DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

H. 13

No. 190

April 7, 1965.

CAPITAL MARKET DEVELOPMENTS ABROAD

I. Canada
II. Nine Charts on Financial Markets Abroad
III. Latest Figures Plotted in H. 13 Chart Series, 1965

I. Canada: Money and Capital Markets, December 1964 to March 1965

From early December to the end of January, financial markets in Canada regained stability after being unsettled by international developments in late November, and there was a general modest easing of market yields. (See Table 1.) However, conditions deteriorated again during February, first in expectation of further U.S. measures to strengthen the balance of payments, and then after February 10 when the measures were announced. Not until early March was there a material improvement in market tone; and after mid-March yields again began to show an easing tendency.

Table 1. Canada: Selected Financial Data, Nov. 1964-Mar. 1965
(per cent per year, U.S. Cents per Can. dollar)

	Level	Changes (points)				Level
	Nov. 18	Nov. 18 to Dec. 2	Dec. 2 to Jan 27	Jan. 27 to Mar. 3	Mar. 3 to 24	March 24
Interest rates:						
Day-to-day	3.63	+17	+8	-43	-10	3.35
3-month Treasury bills	3.68	+19	-13	+4	-15	3.62
Govt. bonds:						
5%, 1968	4.80	+9	-38	+35	-16	4.70
4-1/4%, 1972	4.89	+14	-22	+20	-4	4.97
5-1/4%, 1990	5.10	+2	-10	+13	-3	5.12
Yield differentials:						
Treasury bills 1/	-.09	-10	-34	+26	+56	.29
Prime finance paper 1/	+.32	+8	-25	+12	+42	+.79
Central Govt. Bonds						
3-years	.76	--	-32	+29	-15	.58
7-years	.80	+7	-21	+16	0	.82
25-years	.94	-2	-6	+10	0	.96
Canadian dollar:						
Spot rate (U.S. cents)	93.18	-.15	+.12	-.55	-.35	92.25
3-mo. Forward (%)	-0.13	--	- 21	+37	+58	+0.61

1/ Three-month, covered basis, plus (+) favors Canada.

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When securities markets became unsettled in February, the Bank of Canada acted to steady them; but the scale of support was much below the official operations during the difficulties last November. From February 10 through March 3, some $76 million of marketable government securities were purchased by the Bank of Canada at a time when the general public sold some $53 million. (See Table 2.) Last November, by contrast, the Bank of Canada purchased $159 million of securities during the day of November 23 to halt the massive selling wave set off by the overnight announcement of the rise in British Bank Rate from 5 to 7 per cent.

Table 2. Canada: Holdings of Central Government Direct and Guaranteed Debt, 1964-1965
(par values; millions of dollars)

	Level	Changes				Level
	Nov. 18 1964	Nov. 18 to Nov. 25	Nov. 25 to Feb. 10	Feb. 10 to Mar. 3	Mar. 3 to Mar. 24	Mar. 14 1965
A. Commercial banks						
Treasury bills	1264	-7	+48	-18	+46	1333
Other	2448	+19	+43	+17	-24	2503
B. Bank of Canada						
Treasury bills	469	+62	-79	+30	+7	489
Other	2558	+18	-86	+46	-20	2516
C. General public						
Treasury bills	363	-38	-34	+45	-30	306
Can. sav. bonds	5520	+134	-46	-21	-18	5569
Other	7353	-38	-27	-98	+23	7213
D. Govt. accounts						
Treasury bills	34	-7	+64	-56	-23	12
Other	606	+4	-63	+17	+14	578

Source: Bank of Canada

By contrast, other Canadian security markets were not as unsettled by U.S. developments during February. The McLeod index of corporate, municipal and provincial bond yields show little change between end-January and end-February.

However the foreign exchange market did react strongly to U.S. developments. The spot Canadian dollar eased from 93.15 U.S. cents on January 27 to 92.25 U.S. cents on March 24. In addition, the three-month forward rate shifted from a discount to a premium against the dollar. Largely because of the forward premium, the yield differential in favor of Canadian short-term obligations (both Treasury bills and prime finance paper) over comparable yields in the United States widened somewhat. (See Charts 1 and 2.)

Despite this yield differential, however, market reports indicated a withdrawal of U.S. funds from Canadian markets and institutions during March. In part, these withdrawals were seasonal because some U.S. investors needed funds for the March tax date; but they also were in response to the official request that U.S. residents gradually repatriate money market investments abroad. The rise in rates offered by Canadian banks for 3-month U.S. dollar deposits from 4-1/8 per cent between January 21 and March 24 to 4-1/2 per cent on March 25 may reflect these withdrawals. By March 31, the rate had dropped back to 4-3/8 per cent.

