DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
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CAPITAL MARKET DEVELOPMENTS ABROAD

I. Canada
II. Nine Charts on Financial Markets Abroad

I. Canada: Money and Capital Markets in July

Funds began moving into Canadian markets in sustained volume during July and official reserve accruals amounted to $306 million for the month. The inflow was chiefly made up of the unwinding of earlier shifts in commercial transactions (leads and lags) against the Canadian currency. In addition, some foreign funds are reported to have moved into Canadian commercial paper which offered a fully-hedged yield of about 3.60 per cent, into Treasury bills which offered a yield (without forward exchange cover) of about 5-1/2 per cent for the 3-month and of 5.69 per cent for the one-year bill and perhaps also into Government of Canada bonds.

Credit conditions remained tight throughout July. The chartered banks had to borrow from the Bank of Canada $26 million in the week of June 18 and $53 million in the week of July 23. Short money rates had a generally rising tendency early in the month but began to ease late in July. The 3-month Treasury bill yield reached a peak of 5.51 per cent on July 19 and eased to 5.39 per cent on August 2 as the Bank of Canada acquired significant amounts of bills in the latter part of July.

Bond yields were maintained throughout the month. The yield curve on Government of Canada securities remained virtually flat at around the 5-1/2 per cent level or roughly about 20 to 50 basis points above the levels prevailing before the emergency austerity measures announced on June 24. Market yields on Treasury securities (in per cent per annum) in recent weeks have been:

	April 12	June 6	20	27	July 18	August 1
Treasury bills:						
3 months	3.04	3.62	4.92	5.45	5.51	5.39
6 months	3.24	3.83	5.16	5.73	5.74	5.62
Bonds:						
1964 (May)	3.58	4.05	5.12	5.34	5.76	5.75
1965 (Sept.)	3.93	4.50	5.32	5.55	5.58	5.58
1967-68	4.13	4.31	4.74	5.11	5.11	5.03
1975-78	4.80	4.94	5.07	5.23	5.42	5.44
1979	4.77	4.95	5.05	5.26	5.48	5.48
1996-98	4.88	4.94	5.04	5.13	5.15	5.19

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Continued heavy sales of bonds by the chartered banks to finance their loan expansion put substantial pressures on bond yields. In addition, the Bank of Canada offset its purchases of Treasury bills after mid-July by sales of bonds. During the month, the chartered banks sold $350 million of bonds and the Bank of Canada $34 million.

Nonbank investors found government securities attractive at prevailing yields. During July, they acquired $315 million of bonds and $132 million of Treasury bills. These figures include purchases of both residents and non-residents.

Yields continued to edge up in the corporate and local-government sectors of the bond market. Long-term yields in these sectors of the market (in per cent per annum) were:

	1962			
	April 30	May 31	June 29	July 31
10 Provincial	5.19	5.43	5.67	5.87
10 Municipal	5.38	5.65	5.98	6.17
10 Public utilities	5.17	5.27	5.70	5.74
10 Industrials	5.15	5.39	5.71	5.77
40 Bond yield average	5.22	5.44	5.77	5.89

At prevailing yields, Canadian local government units have again become interested in borrowing in the United States. In the month ending June 30, A. E. Ames & Co. reported Canadian corporate and local-government borrowings in this country at $37.6 million.

Demands for bank loans continue strong at the prevailing 6 per cent prime rate. For the seven weeks prior to July 11, bank loans increased by $510 million but they declined $36 million in the two weeks ending July 25. It is as yet too early to have any indication of the impact of the June 24 austerity measures upon Canadian business developments.

Money market. Short-term interest rates on the Canadian money market continued to rise slightly during the first half of July from the previous high attained in late June, and then declined somewhat during the last two weeks of the month. The rate on 3-month Canadian Treasury bills rose from 5.45 per cent on June 28 to a high of 5.51 per cent on July 19, then declined to 5.39 per cent on August 2. (See Table and Chart 1.) The rate on 6-month Treasury bills hovered near its June 27 level of 5.73 per cent, and then declined to 5.62 per cent on August 2.

The short-term money market in Canada has been held tight--particularly during the first half of July--by substantial net sales of Treasury bills by both the Bank of Canada and the Canadian chartered banks. (See Table.) The Bank of Canada sold $56 million during the last week of June, and another $23 million during the first two weeks of July. However, the Bank of Canada acquired $53 million in Treasury bills in the last three weeks of July. The chartered banks remained sellers of Treasury bills during most of June and July--sales amounted to $152 million between June 6 and July 25. During the week ended August 1, however, purchases of $64 million of bills by the chartered banks contributed to the easing of the short-term market, the largest acquisition for any week in 1962.

After a decline during mid-June and a jump late in the same month, the covered arbitrage incentive in favor of the Canadian Treasury bill against the U.S. bill remained during most of July at about the same level it occupied during late May--about one-half of 1 per cent. (See Table and Chart 1.) Early in July, forward Canadian covering was reported to be somewhat limited in availability. The covered arbitrage incentive in favor of the Canadian bill dropped to 0.42 per cent on June 26, and then rose to 0.68 per cent on August 2.

