DIVISION OF INTERNATIONAL FINANCE

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

H. 13
No. 176

December 16, 1964.

CAPITAL MARKET DEVELOPMENTS ABROAD

I. Canada: Money and Capital Markets, July-November, 1964

Summary

* At the end of business on November 23, the Bank of Canada raised discount rate from 4 to 4-1/4 per cent after discount rate increases of 2 per cent in the United Kingdom and 1/2 per cent in the United States had been announced earlier that day. International developments prompted this step, rather than domestic considerations. Despite the larger rise in discount rate in the United States, differentials on both short-term financial obligations and on bond yields between the United States and Canada were no lower on December 4 than they had been on November 18. (See Table 1.)

* ERRATA - OPENING SENTENCE CORRECTED ACCORDING TO ERRATA NOTICE. 12/24/64

Table 1. Canadian-U.S. Comparative Market Yields on Bills and Bonds, July-December 1964
(yields and differences in per cent per year; (+) favors Canada)

	July 8	Aug. 19	Sept. 16	Oct. 21	Nov. 18	Nov. 23 1/	Nov. 25	Nov. 27	Dec. 4
Three-month paper, fully-hedged:									
Can. treasury bills (covered)	3.74	3.37	3.55	3.43	3.49	3.50	3.55	3.51	3.64
U.S. treasury bills	3.45	3.48	3.52	3.56	3.58	3.70	3.77	3.79	3.76
Difference	.29	-.11	.03	-.13	-.09	-.20	-.22	-.28	-.12
Can. finance paper (covered)	4.16	4.02	4.26	4.20	4.20	n.a.	n.a.	4.10	4.40
U.S. finance paper	3.88	3.75	3.75	3.88	3.88	n.a.	n.a.	4.00	4.00
Difference	.78	.27	.51	.32	.32	n.a.	n.a.	.10	.40
Government bonds:									
Can. 1967-68, 2-3/4%	4.31	4.47	4.49	4.44	4.34	4.46	4.50	4.50	4.42
U.S. 1963-68, 2-1/2%	3.82	3.78	3.90	3.91	3.87	3.94	3.95	3.93	3.94
Difference	.49	.69	.59	.53	.47	.52	.55	.57	.48
Can. 1972, 4-1/4 %	5.00	5.12	5.07	5.02	4.89	5.03	5.05	5.05	5.05
U.S. 1967-72, 2-1/2%	3.94	3.90	4.00	4.03	3.99	4.05	4.04	4.04	4.02
Difference	1.06	1.22	1.07	.99	.90	.98	1.01	1.01	1.03
Can. 1979, 3-1/4%	5.14	5.15	5.14	5.11	4.97	5.05	5.05	5.05	5.04
U.S. 1978-83, 3-1/4%	4.10	4.13	4.20	4.18	4.13	4.17	4.17	4.17	4.19
Difference	1.04	1.02	.94	.93	.84	.88	.88	.88	.85
Can. 1996-98, 3-1/4%	5.11	5.14	6.12	5.13	5.04	5.06	5.08	5.06	5.06
U.S. 1995, 3%	3.73	3.78	3.82	3.81	3.75	3.78	3.78	3.78	3.79
Difference	1.38	1.36	1.30	1.32	1.29	1.28	1.30	1.28	1.27

1/ Discount rate change effective evening of the 23rd.

The unexpected developments in the United Kingdom and then in the United States during the course of November 23 produced a sharp reaction in Canadian financial markets. During Monday, November 23, the Bank of Canada was actively purchasing both Treasury bills and other government securities which were being sold by private investors. For the week ending November 25 the Bank of Canada added $62 million to its Treasury bill and $18 million to its bond holdings. Non-bank investors reduced their holdings of Treasury bills by $39 million and of marketable bonds by $37 million.

Earlier in the period under review, from mid-June through mid-September, financial markets had tightened in Canada as the high level of domestic activity led to heavy increases in bank loans to the private sector. During this period, the chartered banks made substantial sales of government securities to finance their additions to loans; these sales were in part offset by some Bank of Canada purchases of these securities and by Treasury repurchases out of an unexpectedly large cash surplus. Bank liquidity fell and interest rates rose in all maturities. (See Table 1.)

After mid-September, however, conditions in Canadian markets eased perceptibly. Official purchases of foreign exchange aided the liquidity position of the banks as capital inflows from the United States exceeded amounts needed to cover the Canadian payments deficit on other transactions. Thus, official reserve gains from September through November amounted to (US) $273 million (including a $112 million Canadian repayment to the I.M.F.). These capital inflows also helped to push the spot Canadian dollar from 92.79 U.S. cents on August 31 in a fairly steady movement to its effective ceiling of 93.25 U.S. cents on November 20. On the domestic side, a partly seasonal slowing down in the increase in loans to the private sector contributed to the easing of conditions in Canadian financial markets after mid-September. Interest rates fell across a range of maturities, and U.S.-Canadian yield differentials narrowed considerably from August 19 to November 18. (See Table 1.)

Canadian borrowing in U.S. markets rises

During the period under review, funds flowed into Canada from the United States on both short-term and long-term accounts. On the short-term side, covered yield differentials favoring Canadian over U.S. finance paper were usually in the range of 27 to 51 basis points and produced a continuing modest flow of U.S. funds to Canada. On November 27, just after the Bank rate changes, the differential was only 10 basis points but by December 4 it had returned to 40 basis points. (See Table 1.)