During February and March, yield differentials between comparable Canadian and U.S. government securities were somewhat wider than they had been in late 1964 and early 1965. These differentials had narrowed during the three months November 1964 to January 1965 when the Canadian authorities eased credit conditions in order to reduce incentives for borrowing in U.S. markets: heavy borrowings during September and October of 1964 (after the Canadian exemption from the I.E.T. was formally announced) raised the possibility of excessive capital inflows. In the words of the Bank of Canada's Annual Report, the monetary authorities "permitted the chartered banks' money market assets to rise moderately in the last quarter of 1964" in an attempt to avoid this possibility.1/ This easing was in contrast to Canadian monetary policy during the first three quarters of 1964: the Bank of Canada forced the chartered banks to finance part of their strong loan expansion by sales of Government securities and other liquid assets. As a result, the liquid asset ratio of the chartered banks fell from an average of 18.25 per cent for December 1963 to an average of 16.35 per cent for August 1964. On March 24 of this year, it stood at 16.93 per cent.

Canadian financial markets weaken in February. The U.S. balance of payments measures announced on February 10 and the ensuing program to moderate the flow of U.S. dollars abroad gave additional impetus to a weakening trend in Canadian financial markets. The consequent rise in Canadian bond yields during February widened the spread between comparable Canadian and U.S. government securities. The differentials on March 24 were in a range of from 58 to 82 basis points, not significantly different from those of December 2, 1964, before the Canadian market was steadied. (See Table 1.)

During February some large U.S. institutional investors reduced purchases of Canadian securities and a number of Canadian issues originally scheduled for negotiation in New York were shifted to Canadian markets. The Canadian press reported that the list of such offerings included $75 million for the Steel Company of Canada, $35 million for Trans-Canada Pipe Lines, $25 million for Dominion Textiles, and $20 million for Dominion Tar and Chemical Company. In addition, fears that some U.S. investment institutions might be in the process of cutting back their portfolios of Canadian securities accentuated the general weakness in the government bond market.

Official support of the bond market in February was only part of the attempt by the monetary authorities to reduce Canadian borrowing in this country. Earlier, in late December, government officials are reported to have suggested to Canadian local government officials that it would be in their own interest to curb their resort to lower cost U.S. funds in order to safeguard their exemption under the Interest Equalization Tax Act. To facilitate local-government and other Canadian bond flotations,

1/ Bank of Canada Annual Report for 1964 p. 34.

the Canadian authorities have been confining the large Treasury refinancings in January and in March to the short end of the maturity range.

By contrast with these developments, yields on municipal, public utility and industrial bonds continued to fall from end-January to end-February. (See Table 3.) Yields on provincial offerings rose slightly, perhaps in reaction to the sharp falls between October 1964 to end-January 1965 and the prospect of some cutback in their access to financing in the United States.

Table 3. Canada: Local Government and Corporate Bond Yields, Sept. 1964 to Feb. 1965 (end of month averages)

	Level Sept. 1964	Changes (basis points) Oct. to Dec.	Jan. 1965	Feb. 1965	Level Feb. 1965
10 provincials	5.52	-11	-7	+5	5.39
10 municipals	5.65	-8	-5	-2	5.50
10 public utilities	5.49	-1	-9	-2	5.37
10 industrials	5.51	-4	-5	-4	5.38

Source: McLeod, Young, Weir

Canada and the U.S. payments program

After the U.S. payments program was announced in early February, the Canadian authorities reaffirmed that "our policies will continue to be directed towards general stability in our foreign exchange reserves. It is not our desire or intention to increase our reserves through the proceeds of borrowing in the United States under the exemption."

Special provisions for Canadian needs have been incorporated in the new program. First, the guidelines for lending by U.S. banks propose special consideration for the needs of Canada. In addition, the existing Canadian exemption from the interest equalization tax for new bond issues remains intact. Such new issues--amounting to U.S. $700 million in 1964 on a U.S. payments basis--have been the major source of U.S. funds for Canada.

Flow of new issues still strong. The level of activity in the Canadian new issues market apparently expanded considerably in January-February, as in November-December, over the comparable levels of the previous years. According to A.E. Ames and Co. data, total new bond issues exceeded $1.8 billion in this four-month period compared to $1.2 billion over November 1963-February 1964. (See Table 4.) The bulk of the recent expansion was in Canada-pay issues.

Total new issues in January-February alone amounted to about $820 million, down about $150 million from the previous two-month total. However, most of this decline reflects the fall-off in new issue activity in New York, following the unusually large take-down during the fourth quarter of previously negotiated issues.

Table 4. New Canadian Bond Issues
(par values; million Canadian dollars)

	Canadian-pay				U.S.-pay			
	1963-64		1964-65		1963-64		1964-65	
	Nov.-Dec.	Jan.-Feb.	Nov.-Dec.	Jan.-Feb.	Nov.-Dec.	Jan.-Feb.	Nov.-Dec.	Jan.-Feb.
Federal govt. 1/	300	350	475	450	--	--	--	--
Provincial-Municipals	171	251	180	234	--	28	126	37
Corporations	60	64	137	91	--	22	62	15

Source: A.E. Ames and Co. Ltd.
1/ Includes direct and guaranteed bonds.