The spread in favor of Canadian finance paper widened as finance paper rates rose with other short-term rates in late June, and some funds reportedly flowed into Canada from abroad. Comparative yields on 30-to-89 day paper for leading houses (in per cent per annum) were as follows:

	Canada	U. S.	Spread	90-Day Forward Exchange	Net Incentive
June 15	3.50-3.75	2.88-3.00	0.69	-1.02	-0.33
29	5.50	3.00	2.50	-1.90	+0.60
July 6	5.25-5.50	3.13	2.55	-1.89	+0.66
24	--	3.00	--	-1.95	--

Bankers' acceptance market. A move to broaden the Canadian money market with the introduction of a market for bankers' acceptances on June 11 was reported in "Capital Market Developments" for May and June, dated July 6. While the introduction did take place on schedule, the new medium was introduced in an atmosphere of increasing short-term money-market rates so that the new market was not able to start functioning. Acceptances were to be offered in the money market beginning June 11 in various denominations from $200,000 to $1,000,000 for terms ranging from 30 to 90 days. At the time of introduction, it appeared that these acceptances could sell on the market for yields approximating 4 per cent. After allowing a 1-1/4 per cent bank charge for guaranteeing the paper, it would still be possible for a borrower to obtain short-term funds at a cost of about 5-1/4 per cent, which was below the 5-1/2 per cent prime lending rate of the banks then prevailing. This situation, however, lasted for only a very few days during which dealers estimated a total of only two or three acceptances were issued. Thereafter, rising short-term interest rates made acceptances a more costly source of funds (after accounting for the charge by banks) than loans directly from banks. The increase on June 25 from 5-1/2 to 6 per cent in the prime lending rate by chartered banks, moreover, has not been sufficient to revive the acceptance market. With the prime rate now equal to the maximum lending rate of the chartered banks under Canadian law at 6 per cent, an acceptance must sell to yield something less than 4-3/4 per cent (after allowing for the 1-1/4 per cent charge by the bank for acceptance) if it is to have any advantage over borrowing directly from the bank. This maximum rate, in turn, is well over 1/2 per cent less than the yields at which 30-day Canadian Treasury bills have been selling. The bankers' acceptance is for the present, then, frustrated by unfortunate timing; its role in the Canadian money market will develop only as and when a significant drop occurs in the structure of short-term interest rates.

Bond market. Bond yields throughout July were little changed from late-June levels. The yield curve on Government of Canada securities remained very nearly flat at 5-1/2 per cent, about 1/4 - 1/2 per cent above market yields prior to the beginning of the emergency austerity program on June 24.

Bond yields were subject to substantial pressure thoughout the month as chartered banks continued very heavy selling of Government bonds to finance general loan expansion. These amounted to $350 million for the month of July. These pressures were augmented as the Bank of Canada offset Treasury bill purchases with sales of $52 million in Government bonds during the last two weeks of the month.

Nonbank investors found prevailing yields sufficiently attractive to acquire, during July, $315 million in Government bonds and another $132 million in Treasury bills.

Yields in the corporate and local-government sectors of the bond market continued to edge upward. By the end of July, yields in these sectors reported by McLeod, Young, Weir and Company ranged from 5.74 per cent for public utilities to 6.17 per cent on municipals (see Table).

Signs are appearing to suggest that the high structure of long-term interest rates may be forcing some provincial and municipal governments out of the Canadian market. Alberta's deputy-treasurer, for example, announced on July 26 that the Government of Alberta would not borrow at 6 per cent, and that an issue of $10-$15 million planned for August would be postponed at least until the year-end due to the high interest rates. It appears likely that many local units in similar straits may increasingly look to the U.S. market for lower-cost capital. The Government of British Columbia during July borrowed $45 million in U.S. short-term funds in two sales of 6-month 4-1/2 per cent paper. It was also reported in late July that Ottawa City had floated privately in the U.S. market an issue of $13.8 million at yields of 4-3/4 per cent for the first 10 years and 5-1/4 per cent for the remaining term. According to A. E. Ames & Co., Canadian corporate and municipal bonds sold on the U.S. market amounted to $100 million in May and $37.5 million in July.

Sales of New Canadian Securities Payable in U.S. Funds
(Can.$ millions)

	Total	Provincial, Direct and Guaranteed	Municipal	Corporation
1960				
I	144.1	37.0	82.1	25.0
II	93.9	40	28.6	25.3
1961				
I	11.0	--	--	11.0
II	106.4	--	26.4	80.0
1962				
I	3.0	--	--	3.0
II	101.5	--	1.5	100.0
Monthly:				
April	1.5	--	1.5	--
May	100.0	--	--	100.0
June	--	--	--	--
July	37.6	--	13.8	23.8

Source: A. E. Ames & Co., Weekly Bond Sales Summary.

Bank loans and bank liquidity. The rapid expansion of bank loans continued through the first half of July. During the first two weeks of the month, general loans of Canadian chartered banks increased by $166 million. For the seven-week prior to July 11, the increase in general loans by chartered banks amounted to $510 million. Between July 11 and July 25, however, these loans contracted by $36 million.

