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No. 50CAPITAL MARKET DEVELOPMENTS ABROAD

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FEDERAL RESERVE BANK
OF RICHMOND

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

I. Canada: Money and Capital Markets during February

Private sales of Canadian dollars and a continuing decline in the spot rate which were evident in January were intensified during February. The spot rate declined from 95.88 U.S. cents on December 28 to 95.66 U.S. cents on January 25 and to 95.22 U.S. cents on March 1. In exchange support operations, the Canadian authorities reported official reserve losses of (U.S.) \$134 million in January and (U.S.) \$175 million in February.

Canadian commercial banks reported substantial return flows during January of non-Canadian currency deposits lost in December. These deposits rose from \$2.7 billion at the end of 1960 to an unprecedented peak of \$3.9 billion in November 1961 (see Table). Since the growth of these deposits during 1961 was concentrated in the months of May and June and again in October and November when uncertainty about official intentions unsettled the foreign-exchange market, the deposit accruals appear to represent, according to one market report, "the acquisition of very substantial Canadian holdings of U.S. dollars by business firms and speculators."

During 1961, Canadian banks became much more active in so-called "Euro-dollar" operations to take advantage of the high yields prevailing in European centers. Since the Canadian banks made no appreciable additions to their "street loans" to security dealers in New York in 1961, it would appear that much, and perhaps most, of their non-Canadian dollar deposit accruals may have been employed in Euro-dollar and other European operations.

After moderating during January, the upward movement in Canadian short money rates which developed in the closing weeks of 1961 was resumed in mid-February. The Treasury bill yield moved up from 3.08 per cent on January 4 to 3.17 per cent on February 22 and 3.21 per cent on March 1. This rise coincided with reports that the Canadian business recovery seems to be maintaining its momentum, although the latest production and unemployment statistics do not extend beyond December. During February, the Bank of Canada was a net seller of Treasury bills. During the month, yields on Government of Canada bonds were unchanged but the average yield for 40 provincial and corporate bonds declined from 5.41 per cent on January 31 to 5.34 per cent on February 28.

Money market. After a pause in January, Canadian short-term interest rates moved moderately upward during February. From a level of

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3.07 per cent on February 1 and 3.01 per cent on February 8, the average auction yield on the 3-month Treasury bill rose during the last three weeks of the month and reached 3.21 per cent on March 1 (see Table). At this yield, the Canadian bill rate has returned to the May (1961) level (see Chart 1). The 6-month bill rate, relatively unchanged in January, moved from 3.26 per cent on February 1 to 3.41 per cent on March 1 (see Table). Although rates for day-to-day money also rose in February -- 2.45 per cent on January 31 to 2.80 per cent on February 28, the monthly average for February (2.62 per cent) was slightly below the average level of 2.69 per cent in January, when the week-to-week trend was downward.

In February, the Canadian chartered banks disposed of \$8 million in Treasury bills (see Table). The Bank of Canada reduced its bill holdings by \$42 million, and \$20 million in Treasury bills were also sold from Government account holdings. These offerings, totaling approximately \$69 million, were absorbed by the general public.

With the U.S. Treasury bill rate unchanged at 2.68-2.69 per cent on February 1 and on March 1, the higher Canadian bill rate produced a wider spread of 53 basis points in its favor. With little change in the discount on the forward Canadian dollar, the net incentive to hold the Canadian bill rose from 0.25 per cent on February 1 to 0.40 per cent on March 1 (see Table and Chart 1).

Yields on short-term Canadian finance paper were unchanged during February. With U.S. rates moving somewhat higher, the spread in favor of Canadian paper fell from 31 basis points on January 26 to 13 basis points on February 23. 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>
December 29	3.25	2.63-2.75	0.56
January 26	3.00-3.25	2.75-2.88	0.31
February 23	3.00-3.25	3.00	0.13

Bond market. Yields on Canadian Government bonds with maturities of 3 years and over declined only slightly during the month. The following comparison shows yields on selected maturities on March 1 as well as for the first and last reporting dates in January.

<u>Maturity</u>	<u>January 4</u>	<u>January 31</u>	<u>March 1</u>
May 1964	3.76	3.75	3.67
January 1975-78	4.96	4.98	4.96
September 1983	5.00	5.04	5.00

Yield spreads between comparable Canadian and U.S. Government bonds showed little change during February. The spread on the intermediate-term issue widened somewhat (see Table).