On the long-term side, a substantial calendar of new Canadian issues in United States markets is suggested from press reports of new offerings; market reports suggest that gross new Canadian issues may have been running at a quarterly rate of around $450 to $550 millions in the fourth quarter of 1964, following the signing of the Canadian exemption from the I.E.T. (See Table 2.) But net new issues for late 1964 may fall within a range of $225 to $275 million when allowance is made for the scheduled repayment of $70 million to its United States parent company by Union Carbide of Canada, and for the 1963 rate of security retirements.

Table 2. Canada: Selected U.S.-Pay New Security Flotations, July-November, 1964

Approx. Date		Borrowers	Amounts (Millions)	Coupon	Net Rate	Maturity
July	7	Texas Gulf Sulphur *	25	--		
	8	International Minerals and Chemical Co. *	125	5-1/2		18 yrs.
	22	Coronation Credit Co.*	6			1979
		Province of Newfoundland *	10	4-7/8-- 5-1/4		3-20 yrs.
Sept.	1	British Columbia Schools (provincial guarantee)*	10	4-1/2		1-20 yrs.
Oct.	2	Bell Telephone of Canada *	50	4-3/5		1989
	3	Manitoba Hydro	25	4-1/4	4.75	1989
	8	City of Vancouver	6	4-3/4		1-20 yrs.
	15	Quebec Hydro	50	4-3/4		1989
		Province of New Brunswick	7.5	5-1/2	5.59	1989
	22	Province of Nova Scotia	25	4-1/2	4.77	25 yrs.
		City of Montreal *	60	5-1/2		2004
		Montreal Catholic Schools *	7.9	5		1989
Nov.	9	Campbell Miners*	6.5	6		1973
	11	Toronto-Dominion Tower *	25	4.85		1989
	20	Alberta Government Telephone *	25	4-3/4	4.75	
	27	City of Winnipeg *	6	4-3/4		1965-89

* Private Placement.

Spot Canadian dollar near ceiling

On November 20th, the spot Canadian dollar stood at its ceiling of 93.25 U.S. cents, having risen more than 70 basis points from early July. (See Table 3 and Chart 8.) The rise in the spot rate reflects the continued high level of Canadian export earnings through August-September, and the current high levels of Canadian new issue activity in New York. From August at least through October, the rise in the spot Canadian dollar had been moderated by substantial acquisitions of foreign exchange by the authorities. Immediately following the changes in the U.S. and Canadian discount rates, the spot Canadian dollar remained near its ceiling.

Table 3. Canada: Spot and Forward Foreign Exchange Rates 1/
(per cent per year, U.S. cents per Canadian dollar)

	July 15	Aug. 19	Sept. 16	Oct. 30	November 18	November 20	November 25	November 30	Dec. 4
Spot Rate: (U.S. cents)	92.45	92.70	93.01	93.06	93.18	93.25	93.25	93.23	92.95
Forward Premium (%)	+.2	-.3	-.2	-.2	-.1	-.1	-.2	-.3	-.1

1/ Par value 92.50, ceiling 93.24 U.S. cents.

Arbitrage incentives move towards New York

Following the U.S. and Canadian discount rate changes, hedged yield differentials on treasury bills and on prime finance paper briefly improved in favor of New York by roughly 20 basis points, largely reflecting the movement of the forward Canadian dollar to a wider discount against the U.S. dollar. However, by December 4 the hedged incentives on 3- and 6-month finance paper had widened again to around 40 points in favor of Canada, and the covered differential on 3-month treasury bills had returned about to its November 18th level. (See Table 1 and Charts 1 and 2.) These adjustments reflect increases in the rates on Canadian finance paper, and a fall in the forward discount.

The covered incentives on bills and finance paper had remained unchanged in the month ending November 18. Earlier, from June 19 through August 21, hedged yield differentials favoring Canada had narrowed, primarily reflecting a 60 basis point shift in the forward Canadian dollar from a premium of .27 per cent to a discount of -.34 per cent per year.

Bank loans expand

During the five and a half months ending in mid-September, the commercial (chartered) banks' liquidity position tightened, reflecting the quite rapid expansion of bank advances to the private sector, as well as the drawing down of Government of Canada deposits with the commercial banks. The substantial increase in commercial bank loans--amounting to $740 million--was financed by bank sales of $321 million of central government bills and securities (see Table 4), and by an increase of $252 million in non-government deposits; at the time, central government deposits with the commercial banks were drawn down $139 million. These transactions have tended to reduce liquid assets holdings of the commercial banks even as their Canadian dollar deposit liabilities were rising. As a result, liquid asset ratios tended to fall through the middle of September. (See Table 5.)

The increase in bank loans began leveling out after perhaps mid-August, partly reflecting normal seasonal movements; from mid-September, bank holdings of government securities began to rise again; and in the six weeks through November 18 the rise in deposits greatly outpaced the increase in bank loans, which again were rising more briskly.