The expansion in general bank loans has taken place at a time when the Bank of Canada has been keeping an extremely tight hold on bank reserves. The degree of austerity exercised during the period can be clearly seen by the following data on cash reserves and liquid assets of chartered banks. After a slight increase due to advances from the Bank of Canada received one week and repaid the next, cash reserves of chartered banks were lower by $50 million on August 1 than the average for the week ending the preceeding June 27--the week during which the emergency austerity program was begun.

In these circumstances, the chartered banks financed the expansion in loans by massive sales of Treasury bonds and bills. Since June 6, the chartered banks have sold $608 million of their holdings of Government bonds -- about 22 per cent of their total holdings of such securities on June 6. Since June 20, net sales of Government bonds by the chartered banks have amounted to $414 million (see Table).

Canadian Chartered Banks:
Cash Reserves & Other Assets

(In millions of dollars or per cent)

	Cash Reserves	Cash Ratio	Liquid Assets	Liquid Asset Ratio	General Loans a/	Treasury Bills a/	Canadian Government Bonds a/
Average for month:							
March	1,101	8.1	2,451	18.04	5,905	1,181	2,708
April	1,113	8.1	2,351	17.12	6,033	1,075	2,679
May	1,114	8.1	2,358	17.13	6,261	1,048	2,719
June	1,165	8.18	2,286	16.05	6,519	1,009	2,457
July	1,159	8.20	2,195	15.53	6,649	908	2,212
Average for week ending:							
June 13	1,150	8.1	2,313	16.2	6,350	1,054	2,646
20	1,170	8.2	2,268	15.9	6,432	1,023	2,521
27	1,196	8.4	2,265	15.9	6,519	1,009	2,457
July 4	1,135	8.03	2,218	15.69	6,623	1,010	2,437
11	1,143	8.09	2,226	15.75	6,685	995	2,347
18	1,147	8.11	2,179	15.41	6,662	947	2,280
25	1,185	8.39	2,181	15.43	6,649	908	2,212
as of: Aug. 1	1,146	8.09	2,187	15.44	n.a.	972	2,107

a/ Weekly data are for the last Wednesday of the month. Weekly figures are holdings as of date indicated.

Source: Bank of Canada, Weekly Financial Statistics and Statistical Summary, June, 1962.

Sales of Treasury bills have reduced the liquid-asset ratio of the chartered banks to very near the agreed-upon minimum of 15 per cent. The cash reserve ratio of these banks has held very near the 8 per cent legal minimum. Perhaps illustrative of the tightness in the liquidity and reserve position of the chartered banks is the fact that the Bank of Canada, in July, began to report these ratios in terms of two decimal places rather than one, as they had formerly done.

Because of the tightness of credit, the chartered banks, on July 1, raised the interest rate on savings deposits from 2-3/4 to 3 per cent; and on July 3, they raised the prime lending rate from 5-1/2 to 6 per cent, the maximum that banks can charge under the Bank Act. Most loans have been made at this rate, though some have been reported at fractionally less.

The chartered banks have also announced their intention to try to do away with overdrafts as a means of extending credit. The Canadian banks have several times in the past tried and failed to do away with the accepted use of overdrafts, which for many years has been a part of Canadian banking. Under the present circumstances, however, the banks feel that conditions favor them, and hope to be able to rid themselves of the system by the beginning of September. This change is presumably an attempt on their part to bring under better control their loan commitments to their customers.

Dual Bank rate. Since November 1, 1956 the Bank of Canada has maintained a "floating" discount rate at a level 1/4 of 1 per cent above the preceeding week's average auction rate on 3-month Treasury bills. As a part of the emergency program begun in late June, however, the Bank rate was divorced from the Treasury bill rate and fixed at 6 per cent. The result is that Canada now has a dual Bank rate whenever the auction rate on 3-month Treasury bills is less than 5-3/4 per cent. For, while the official rate is now set at 6 per cent, money market dealers are still allowed to borrow from the Bank of Canada (under purchase and resale agreements) at 1/4 of 1 per cent above the Treasury bill auction rate, or at 6 per cent, whichever is lower.

Operations of Canadian banks in non-Canadian currencies. Following an increase of $82.5 million increase in April, non-Canadian dollar deposits increased by $207.9 million in May, and then fell $92.3 million in June, the latest period for which data are available.

Call loans by Canadian banks in the New York market declined sharply in June and July, as shown by the following estimates (in U.S. $ millions) of the New York State Banking Department.

	1960	1961	1962			
	Dec.	Dec.	Apr.	May	June	July
U.S. banks	1,496	1,963	1,828	1,430	1,361	1,042
Foreign agencies	849	859	959	752	610	487
Compare a/						
Canadian	829	809	848	727	541	n.a.
Other (residual)	20	50	111	25	69	n.a.

a/ Call loans, as reported by Canadian banks, converted into U.S. dollars at end-of-month exchange rates.

Foreign exchange. The Canadian dollar strengthened almost continually through the last week of June and throughout July. This strengthening began almost immediately after Prime Minister Diefenbaker's announcement on June 22 of impending emergency measures by the Government of Canada to strengthen the dollar. It was reinforced when the austerity program was announced on June 24.

(For details, see "Capital Market Developments" July 6, 1962.) Combined with over $1 billion in external help aimed at increasing Canada's ability to carry out its announced intentions, these measures underscored the Government of Canada's determination to defend the 92.5-U.S. cent rate for the Canadian dollar established on May 2.