Yields on provincial and corporate bonds declined from an average of 5.41 per cent on January 31 to 5.34 per cent on February 28, according to McLeod, Young, Weir & Co. estimates. Recent average bond yields were (in per cent per annum):

	1961		1962	
	March 1	Sept. 1	Jan. 31	Feb. 28
10 Provincial	5.53	5.38	5.43	5.31
10 Municipal	5.83	5.60	5.65	5.54
10 Public utilities	5.47	5.39	5.25	5.23
10 Industrials	5.51	5.43	5.31	5.28
40 Bond yield average	5.59	5.45	5.41	5.34

According to A. E. Ames & Co., \$674 million of new securities (exclusive of regular short-term financing) were issued in the period ending February 26. None of this amount, representing primarily new issues of Provincial and Municipal bonds, was sold on the U.S. market.

Debt-management program. The Canadian authorities followed the successful marketing in January of the \$150 million issue of short-term bonds maturing April 1, 1963 with a similar offering in February. On February 12 the Minister of Finance announced an additional issue, amounting to \$150 million, in the form of bonds due April 1, 1963. This offering, for delivery on March 1 at a yield of approximately 3.56 per cent, was fully subscribed. This short-term offering continues the program of spacing Government borrowing at more frequent intervals in moderate amounts. In his announcement of the latest issue, the Minister of Finance indicated that he expected to refund maturities totaling \$625 million falling due between May 1 and September 1 and that, in addition, consideration was being given to raising \$300-400 million of new cash during this same period.

Fiscal 1962-63 expenditure estimates. The 1962-63 expenditure estimates presented by Finance Minister Fleming on February 12 suggest a continuation of the Government's large spending programs. Total expenditures under the ordinary budget and the Old Age Security Fund program (including increases resulting from the anticipated passage of legislation raising old age pensions by \$10 per month) stand at \$7,012 million, an increase of 4.2 per cent over 1961-62 spending estimates. Based on the figures presented by the Finance Minister, the total ordinary budget deficit for 1962-63 at current tax rates may well be in the vicinity of \$650 million, or roughly half the size of the forecasted deficit for 1961-62. It is now anticipated that the 1962-63 budget will be presented to Parliament during March.

Bank loans and money supply. On a seasonally adjusted basis, it is estimated that money supply declined slightly while general bank loans registered a further upward movement through February 21, the last data available. During this period, loans rose by \$110 million as compared with an increase of \$209 million in January. Bank liquidity improved

slightly, the liquid asset ratio of the chartered banks moving from 17.9 per cent in January to 18.0 per cent in February, at which point it was 3 percentage points above the required minimum (see Table).

Operations of Canadian banks in non-Canadian currencies. During January, the chartered banks reported the return of the bulk of non-Canadian currency deposits lost in December. These deposits rose only from \$1.8 billion at the end of 1957 to \$2.7 billion at the end of 1960; last year, however, they reached the unprecedented level of \$3.9 billion in November (see Table).

The fact that the deposit increases were concentrated in the second and fourth quarters when the foreign exchange market was unsettled by uncertainty about official intentions about exchange operations, suggests that bank customers were building up non-Canadian currency deposits as a hedge against a declining exchange value for the Canadian dollar. On a monthly basis, these deposits rose by \$213 million in May, \$245 million in June, nearly \$168 million in October and \$158 million in November.

Yet Canadian banks did not employ these deposit accruals as "call loans" in the New York market. Estimates of the New York State Banking Department show recent total loans to security dealers (in millions of U.S. dollars):

	1960	1961			1962	
	Dec.	Mar.	June	Sept.	Dec.	Jan.
U.S. banks	1,496	1,043	1,610	1,634	1,963	1,288
Foreign agencies	849	739	978	884	859	881
<u>Compare</u>						
Canadian a/	829	710	957	800	809	787
Other (residual)	20	30	21	84	50	94

a/ As reported by Canadian banks, converted into U.S. dollars.

A comparison of U.S. short-term liabilities to Canada (reported in Federal Reserve Bulletin) less official Canadian holdings of U.S. dollars (as reported by the Exchange Fund) yields (as a residual) a rough estimate of private (banking and non-banking) Canadian holdings of short-term U.S. assets. This calculation shows only a small rise in these holdings during 1961, as these figures show (in billions of U.S. dollars):

	1960	1961			
	Dec.	Mar.	June	Sept.	Dec.
U.S. short-term liabilities	2.4	2.4	2.7	2.7	2.8
Exchange Fund - U.S. dollars	0.9	1.1	1.1	1.0	1.6
Other - residual	1.5	1.4	1.6	1.7	1.6

1/ These figures include Canadian operations in U.S., European and Latin American currencies.