Table 4. Canada: Changes in Holdings of Central Government Direct and Guaranteed Debt, 1964

(Increases (+), par values in millions of Canadian dollars)

	1964 April 1 to Aug. 12	Aug. 12 to Sept. 16	Sept. 16 to Nov. 18	Nov. 18 to Nov. 25
A. Commercial Banks				
Treasury bills	-81	-43	+154	-7
"Other"	-156	-41	-40	+19
Total	-237	-84	+114	+12
B. Bank of Canada				
Treasury bills	+50	+27	-87	+62
"Other"	+60	-25	-11	+18
Total	+110	+2	-98	+80
C. "General Public"				
Treasury bills	-14	+16	-83	-39
Canada Savings Bonds	-146	-32	+583	+134
"Other"	+145	+25	-12	-37
Total	-15	+9	+488	+58
D. Total Change in Government Paper Outside Govt. Accounts				
Treasury bills	-45	--	-16	+17
Canada Savings Bonds 1/	-146	-32	+583	+134
"Other"	+49	-41	-63	--
Total	-142	-73	+504	+151

1/ Canada Savings Bonds are not marketable.
Source: Bank of Canada, Weekly Financial Statistics.

Government debt transactions

From November 18 to 25--the week of the discount rate changes--substantial non-bank net sales of marketable securities were met by the Bank of Canada which, together with central government sinking funds, bought up $77 million worth. (See Table 4.) During this week government bond prices fell, and yields rose 8 to 28 basis points across a range of maturities. Commercial bank holdings of bonds rose, interrupting a fairly steady seven-months long downwards trend.

Table 5. Canada: Selected Assets and Liabilities of the Commercial Banks, June-November, 1964

	Changes ($ million) during				Outstanding
	June 13-Aug.12	Aug.12-Sept.9	Sept.9-Oct. 7	Oct. 7-Nov.18	as of Nov.18
1. Assets & liabilities, selected					
General loans	+293	+50	+13	+44	8153
Total deposits	+105	- 3	-103	+425	16173
Treas. bill and govt. securities	-138	-54	+34	+63	3717

	Average of Wed.					
	Jan.	July	Aug.	Sept. 16	Oct. 14	Nov. 18
2. Liquidity ratios 1/						
Cash 2/	8.21	7.83	8.29	8.13	8.11	7.93
"Average" liquid assets 3/	18.03	16.72	16.57	16.52	17.14	17.39
"More" liquid assets 4/	35.98	32.99	33.00	32.10	32.77	32.10

1/ Current month computations, based on average of Wednesdays in the month, or on spot Wednesday returns.
2/ Bank of Canada notes and deposits.
3/ Cash assets plus day-to-day loans and treasury bills.
4/ Average liquid assets plus call loans and government bonds.
Source: Bank of Canada data.

From mid-September through mid-November, commercial bank holdings of Treasury bills had risen sharply, as bank deposits rose much more than loans to the public. The increase in bank holdings of treasury bills, amounting to $154 million, was supplied about equally from sales by the Bank of Canada and by the non-bank public.

Through mid-September, the commercial bank sales of government securities partly had been offset by Central bank purchases, and indirectly, by Dominion government purchases out of an unexpectedly large cash surplus on current and capital transactions. During the five and a half months ending in mid-September, the Bank of Canada purchased $112 million of the $321 million sold off by the banks; and the Dominion government repurchased $178 million worth of non-marketable Canada Savings Bonds from the public, while concurrently the public acquired an additional $173 million of the marketable bonds sold off by the commercial banks. (See Table 4.) Repurchases of central government obligations took place at falling prices, making continued bank liquidations less attractive.

Bond yields up

The discount rate changes interrupted the fall in Canadian bond yields underway since mid-September. During the week of the discount rate change, the yield differentials favoring investment in Canadian over comparable U.S. securities ranged from 57 basis points on shorter dated bonds to 130 points on longer issues. By December 4, Canadian markets had settled, and bond prices firmed; the yield differential had fallen back roughly to its range of November 18--about 48 points on the short end to 127 points on the long end. Under normal market conditions, a spread of about 50 basis points is considered sufficient to move funds.

Yields had declined moderately across a wide range of maturities in the month from mid-September through mid-November. The decline in yields ranged from 19 basis points for call money to 8-18 points on government bonds. (See Table 1.) The firming of bond prices in this period had attracted Canada-pay issues of several provinces. (See Table 6.) On November 16 the Government of Canada had placed its $475 million refinancing in the short and medium-term market, rather than in the firming long-term market. Following announcement of the terms of the issue, which was heavily oversubcribed, long-end bond prices rose further, and the U.S.-Canadian yield spread narrowed further.

Table 6. Canada: Selected New Security Issues In Canadian Markets
(millions of Canadian dollars, and per cent per annum)

Date		Borrower	Amount	Coupon	Price	Net Return	Maturity
July	2	Quebec Auto (prov. guar.)	50	5-3/4	99.25	5.81	1989
Aug.	13	Industrial Acceptance Co.	10	5-3/4	99.00	5.83	1984
	26	Province of New Brunswick	10.5	5-1/2	97.00	5.73	1988
	26	Traders' Finance Co.	15	5-3/4	98.50	5.87	1984
Sept.	2	Ontario Hydro	65	5-1/4	97.50	5.46	1984
	9	Province of Quebec *	100			5.05	1965-68
	9	Bank of Montreal *	70			5.4 avg.	1965-68
	9	Kinross Mortgage*	50			5.67	1966-67
	16	Government of Canada	400	3-1/2--5.0			1965-68
Oct.	19	Trader's Finance	6	6.0	100	6.0	1986
						Principal tranche	
	20	City of Toronto	33.5		99.75	5.52	1984
	22	Province of New Brunswick	5.9	5-1/2		5.60	1994
	22	Canadian Industries, Ltd.	25	5-5/8	par.	5-5/8	
	22	Husky Oil	20	6.0	par.	6.0	1989
	22	Province of Saskatchewan	15	5-1/2	par.	5-1/2	1985
	27	Manitoba Telephone	12	5-1/4	97.75	5.43	1984
Nov.	2	Province of Ontario	60	5-1/4	98.75	5.35	1984
	4	Quebec Hydro	60	5-1/2	98.75		1988
	16	Government of Canada	475	3-1/2--5-1/4	97.20-par.		1965-75

* Loans by Government of British Columbia out of proceeds of Columbia River water rights sale.