The market rate on the Canadian dollar had hovered at or near its lower support price of 91.75 cents throughout the first three weeks of June, with Bank of Canada losing some $350-$400 million in defending this lower limit. Selling pressure on the Canadian dollar eased, however, immediately in the wake of the announced stabilization program, and the rate climbed to slightly above par by June 26, with the Bank of Canada picking up reserves during the last week of June. By the end of June, Canadian gold and foreign exchange reserves stood at $1,808.7 million, as compared with $1,492 million at the end of May, and $1.1 billion reported by the Prime Minister on June 24. After allowing for the $650 million increase in reserves due to external assistance by the International Monetary Fund, United Kingdom, and United States Federal Reserve Banks (and subject to a rounding error), net increases in Canadian reserves due to market transactions appear to have been around $58 million for the last week in June.

The increase in Canadian reserves of $305.7 million for July includes an advance repayment from the French received in mid-month in the amount of $61 million. Nonetheless, the increase in reserves gained from the market amounted to $244 million and the spot rate remained above par rate during the month of July. By August 6, the dollar remained strong with the Bank of Canada continuing to add to reserves while holding the rate at about 92.8 U.S. cents. Recent changes in Canadian reserves (in millions of U.S. dollars at month-end) were:

	1962						
	Feb.	Mar.	Apr.	May	June 24	June	July
Gold	962.4	963.7	963.2	913.0	n.a.	669.0	n.a.
U. S. dollars	784.3	745.7	631.6	579.8	n.a.	1,139.7	n.a.
Total	1,746.7	1,709.4	1,594.8	1,492.8	1,100.0	1,808.7	2,114.4
Change during period	- 175.2	-37.3	-114.6	-102.0	-392.8	+708.7	+305.7

Stock market. After rather mixed movements during June and July, the Canadian stock market at the end of July stood at virtually the same level it had at the end of June. The New York Standard and Poors industrial Index moved upward early in the month and then declined again to almost the same level at the end of July as it had been at the end of June.

Avg. for week ending	DBS Industrials	N.Y. Standard and Poor Industrials
1962:		
June 14	288.0	58.65
28	285.5	55.85
July 6	282.2	58.93
13	287.5	60.12
20	279.3	59.41
27	285.6	55.26

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	3-mo Can.$ b/	In favor Can. bill c/	Spot Can.$ (U.S. cents)	Finance paper d/: 30-89 days	90-179 days
1962-High	5.51	2.98	2.59	0.13	0.84	95.75	--	--
Low	3.01	2.64	0.22	-2.31	-0.11	91.73	--	--
1962-June 7	3.62	2.64	0.98	-0.55	0.43	91.73	3-3/8-1/2	3-5/8-3/4
14	3.93	2.73	1.20	-1.02	0.18	91.75	3-1/2-3/4	4
21	4.92	2.72	2.20	-2.31	-0.11	91.75	--	--
28	5.45	2.86	2.59	-1.75	+0.84	92.50	5-1/2	5-3/4
July 5	5.43	2.92	2.51	-1.96	+0.55	92.66	5-1/4-1/2	5-1/2-3/4
12	5.48	2.98	2.50	-2.02	+0.48	92.70	--	--
19	5.51	2.93	2.58	-2.02	+0.56	92.72	--	--
26	5.47	2.89	2.58	-2.16	+0.42	92.75	--	--
Aug. 2	5.39	2.83	2.56	-1.88	+0.68	92.75	--	--

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: Canada a/	Spread over U.S. b/	Intermediate bonds (8 yr.): Canada c/	Spread over U.S. d/	Long-term bonds (20 year): Canada e/	Spread over U.S. f/	Long-term bonds (35 year): Canada g/	Spread over U.S. h/
1962 - High	5.74	2.84	5.20	1.29	5.48	1.45	5.19	1.10
Low	3.18	0.19	4.04	0.03	4.73	0.73	4.81	0.82
June 6	3.83	1.10	4.31	0.64	4.95	1.10	4.94	0.98
13	4.12	1.33	4.39	0.72	4.98	1.14	4.97	1.02
20	5.16	2.37	4.74	1.03	5.05	1.17	5.04	1.06
27	5.73	2.84	5.11	1.28	5.26	1.34	5.13	1.10
July 5	5.71	2.69	5.20	1.29	5.37	1.39	5.15	1.05
12	5.72	2.63	5.13	1.25	5.42	1.39	5.15	1.05
19	5.74	2.59	5.11	1.16	5.48	1.44	5.15	1.03
26	5.65	2.54	5.07	1.13	5.48	1.45	5.19	1.08
Aug. 1	5.62	2.58	5.03	1.11	5.48	1.44	5.19	1.06

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.

Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

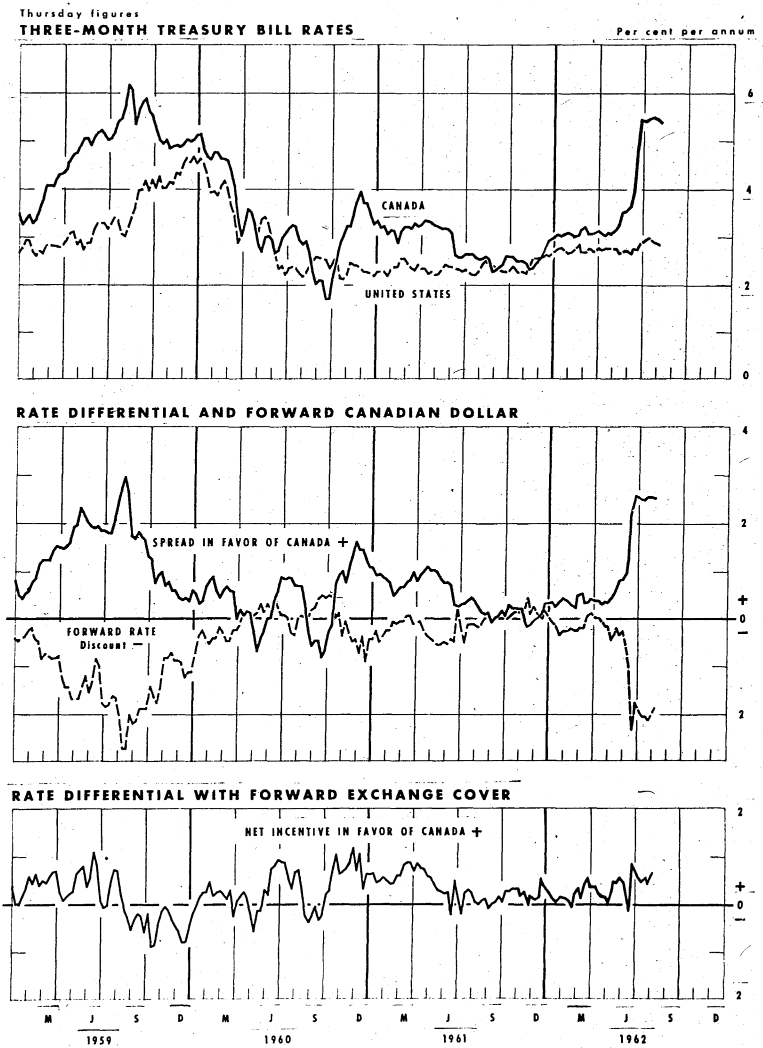


Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

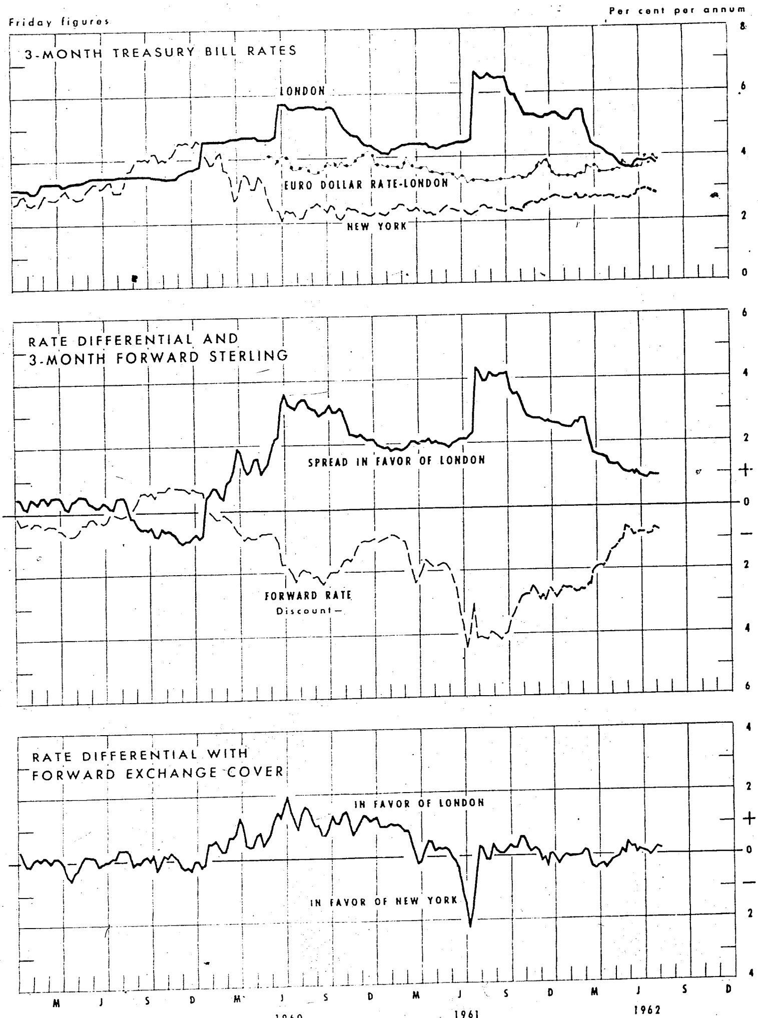
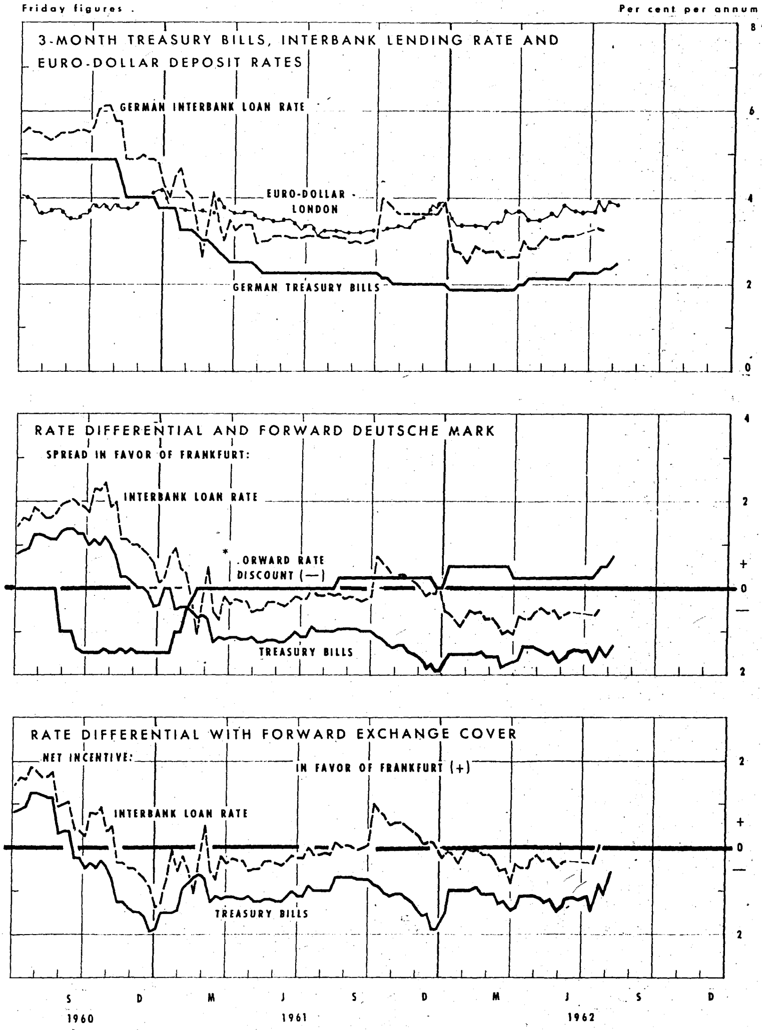