It would appear that Canadian banks greatly extended their activities in Euro-dollar and other European financial markets. The drop in their non-Canadian dollar deposits by \$400 million in December and the rise by \$300 million in January seem to reflect the withdrawal of Euro-dollar deposits by European banks for year-end window-dressing and their return to the Euro-dollar market in January.

The Canadian banks appear to have employed their non-Canadian dollar acquisitions during 1961 not in "street loans" in New York but in European financial centers. They added \$500 million to their "deposits with banks" and \$300 million to their "other loans" (see Table). These categories are thought to cover financial transactions, perhaps largely in U.S. dollars, in European financial centers. The growth in their European dollar operations can be seen in the fact that the percentage of their non-Canadian dollar assets held in "call loans" (presumably in New York) declined from 32 per cent at the end of 1957 to 21 per cent in January 1962. The recent growth in Canadian participation in Euro-dollar transactions is explained by a British financial journalist as "anticipation of the depreciation of the Canadian dollar and their holders are anxious to earn a high yield on their temporary holding."

Foreign trade. In response to rising levels of domestic demand, imports continued to increase in the final quarter of the year. On a seasonally adjusted basis, imports rose from a monthly average of \$496 million in the third to \$533 million in the fourth quarter. After rising sharply earlier in 1961, export sales declined in October and November. Recent monthly or monthly average trade figures, seasonally adjusted, were (in millions of dollars):

	1961					
	I	II	III	Oct.	Nov.	Dec.
Exports	466.9	473.5	514.4	498.1	483.7	n.a.
Imports	463.8	443.2	495.5	530.7	532.5	535.1
Trade balance	+ 3.1	+30.3	+18.9	-32.6	-48.8	n.a.

Foreign exchange. The Canadian dollar was generally weak throughout February, remaining below the February 1 level of 95-1/2 U.S. cents and closing at 95.2 U.S. cents on March 1 (see Table). Reserve losses of \$32 million in November and \$23 million in December were followed by declines of \$134 million in January and \$175 million in February as the authorities intervened to cushion the decline in the rate. Now that year-end dividend payments to nonresidents are probably no longer an important contributing factor, increased commercial demand for foreign exchange would seem to explain the continued weakness of the Canadian dollar in February. Recent changes in official exchange reserves (in millions of U.S. dollars) were:

	End of month				
	1960	1961			1962
	Dec.	Oct.	Nov.	Dec.	Jan.
Gold	885.3	931.6	941.1	946.2	949.6
U.S. dollars	<u>943.9</u>	<u>1,179.0</u>	<u>1,137.7</u>	<u>1,109.6</u>	<u>972.3</u>
Total	1,928.2	2,110.6	2,078.8	2,055.8	1,921.9
Change during period		+ 186.3	- 31.8	- 23.0	- 133.9

The forward Canadian dollar remained at a small discount during February (see Table). The net incentive to hold Canadian bills (covered for exchange risk) rose to about 40 basis points on March 1 but this was still insufficient to encourage any movement of funds to Canada.

Stock exchange. Industrial stock prices rose slightly in February in a partial recovery from the rather sharp losses recorded in January. The weekly average for the index of industrial stock prices on February 22 was 2.2 per cent above January 25, while the New York Standard & Poor industrial index registered an increase of 2.9 per cent during the same period (see Chart 6).

Average for week ending	DBS Industrials	N.Y. Standard & Poor Industrials
1961-Dec. 30	353.1	75.70
1962-Jan. 25	336.8	72.25
Feb. 1	341.7	72.70
8	345.1	74.33
15	346.4	74.56
22	344.2	74.35

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

- Chart 1 - Interest Arbitrage, United States/Canada
- Chart 2 - Interest Arbitrage, New York/London
- Chart 3 - Interest Arbitrage for German Commercial Banks
- Chart 4 - Interest Arbitrage, Frankfurt/London
- Chart 5 - Short-term Interest Rates
- Chart 6 - Long-term Bond Yields
- Chart 7 - Industrial Stock Indices
- Chart 8 - Spot Exchange Rates -- Major Currencies
Against U.S. Dollar
- Chart 9 - 3-month Forward Exchange Rates