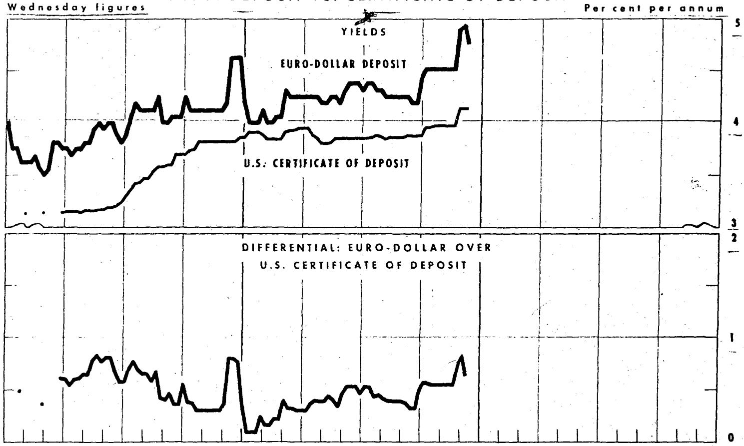
Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

3-MONTH EURO-DOLLAR DEPOSIT VS. CERTIFICATE OF DEPOSIT

Wednesday figures

Per cent per annum



NEW YORK OFFER RATES ON SELECTED 3-MONTH INVESTMENTS

Friday figures

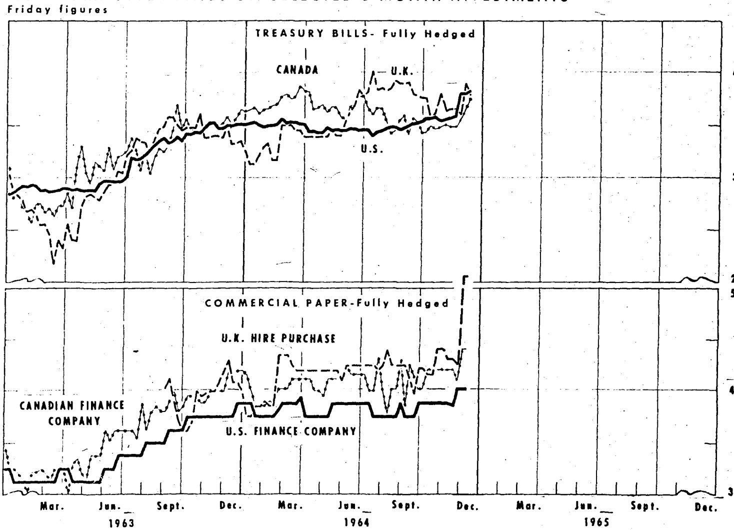
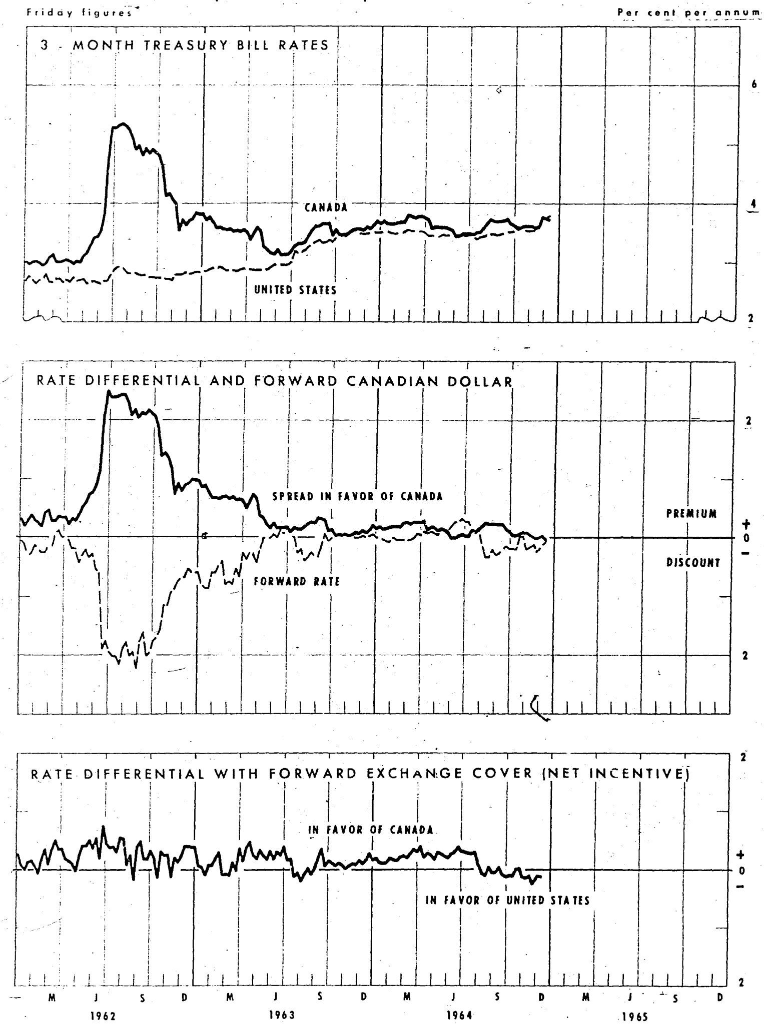


Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Friday figures*



* Thursday figures 1962, Friday thereafter

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

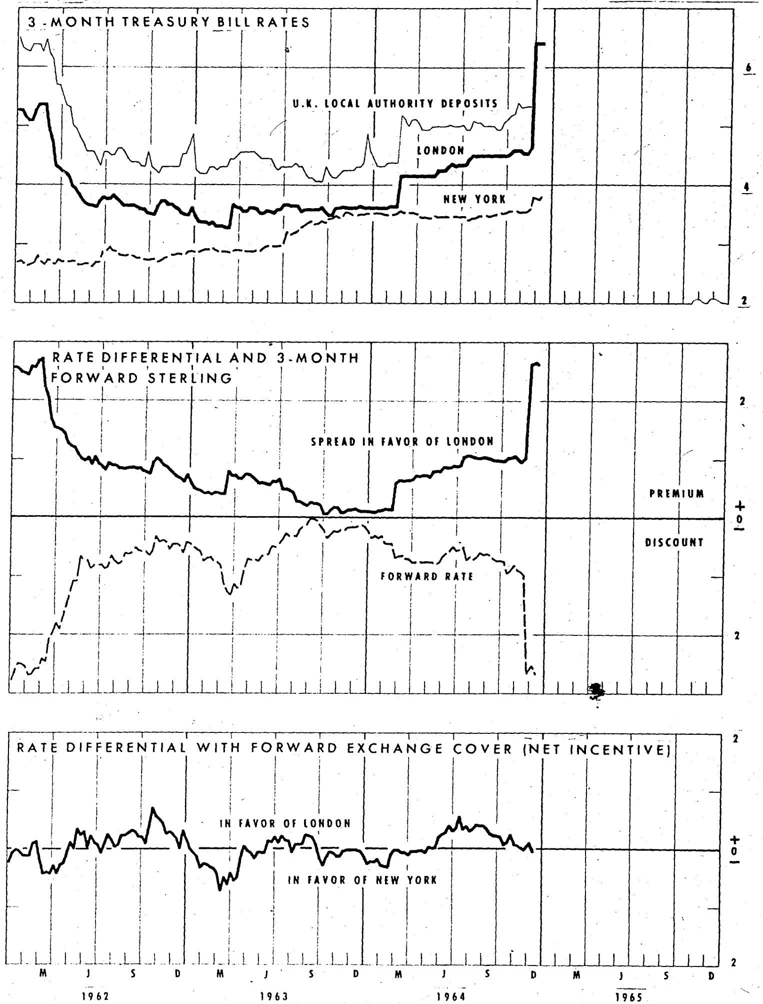


Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum

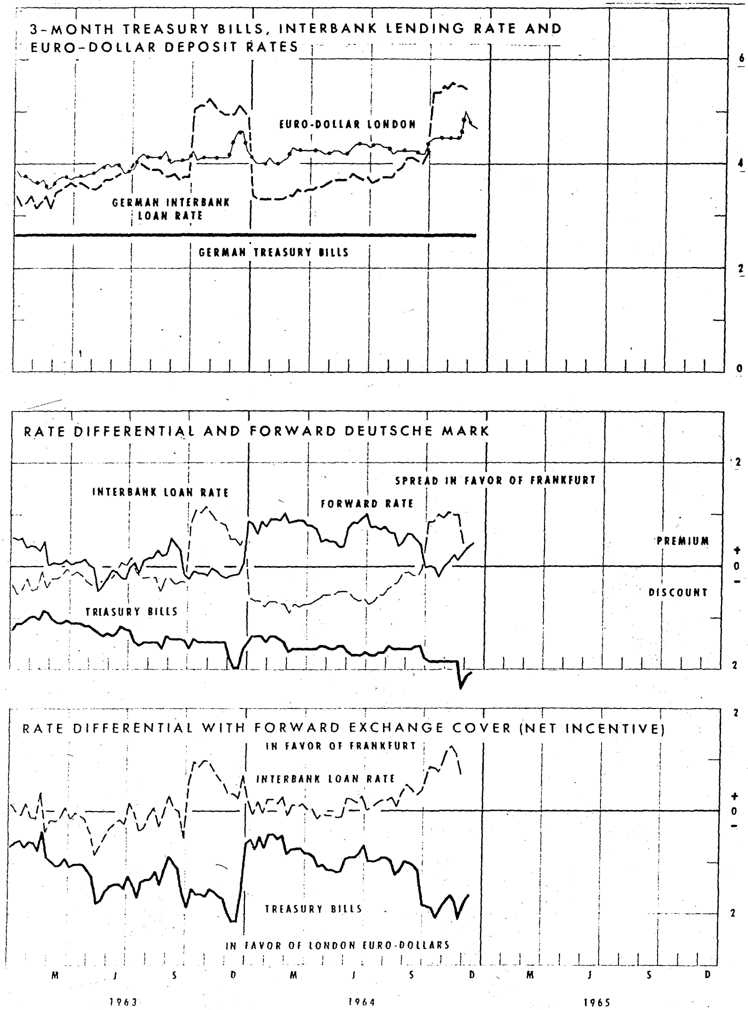
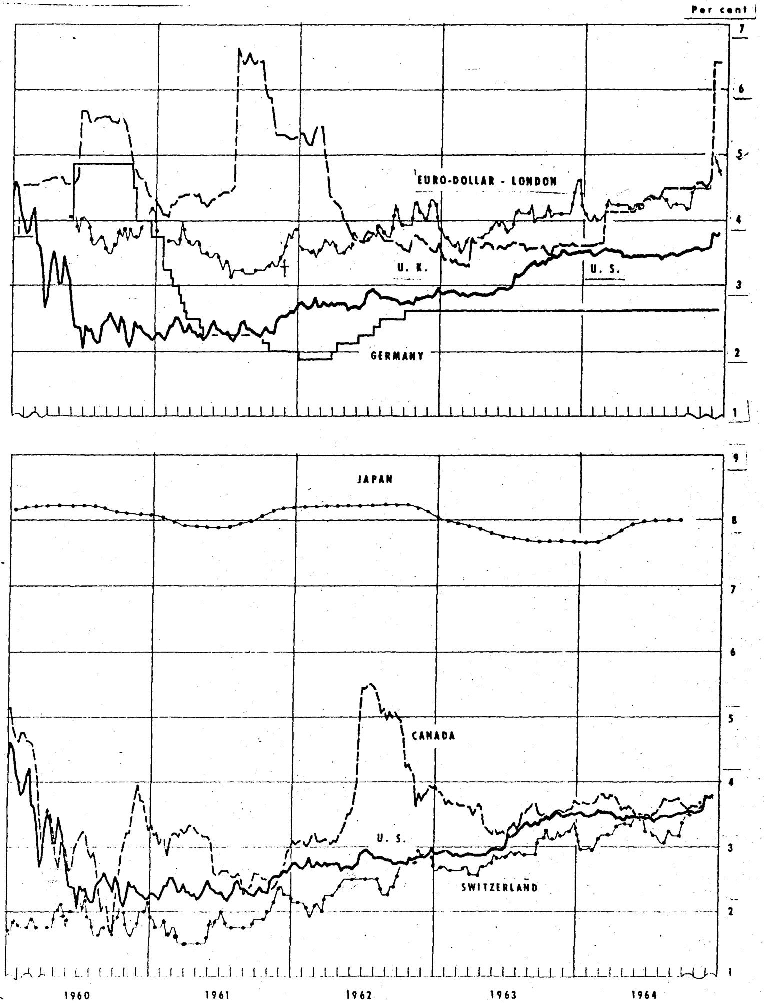


Chart 5

SHORT-TERM INTEREST RATES *



* 3 month treasury bill rates for all countries except Japan (Average rate on bank loans and discounts and Switzerland (3 month deposit rate)