Chart 3

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS



Note: Special forward rate available to German commercial banks

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Chart 4

INTEREST ARBITRAGE, FRANKFURT / LONDON

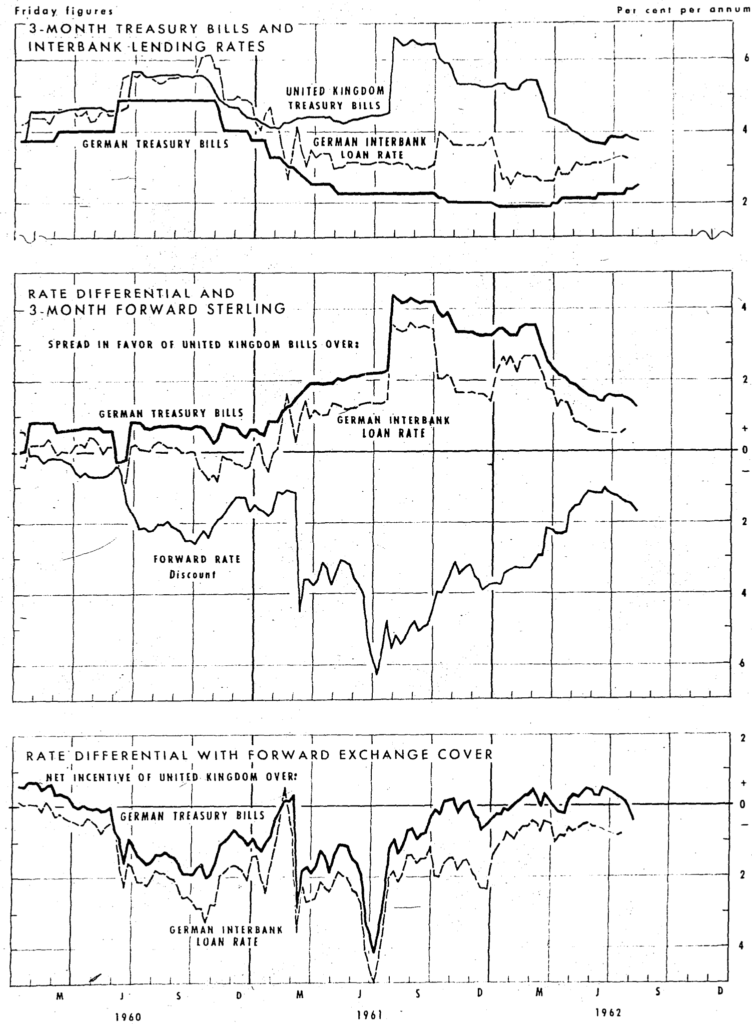
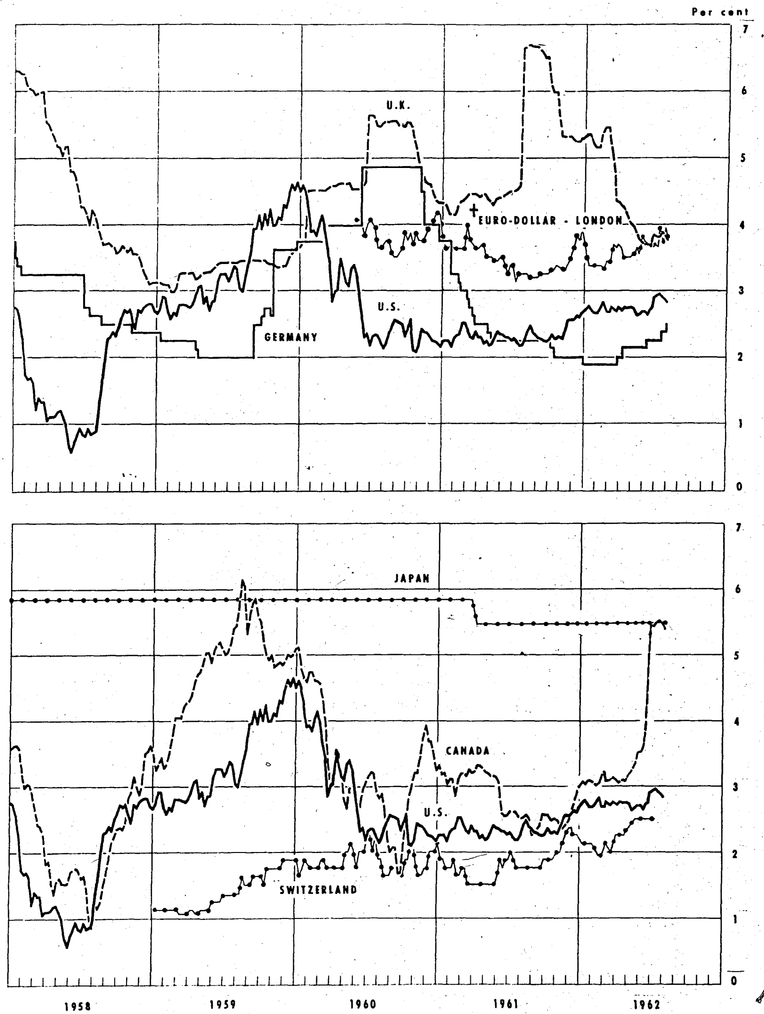