Canada: Treasury Bill Yields and Exchange Rates

3-mo. Treas. bill arbitrage calculation

	Canada a/	U.S. a/	Differ- ence	In		Spot Can. \$ (U.S. cents)	Finance paper ^{d/}	
				3-mo. Can.\$ b/	favor Can.\$/ bill-		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-Jan. 4	3.08	2.72	0.36	-0.07	0.29	95.75	3-1/4	3-1/2
11	3.04	2.78	0.26	-0.13	0.13	95.64	3-1/4 to 1/2	3-1/2
18	3.09	2.71	0.38	-0.33	0.05	95.75	3 to 3-1/4	3-1/2
25	3.10	2.66	0.44	-0.26	0.18	95.66	3-1/4	3-1/2
Feb. 1	3.07	2.69	0.38	-0.13	0.25	95.47	3	3-1/4
8	3.01	2.72	0.29	-0.20	0.09	95.34	3	3-1/4
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	3-1/2
Mar. 1	3.21	2.68	0.53	-0.13	0.40	95.22	--	--

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

	6-mo. Treas. bills		Intermediate bonds (8 yr.)		Long-term bonds			
	Canada a/	Spread over U.S. b/	Canada c/	Spread over U.S. d/	(20 year)		(35 year)	
					Canada e/	Spread over U.S. f/	Canada g/	Spread over U.S. h/
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
Jan. 24	3.26	0.33	4.19	0.05	4.91	0.78	4.98	1.18
31	3.26	0.33	4.18	--	4.91	0.75	4.95	1.15
Feb. 7	3.18	0.25	4.17	0.07	4.89	0.73	4.92	1.15
14	3.25	0.22	4.14	0.09	4.90	0.78	4.92	1.18
21	3.37	0.49	4.17	0.16	4.90	0.75	4.92	1.13
28	3.41	0.55	4.15	0.17	4.90	0.77	4.92	1.13

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</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-Feb.	- 7	- 68	- 96	+ 67	+ 88	- 6	- 26	+ 39
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

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>
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

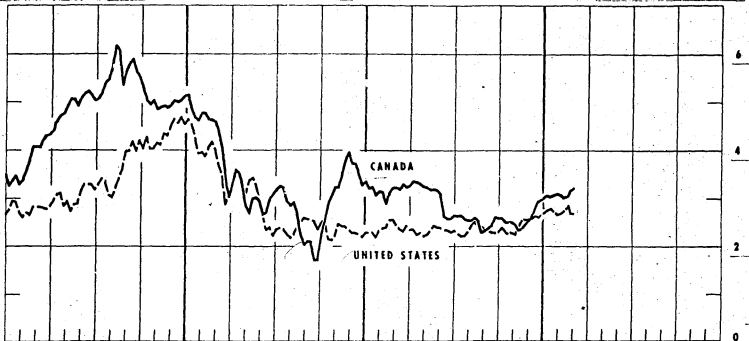
Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

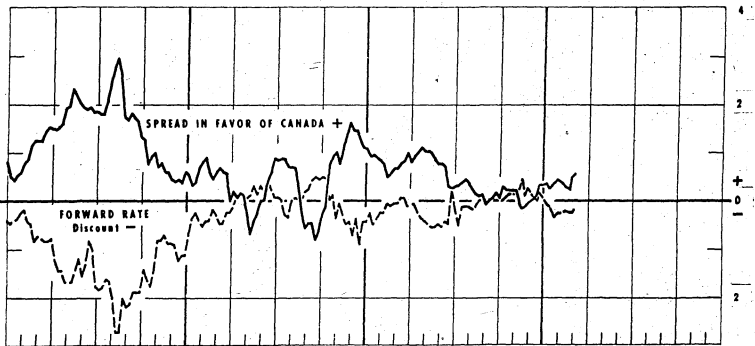
Thursday figures

THREE-MONTH TREASURY BILL RATES

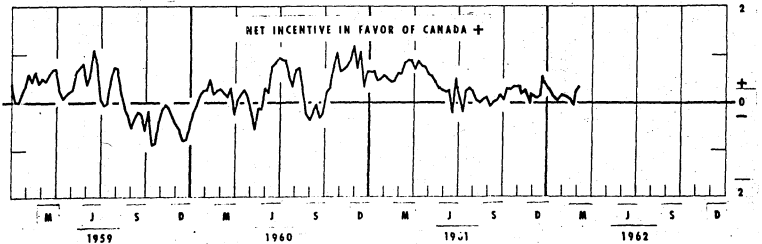
Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER



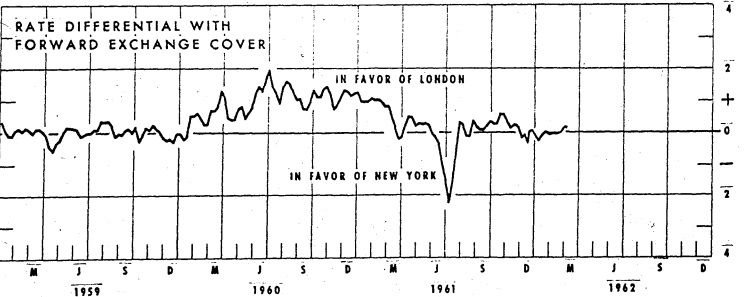
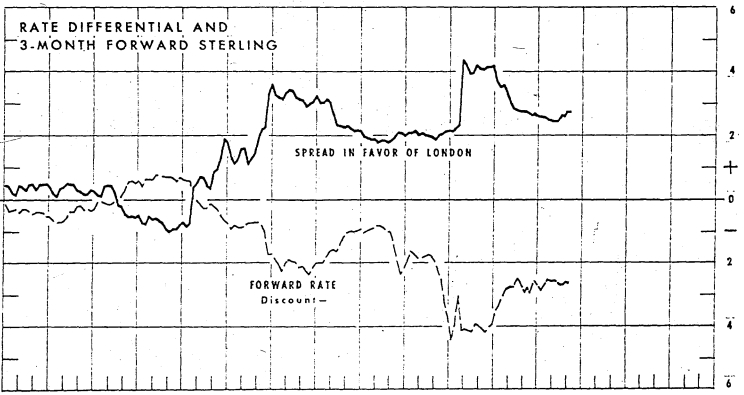
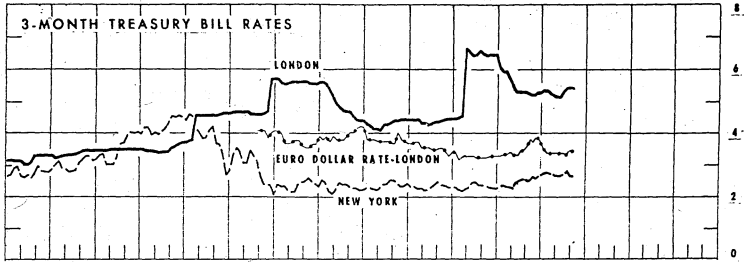
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Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

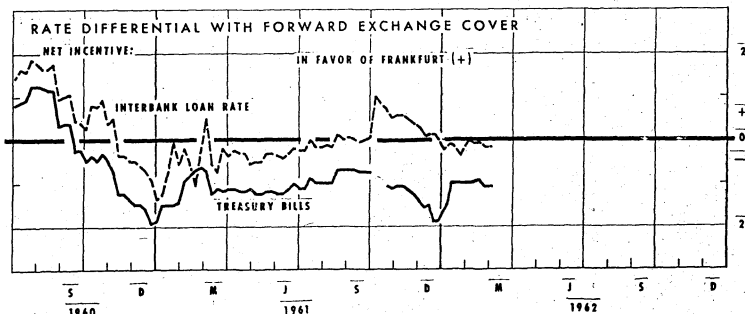
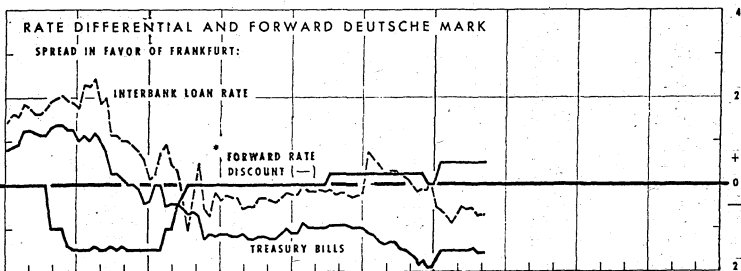
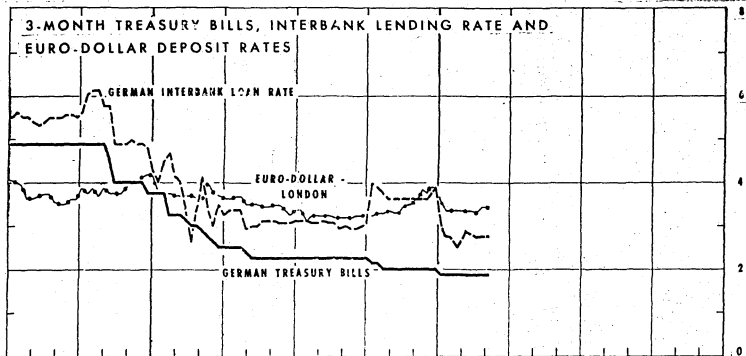
Per cent per annum