† 3 month rate for U. S. dollar deposits in London

Chart 6

LONG-TERM BOND YIELDS

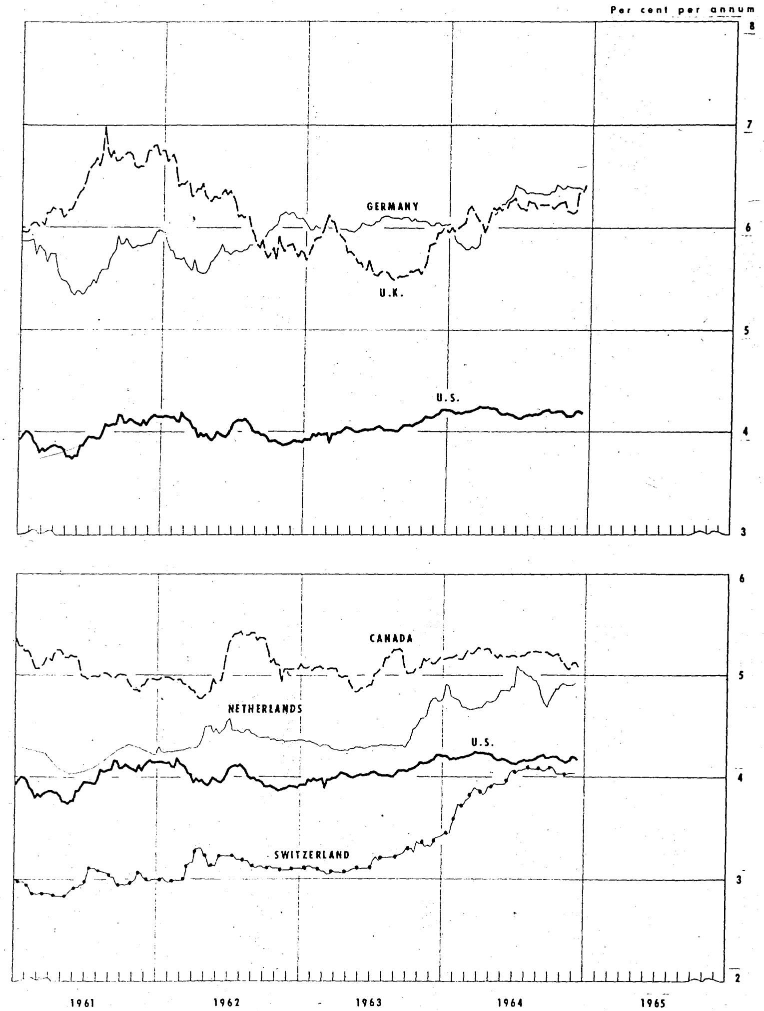
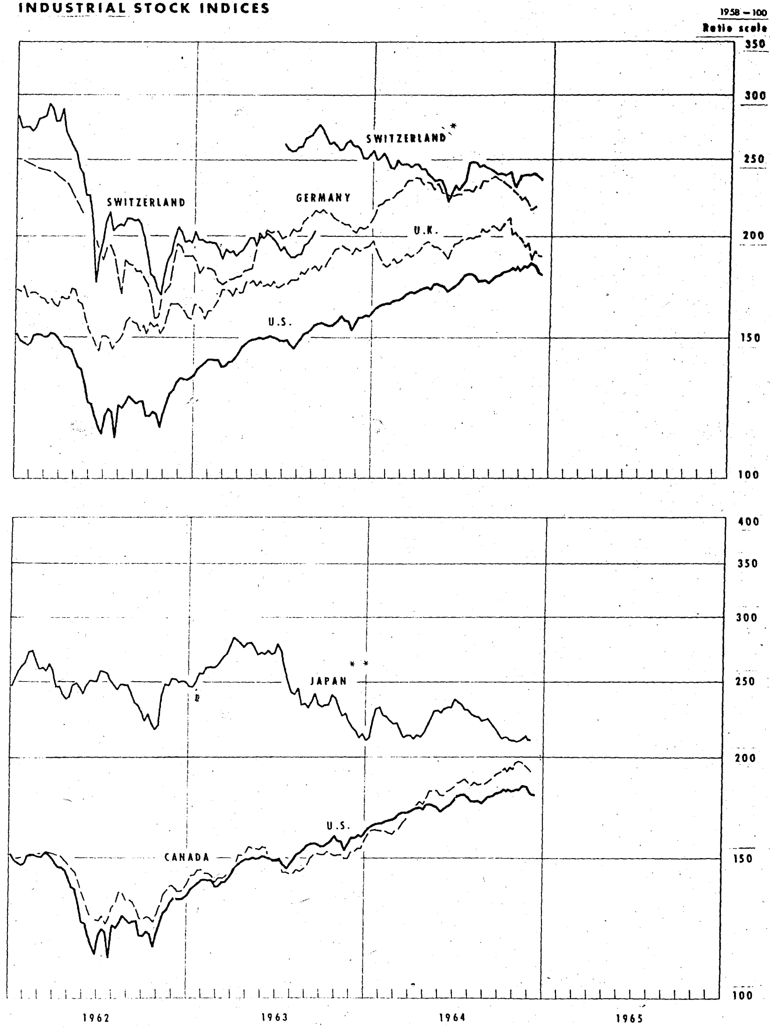