Chart 5

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

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Chart 6

LONG-TERM BOND YIELDS

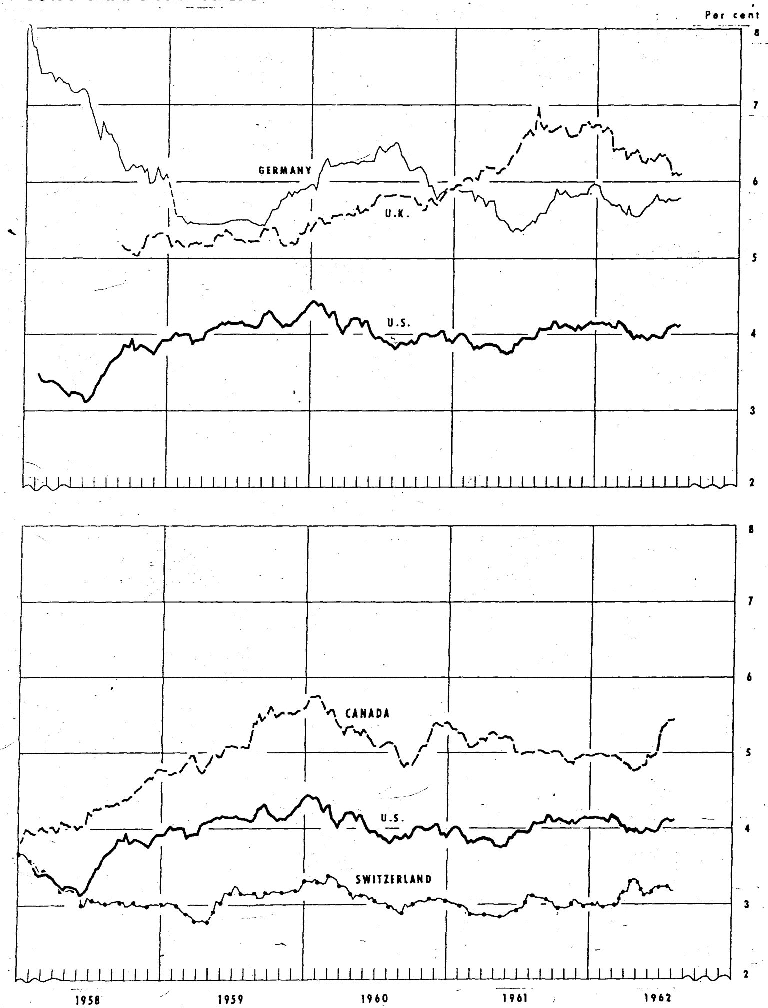
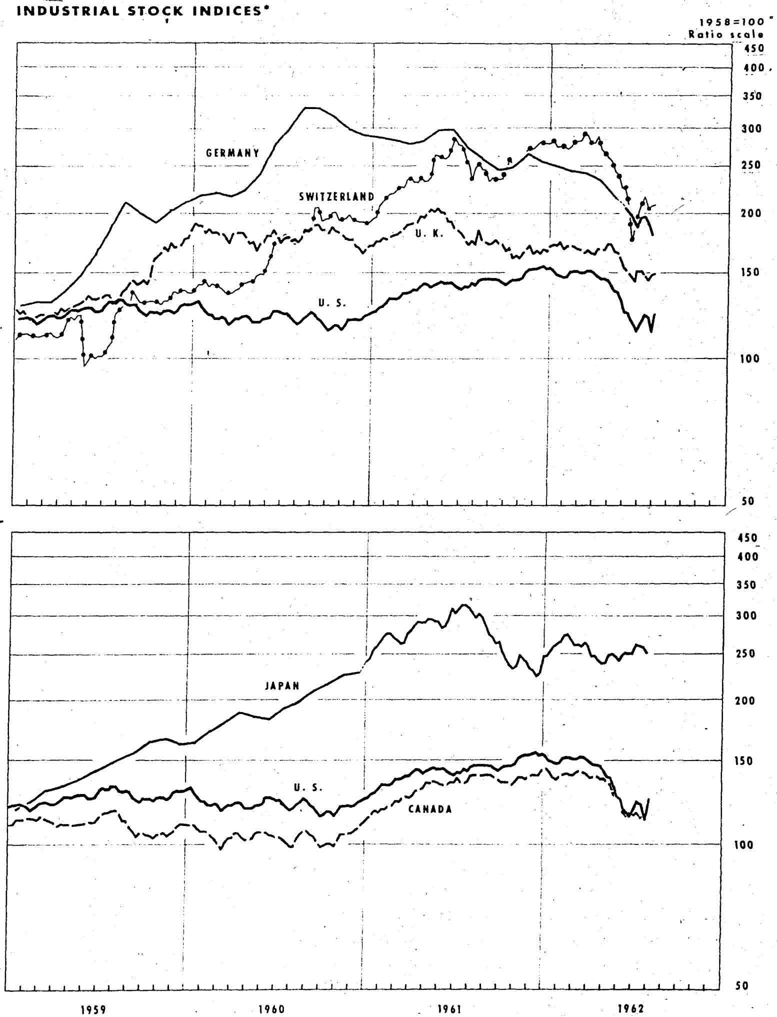