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

Friday figures

Per cent per annum

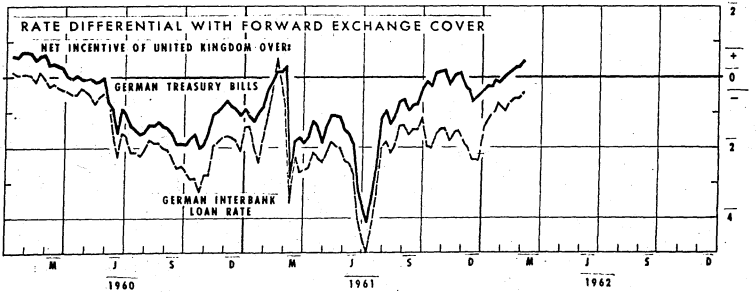
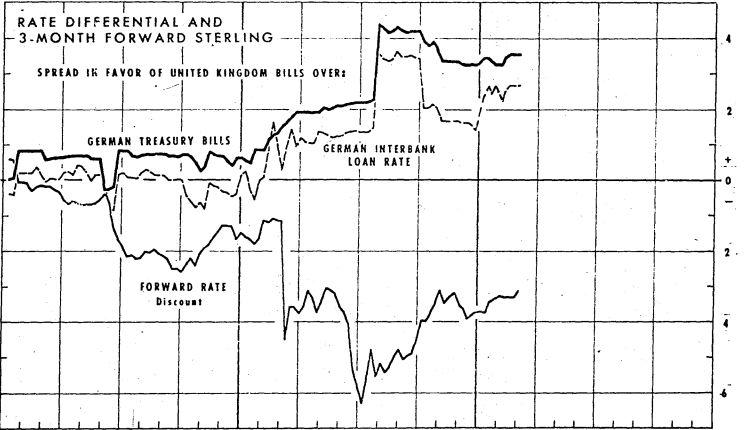
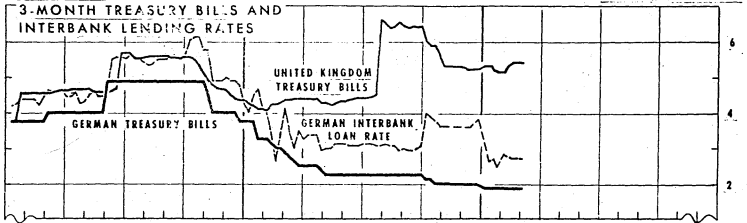
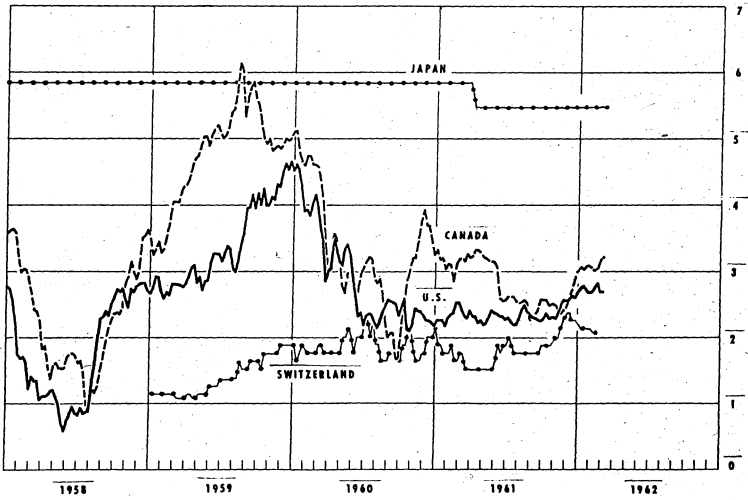
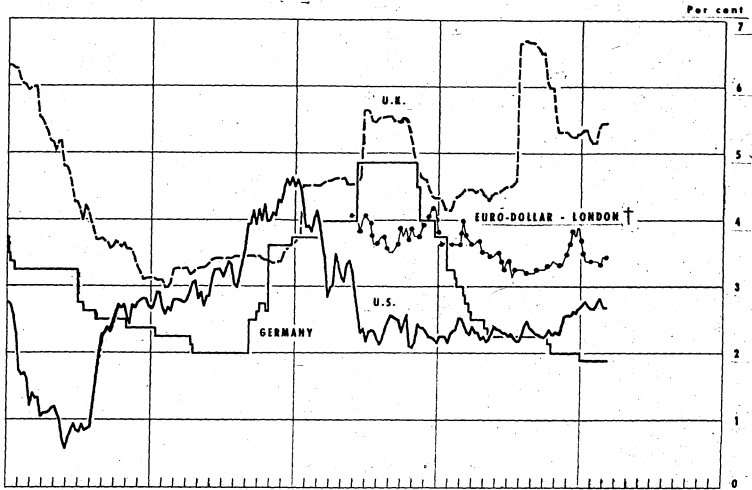