Monetary conditions continue easy. During the period under review, the basic trend toward monetary ease was continued after the 1/4 per cent increase in the Bank of Canada discount rate on November 23. From early December to early March, currency and chartered bank deposits held by the general public rose about $280 million, while general bank loans rose much less. The chartered banks used the increase in deposits to acquire more "non-liquid assets" than "liquid assets" (i.e. cash, day-to-day loans and Treasury bills). As a result, the statutory liquid assets ratio fell from 17.5 per cent on December 2 to 16.8 per cent on March 10. (See Table 5.) From December 2 to March 24, the rate on day-to-day money fell about 45 basis points while the three-month Treasury bill rate fell about 25 basis points. (See Table 1.)

On a seasonally adjusted basis, the recent expansion in the money supply and bank loans has been striking. During February, currency outside banks and chartered bank deposits in the hands of the public rose an estimated $210 million, bringing the total increase for the three months, December through February, to $570 million, or more than 3 per cent. General loans of the chartered banks rose an estimated $260 million during February, bringing the total increase for the three-month period to $360 million, or 4 per cent.

Shift in foreign exchange markets

After late January, as U.S. flows to Canada tapered off, the position of the spot Canadian dollar weakened markedly, beginning a trend which was reinforced after the U.S. balance of payments message of February 10. Between January 27 and March 18, the spot Canadian dollar had dropped from 93.15 U.S. cents to 92.45 cents. Concurrently, the three-months forward Canadian dollar moved up strongly, rising from a discount of 27 basis points to a premium that reached 61 basis points by March 24. (See Table 1.)

Table 5. Canada: Chartered Bank Indicators, November 1964 to March 1965
(million dollars or per cent)

	Level	Changes			Level	
	Nov. 18 1964	Nov. 18 to Dec. 2	Dec. 2 to Feb. 4	Feb. 4 to Mar. 10	Mar. 10	Mar. 17
Cash Assets, Treas. bills	2572	-99	+89	+61	2621	2609
General loans	8153	+99	-48	+129	8333	8378
Govt. Securities	2469	+21	+14	+39	2543	2531
Canadian dollar deposits (less float) 1/	15,604	+66	+272	+31	15,973	16,077
Liquid assets ratio (%)	17.8	-.69	+.38	-.59	16.8	16.9
Currency & chartered bank deposits held by public	16,824	+150	+263	+20	17,257	17,325

Seasonally Adj. Avg. of Wednesday data:

	Level	Changes during			Level
	Nov.	Dec.	Jan.	Feb. e/	Feb. e/
Public holdings of Currency, bank depos.	16,851	+199	+157	+210	17,417
General bank loans	8,127	+44	+53	+260	8487

e/ Seasonally adjusted estimates. 1/ Statutory base.
Source: Compiled from Bank of Canada data.

Prior to January 27, the spot Canadian dollar had regained most of the ground lost in the brief period when markets were unsettled by the November 23 discount rate increase. This recovery in the spot market apparently reflected in part the continued take down of Canadian security issues in New York during January.

The covered advantage of about 1/2 of 1 per cent favoring U.S. over Canadian 3-month Treasury bills that prevailed in early February was eliminated by March 15; as the premium on the forward Canadian dollar continued to grow, the differential shifted in favor of Canada. (See Chart 2.) The hedged differential favoring Canadian over U.S. finance papers also widened out. (See Table 1 and Chart 1.)

Payments and reserves continue strong

The overall Canadian payments and reserves position was quite strong during the third and fourth quarters of 1964, and apparently deteriorated less than seasonally through February 1965.

The quite unprecedented third quarter current-account surplus of $219 million together with the good-sized inflow of long-term capital, yielded a surplus of over $380 million dollars on current and long-term capital accounts combined.

During the fourth quarter, the current account registered a deficit of $169 million. However, the rising tide of long-term inflows, amounting to $477 million, yielded a surplus on long-term capital and current account combined of over $300 million. (See Table 6.)

These large third and fourth quarter surpluses sufficed to finance considerable banking short-term capital outflows of over $500 million--undertaken in part in connection with the sterling crisis--and increases in the net reserves (including I.M.F. transactions) totalling $337 million. A less than seasonal decline of $10 million in adjusted reserves in January-February is considered a sign of continued strength. Most of the increase in adjusted Canadian reserves over the past two years has been taken in gold.

Table 6. Canadian Balance of Payments, 1963-1964
(quarter or quarterly average; millions of dollars)

	1963		1964 p/		
	I-II	III-IV	I-II	III	IV
A. CURRENT ACCOUNT, NET					
Merchandise	- 74	+178	+ 90	+356	+162
Other	-300	-230	-340	-141	-331
Total deficit (-)	-226	- 52	-250	+215	-169
B. CAPITAL MOVEMENTS, NET					
Long-term inflow (+)					
New Canadian bonds	+401	+ 83	+208	+100	+498
Other long-term	-109	- 69	+161	+ 71	- 21
Total long-term	+292	+ 14	+ 47	+171	+477
Short-term inflow (+)	+ 23	+ 24	+215	-130	-127
Total capital inflow (+)	+315	+ 37	+262	- 59	+350
(BALANCE ON CURRENT AND LONG-TERM CAPITAL)	(+ 66)	(- 38)	(-203)	(+386)	(+308)
OVERALL (A+B) SURPLUS (+)	+ 88	- 16	+ 12	+156	+181
D. FINANCING: (increase-)					
Official reserves	- 88	59	+ 33	- 97	+ 54
IMF position	--	- 43	- 45	- 59	+127

p/ preliminary.
n.a. Not available--none
Source: Based on Dominion Bureau of Statistics data.

Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U S. DOLLAR INVESTORS

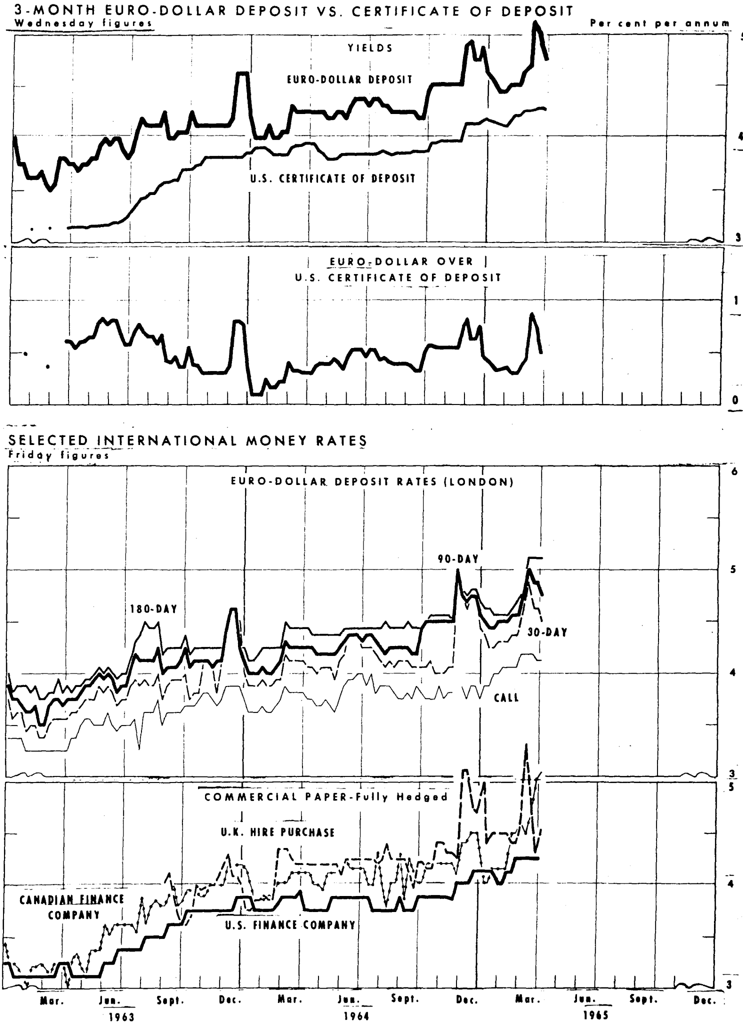

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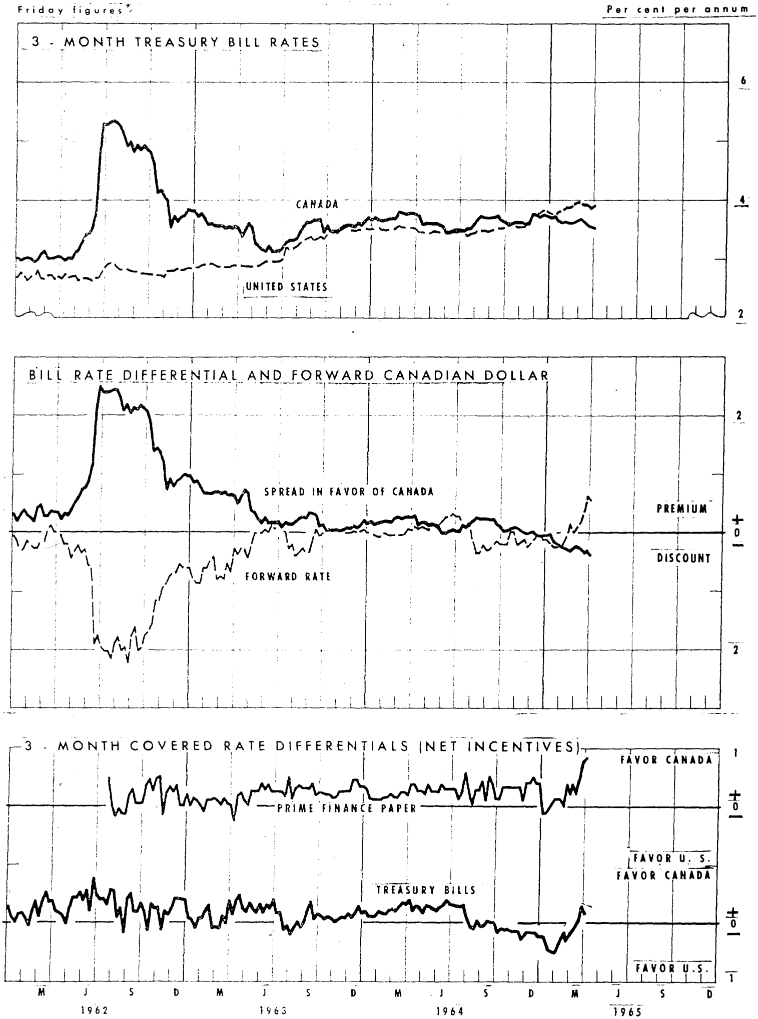
Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Friday figures*