Chart 7

INDUSTRIAL STOCK INDICES*



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

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Chart 8

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

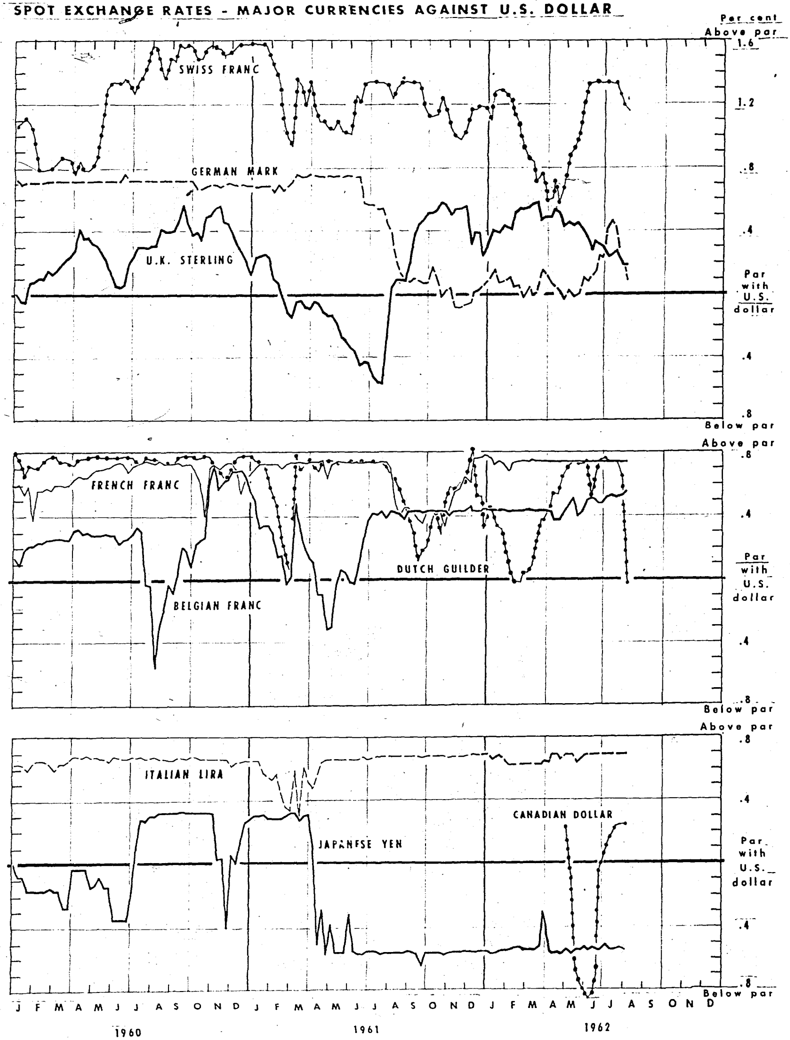

Chart 9

3-MONTH FORWARD EXCHANGE RATES