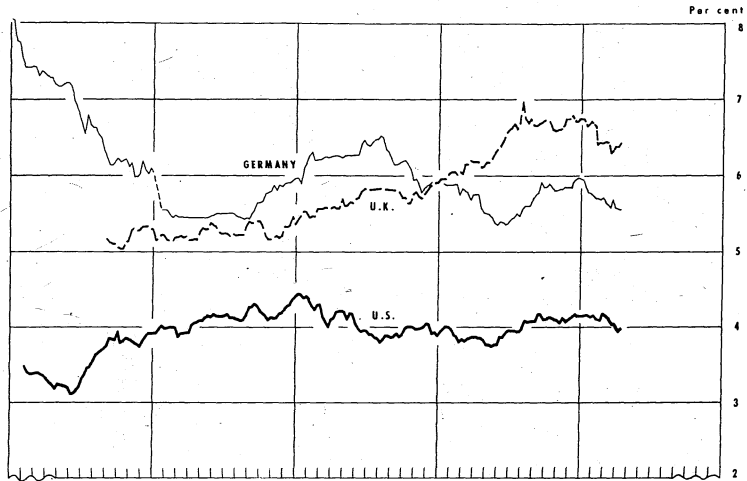
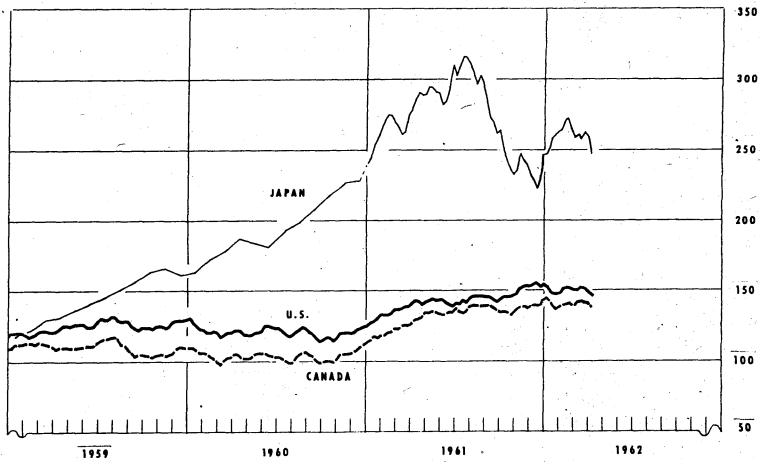
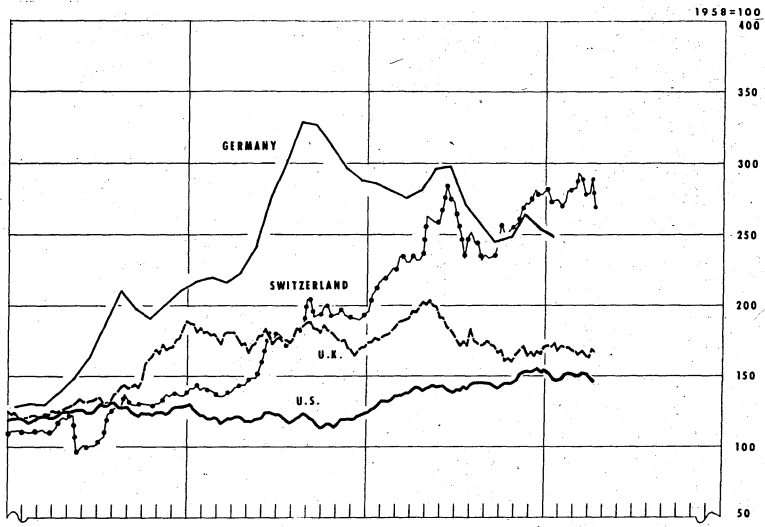


Chart 7

INDUSTRIAL STOCK INDICES*



* Note: Japan: Index of all stocks traded on Tokyo exchange

Chart 8

SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR

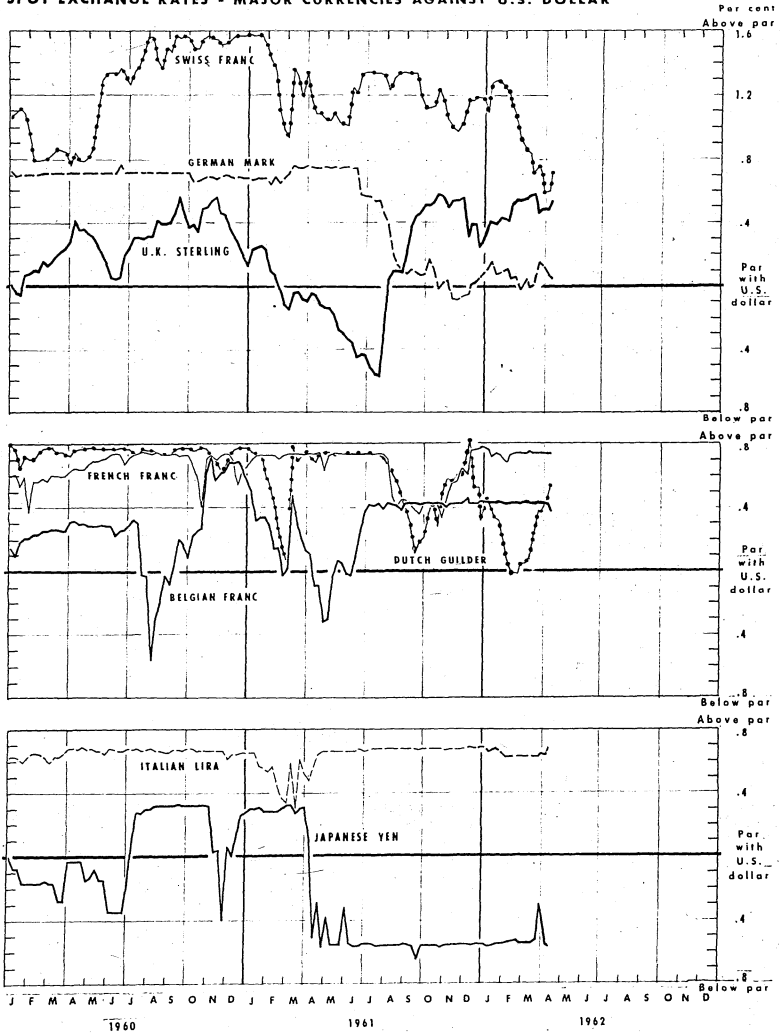


Chart 9
3-MONTH FORWARD EXCHANGE RATES