* Thursday figures 1962, Friday thereafter

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

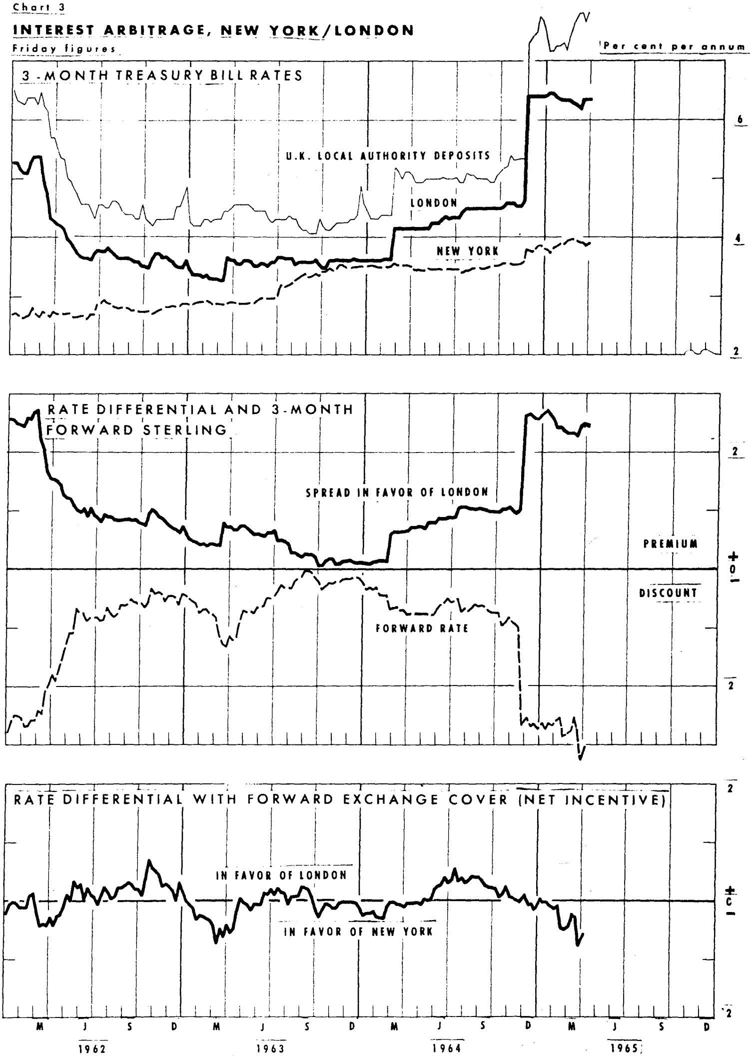


Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

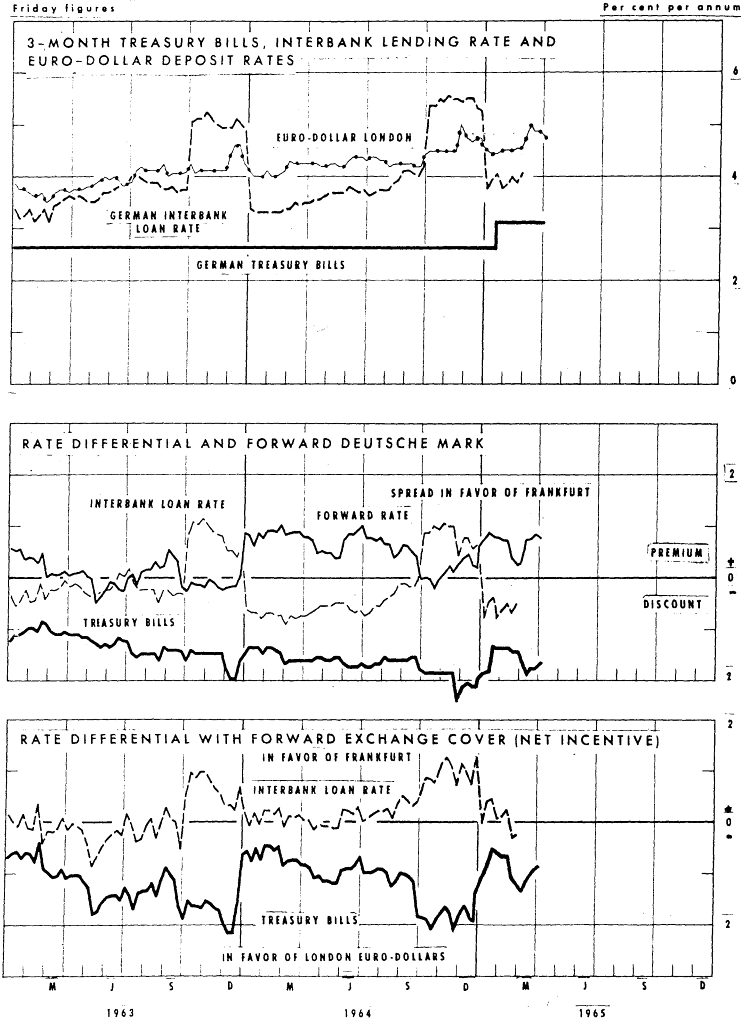
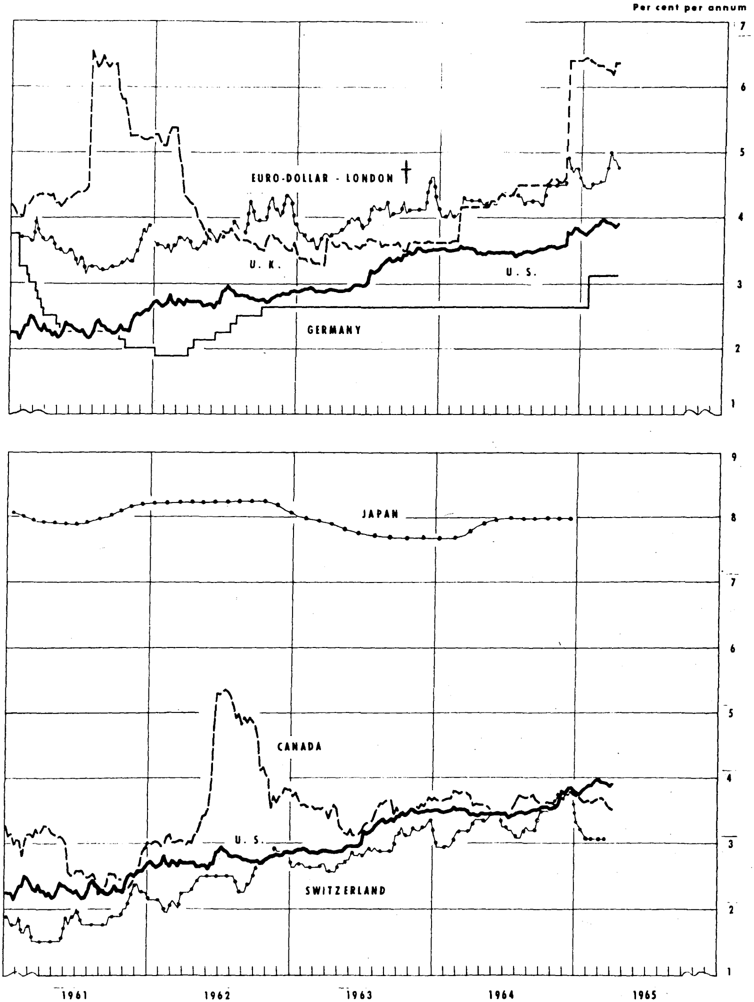