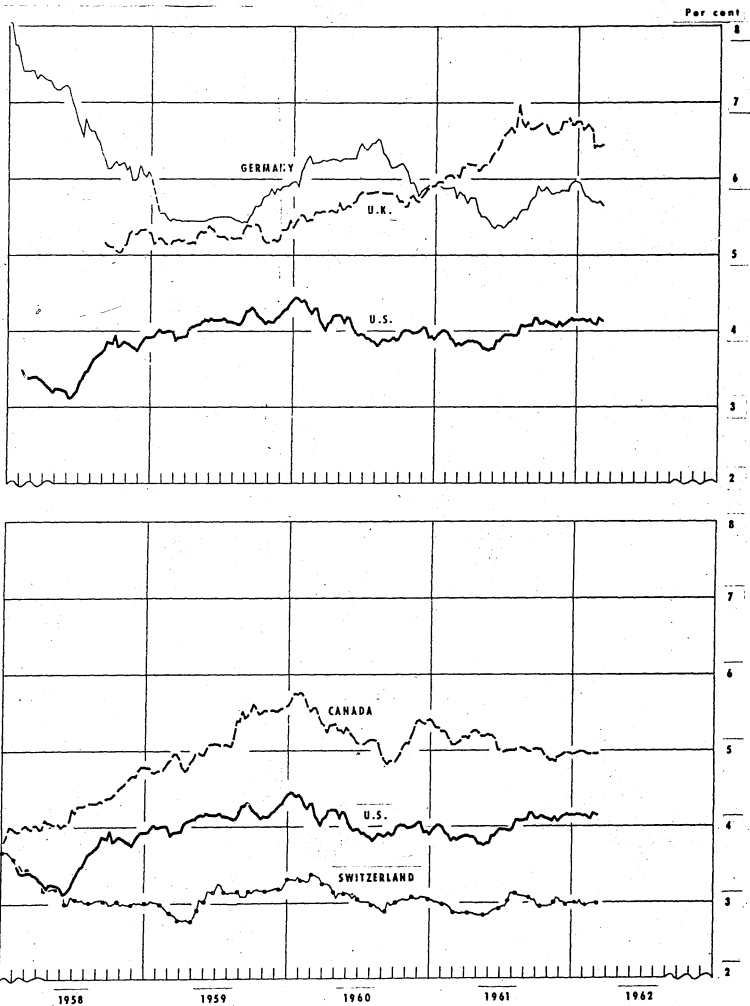
Chart 5
SHORT-TERM INTEREST RATES *



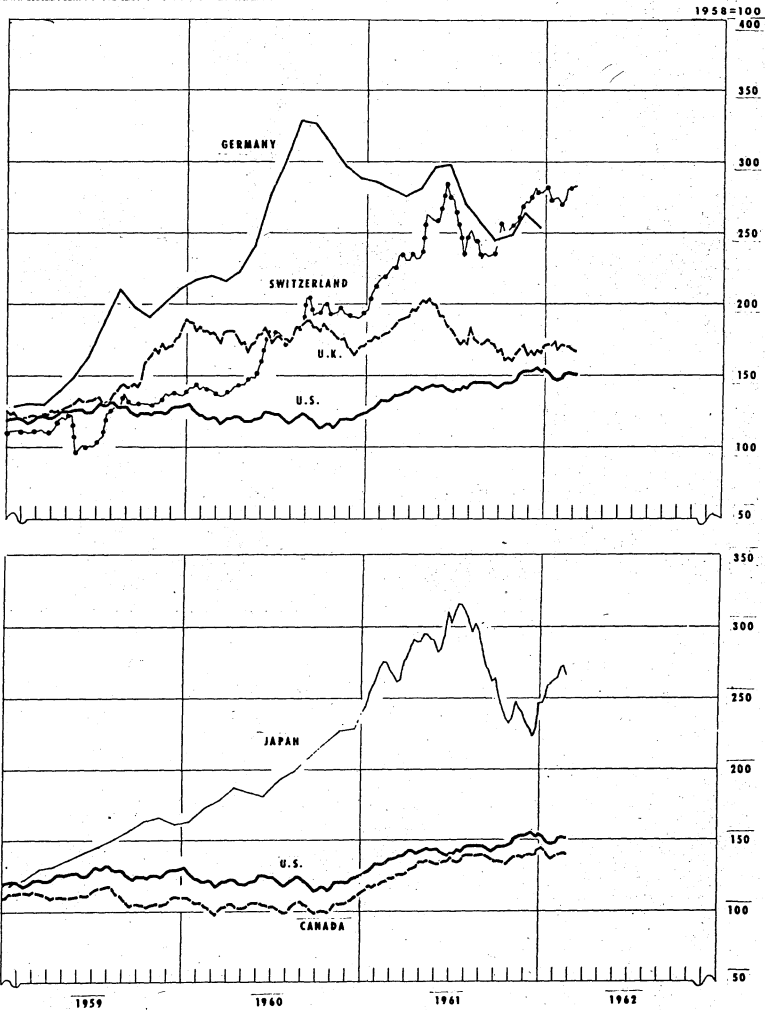
* 3-month treasury bill rates for all countries except Japan (3-month interbank deposit rate) and Switzerland (3-month deposit rate).
 † 3-month rate for U.S. dollar deposits in London