Chart 7

INDUSTRIAL STOCK INDICES



* New series Swiss Bank Corporation industrial stock index

** Japan index of 225 industrial and other stocks traded on the Tokyo exchange

Chart 8

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

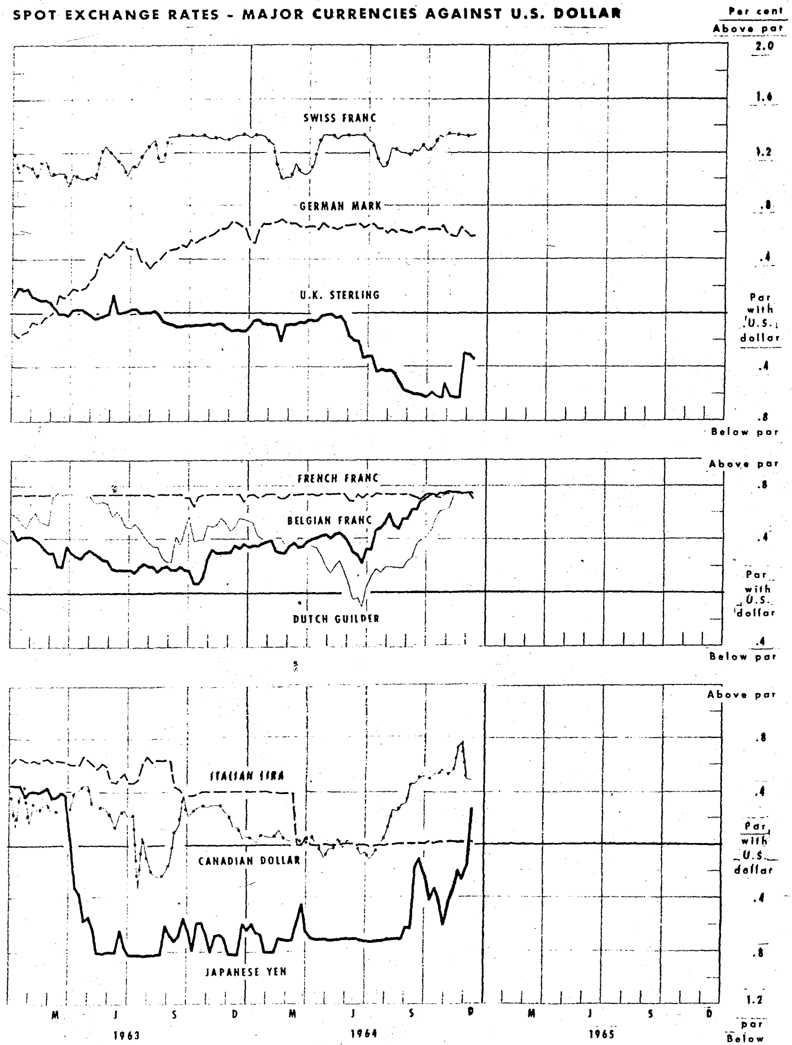
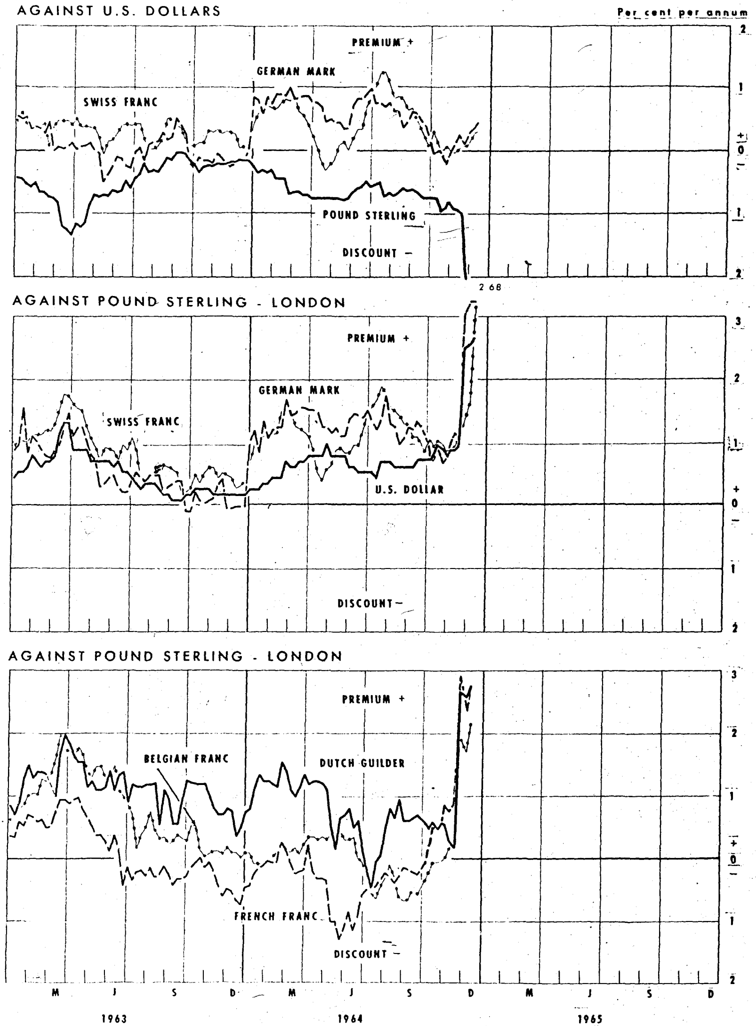


Chart 9

3-MONTH FORWARD EXCHANGE RATES.

Friday figures



III. Latest Figures Plotted In H.13 Chart Series, 1964

Chart 1	Per cent per annum
Upper panel	
(Wednesday, Dec. 9)	
Euro-$ deposit	4.75
U.S. certif. of deposit	4.12
Lower panels	
(Friday, Dec. 11)	
Treasury bills: U.S.	3.81
U.K.	3.78
Canada	3.74
Finance Co. paper: U.S.	4.00
Canada	4.40
Hire-purchase paper, U.K.	5.12
Chart 2	
(Friday, Dec. 11)	
Treasury bills: Canada	3.74
U.S.	3.80
Spread favor Canada	-0.06
Forward Canadian dollar	-0.07
Net incentive (Canada +)	-0.13
Chart 3	
(Friday, Dec. 11)	
Treasury bills: U.K.	6.41
U.S.	3.80
Spread favor U.K.	+2.61
Forward pound	-2.68
Net incentive (U.K. +)	-0.07

Chart 5	Per cent per annum
(Friday, Dec. 11, except as noted)	
Treasury bills:	
U.S.	3.80
U.K.	6.41
Germany	2.63
Canada	3.74
Swiss 3-month deposits (Date: Nov. 15)	3.68
Euro-$ deposit (London)	4.69
Japan: composite rate (Date: Aug. 28)	7.986
Chart 6	
Bonds:	
U.S. govt. (Wed., Dec. 9)	4.17
U.K. war loan (Thurs., Dec. 10)	6.40
German Fed. Railway (Fri., Dec. 4)	6.36
Swiss Confederation (Fri., Dec. 4) *	4.04
Canadian govt. (Wed., Dec. 9)	5.08
Netherlands Government perpetual (Fri., Dec. 4)	4.94
* Swiss Confederation (Fri., Nov. 27)	4.04

For description and sources of data see special annex to H. 13 Number 164, September 23, 1964.