Chart 5
SHORT-TERM INTEREST RATES *



* 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

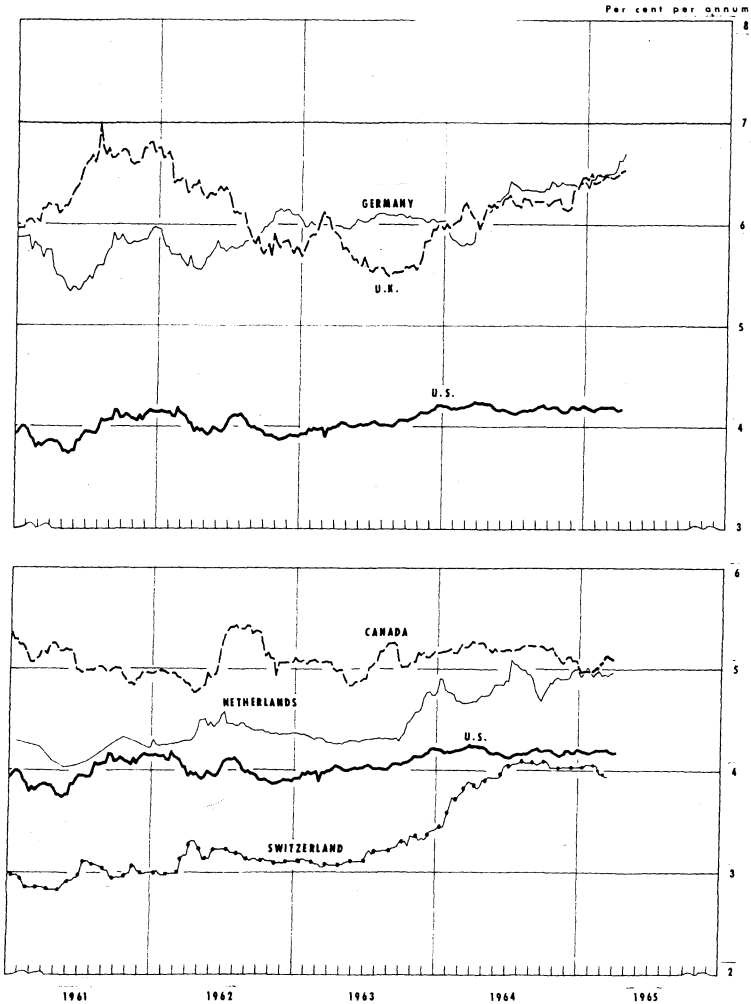
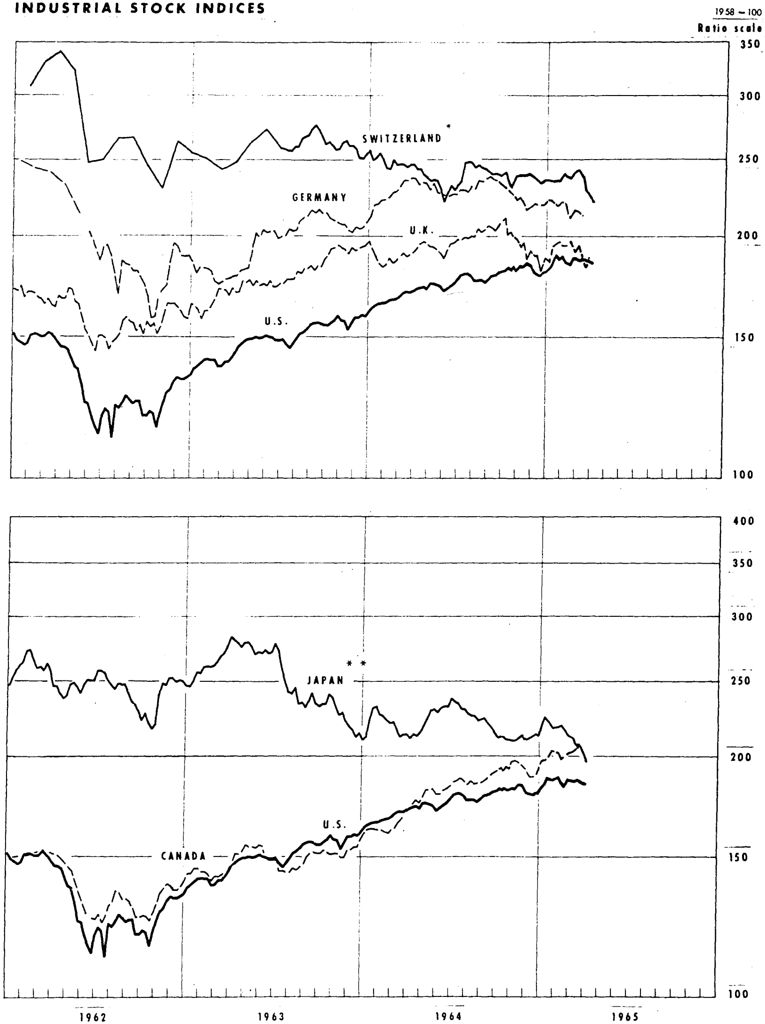