Chart c

LONG-TERM BOND YIELDS



INDUSTRIAL STOCK INDICES*



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

Chart 6

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

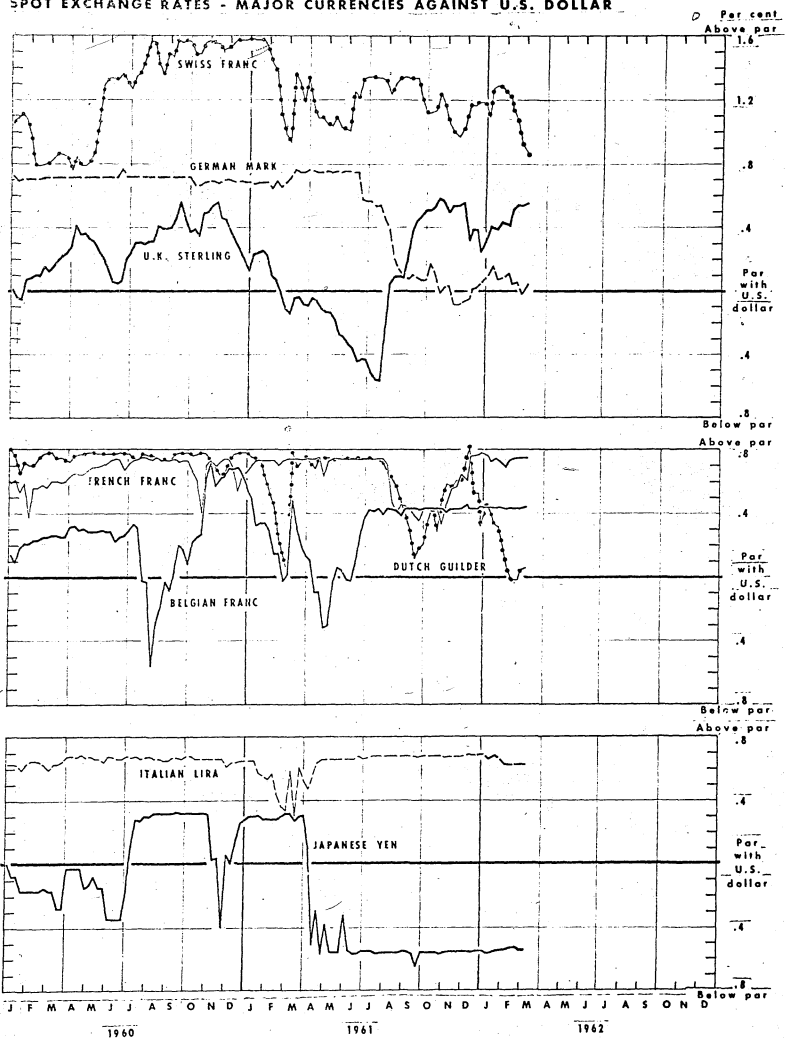


Chart 9

3-MONTH FORWARD EXCHANGE RATES

Per cent per annum