Chart 7

INDUSTRIAL STOCK INDICES



* Swiss Bank Corporation industrial stock

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

Chart 8

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

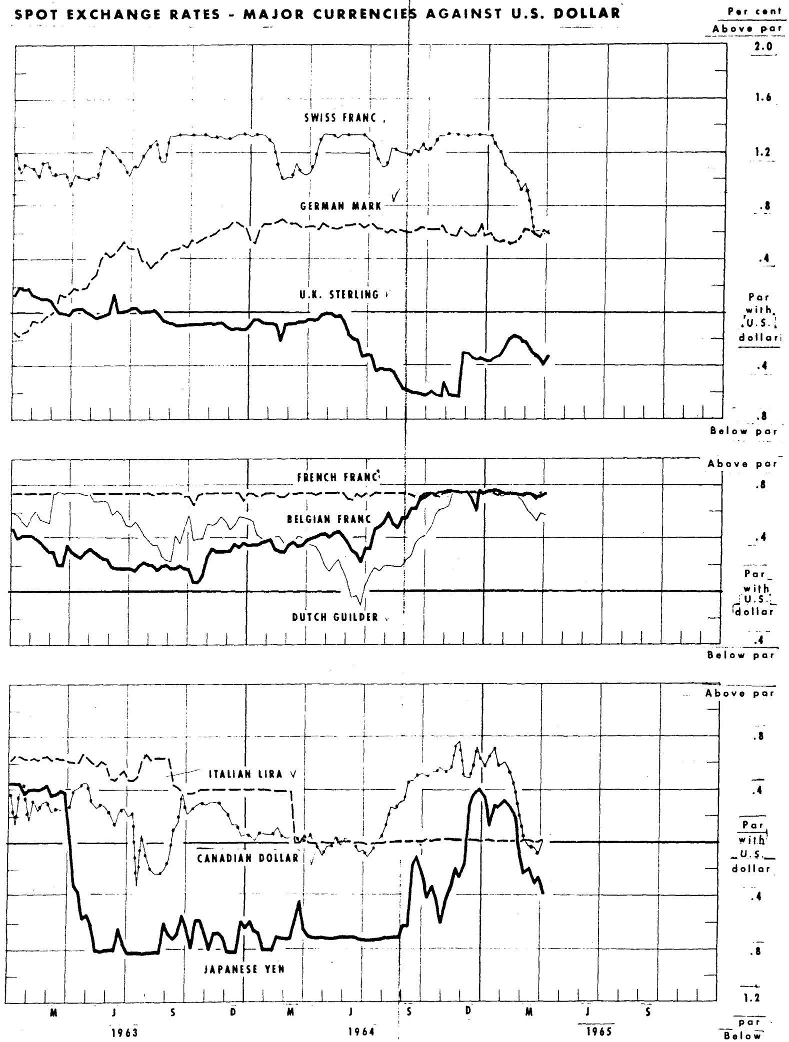
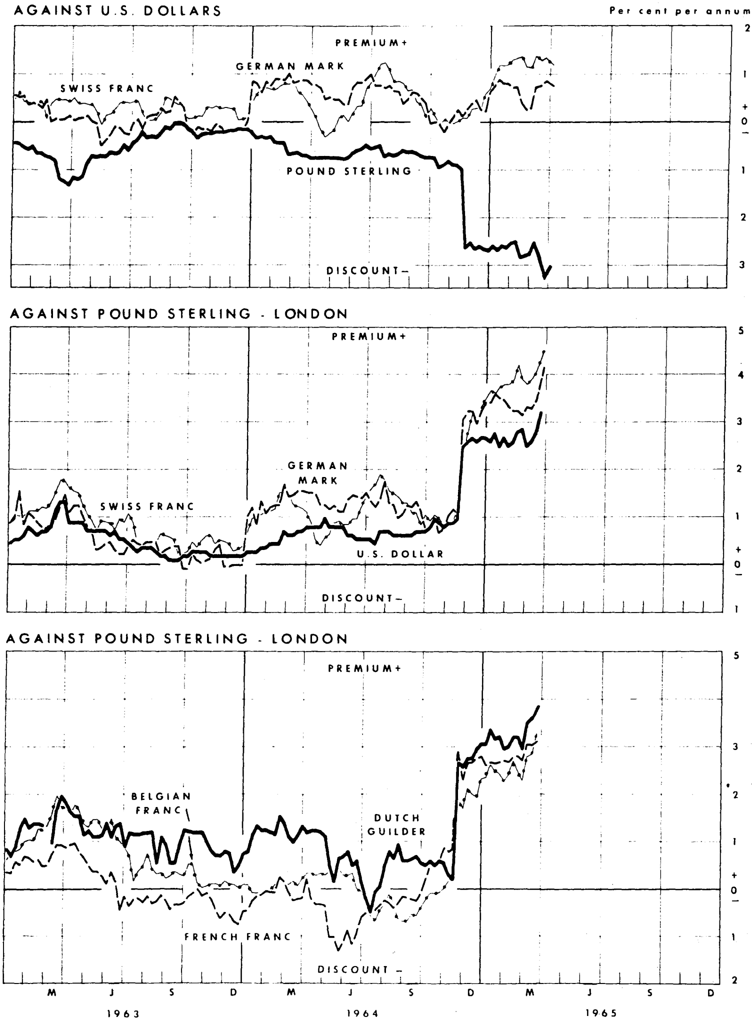


Chart 9

3-MONTH FORWARD EXCHANGE RATES

Friday figures



April 7, 1965

III. Latest Figures Plotted In H.13 Chart Series, 1965

Chart 1	Per cent per annum
Upper panel	
(Wednesday, March 31)	
Euro-$ deposit	4.75
U.S. certif. of deposit	4.26
Lower panels	
(Friday, April 2)	
Euro-dollars: Call	4.12
7-day	4.25
30-day	4.50
90-day	4.75
180-day	5.12
Finance Co. paper: U.S.	4.25
Canada	5.10
Hire-purchase paper, U.K.	4.54

Chart 2	
(Friday, April 2)	
Treasury bills: Canada	3.52
U.S.	3.91
Spread favor Canada	-0.39
Forward Canadian dollar	+0.54
Net incentive (Canada +)	+0.15

Chart 3	
(Friday, April 2)	
Treasury bills: U.K.	6.35
U.S.	3.91
Spread favor U.K.	+2.44
Forward pound	-3.02
Net incentive (U.K. +)	-0.58

Chart 5	Per cent per annum
(Friday, April 2, except as noted)	
Treasury bills:	
U.S.	3.91
U.K.	6.35
Germany	3.12
Canada	3.52
Swiss 3-month deposits (Date: March 15)	3.06
Euro-$ deposit (London)	4.75
Japan: composite rate (Date: Dec. 31)	7.990

Chart 6	
Bonds:	
U.S. govt. (Wed., March 31)	4.17
U.K. war loan (Thurs., April 1)	6.54
German Fed. Railway (Fri., April 2)	6.70
Swiss Confederation (Fri., March 5)	3.94
Canadian govt. (Wed., March 24)	5.09
Netherlands government perpetual (Fri., March 26)	4.96

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