

H. 13
No. 125

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CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. Canada: Money and Capital Markets in September

In mid-September, for the third time within the past three months, a dramatic development in Canada's external economic relations was succeeded by substantial changes in quotations and yields in Canadian financial markets. Rising yields on Treasury bills and government securities followed the Canadian tax on "take-over" investment by foreigners proposed on June 13 and the United States "interest-equalization" tax proposal of July 18, despite quick reversals of official policy in both instances. Market yields continued to advance strongly throughout August, but the increase came to a halt in early September. (See Table 1.) The announcement on September 16 of the unprecedented 230-million bushel sale of Canadian wheat to Russia not only buttressed an already strong Canadian export position but was accompanied by a sharp fall in Treasury bill and bond yields in the second half of September. By early October, Canadian bond yields were not much above levels prevailing in early June, but the spread between yields on bonds and bills had narrowed considerably. Indeed, reflecting the summer increases in Federal Reserve and Bank of Canada discount rates, the yield on Canadian Treasury Bills were almost as high as during the period immediately prior to May 7, when the Bank of Canada had last reduced its discount rate.

Table 1. Canada: Selected Market Yields on Government Securities
(per cent per annum)

	April 24	June 12	July 10	Aug. 28	September 11 25		Oct. 2
Treasury Bills: ^{1/}							
3-months	3.66	3.19	3.33	3.71	3.78	3.58	3.61
6-months	3.80	3.30	3.48	3.95	3.98	3.71	3.76
Bonds							
Sept. 1965	4.51	4.07	4.31	4.64	4.60	4.17	4.09
June 1967-68	4.41	4.07	4.18	4.48	4.48	4.32	4.33
Jan. 1975-78	5.00	4.88	5.02	5.26	5.27	5.08	5.02
Sept. 1996-98	4.97	4.90	4.96	5.06	5.22	5.08	5.02

^{1/} Average tender rate on Thursday following date specified.
 Source: Bank of Canada.

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The improvement in Canada's trade position, actually realized or in immediate prospect, produced a strong recovery for the spot Canadian dollar in foreign exchange markets. After falling sharply from 92.75 U.S. cents on July 16 to 92.13 cents on July 19, the Canadian dollar made only a feeble response to the announced exemption of new Canadian securities from the U.S. interest equalization tax. The spot rate remained below the 92.50-cent par value continuously throughout August and gained strength only with reports in early September of progress in wheat negotiations with Russia. (See Table 2.) From a low of 92.34 cents on September 3, when a discount of .4 per cent per annum prevailed on the three-months forwards, the spot rate climbed to a high of 92.93 cents by September 26, and the discount on the forward dollar disappeared. (See Chart 1.) These new circumstances reversed the losses in official holdings of gold and foreign exchange which had by the end of August reached a cumulative total of 8 per cent from the high of \$2,712 million attained at the end of May. The announced gain in reserves for the month of September was \$97.8 million, and further accretions were rather clearly in store.

Table 2. Canada: Foreign Exchange Rates and Reserves
May - September 1963

End of Period	May	June	July	August	September
	(Foreign exchange rate in U.S. dollars)				
First week	92.95	92.73	92.73	92.44	92.42
Second week	92.84	92.69	92.73	92.33	92.61
Third week	92.78	92.77	92.13	92.31	92.67
Fourth week	92.78	92.78	92.61	92.32	92.87
Fifth week	92.75			92.36	
	(Foreign exchange reserves, in million U.S. dollars)				
Month	2712.0	2691.6	2501.0	2470.5	2568.3

Balance of payments and foreign trade. The recent strengthening of the Canadian dollar has reflected an impressive improvement in the current account sufficient to compensate for the sharply reduced level of long-term borrowing in the United States. From July 1 to September 30, 1963, new flotations of Canadian bonds payable in U.S. dollars have amounted to only \$41.6 million (according to reports of A.E. Ames & Co.) compared with a total of around \$628 million in the first two quarters of 1963. Official Canadian balance-of-payments estimates show that \$1,264 million of Canadian new issues were sold abroad from July 1962 to June 1963 compared with \$447 million in Calendar 1960 and \$533 million in 1961. (See Table 3.)

Chiefly because of rising exports, the Canadian current-account deficit was reduced from \$1,243 million in Calendar 1960 to \$848 million in 1962. (See Table 3.) From July 1962 to June 1963, the deficit was running at the still lower figure of \$592 million. On trade account, for the seven months January to July, a deficit of \$131.6 million for 1962 was replaced by a surplus of \$138.1 million for 1963. Canada accordingly experienced its first trade surplus for that period in more than a decade, and preliminary trade statistics show a further export surplus of \$32.8 million for August. It is noteworthy that this strong export performance has occurred prior to any grain shipments under the new contract with the U.S.S.R.

Table 3. Canadian Balance of International Payments 1960-63 1/
(millions of dollars)

	Annual Totals			Four Quarters ended
	1960	1961	1962	June 30, 1963
Total Current Receipts	7110	7734	8348	8633
Merchandise exports	5392	5889	6364	6590
Travel expenditures	420	482	560	570
Total Current Payments	8353	8716	9196	9225
Merchandise imports	5540	5716	6209	6248
Interest and dividends	653	770	781	782
Current Account Balance	-1243	-982	-848	-592
Balance on merchandise trade	-148	+173	+155	+342
Net Capital Movements	+1204	+1211	+1385	+1556
Direct investment	+650	+515	+525	+470
New Canadian security issues	+447	+533	+710	+1264
Canadian security retirements	-265	-297	-322	-407
Spec. international fin. asst.	--	--	+330	-377
Change in Official Holdings of Gold and Foreign Exchange 2/	+ 39	-229	-537	-964

1/ Partially itemized only. 2/ Minus sign indicates increase.

Source: Dominion Bureau of Statistics, Quarterly Estimates of the Canadian Balance of International Payments, Second Quarter 1963 (Sept. 1963).

Government securities market. There was a general turn-around in prices and yields in the markets for government securities immediately after the wheat contract was signed. The average tender rate on three-month Treasury bills, which had climbed fairly steadily from a low of 3.19 per cent as of June 13 to a peak of 3.78 on September 12, declined 20 percentage points in the two-week period immediately thereafter. (See Table 1.) Rather parallel movements were registered throughout the range of long-term bonds, with the September 1965 issue declining a particularly striking 34 points.

On September 18, the Minister of Finance announced the successful flotation of a new \$325 million Government of Canada cash loan, divided between:

- \$185 million of 3-1/4 per cent Bonds due October 1, 1964;
- \$ 90 million of 4-1/4 per cent Bonds due April 1, 1965; and
- \$ 50 million of 5 per cent Bonds due October 1, 1968.

The proceeds of this offering were earmarked for refunding \$223 million of 3 per cent Bonds maturing October 1, 1963, and for general purposes of the Government of Canada. In addition, the Bank of Canada agreed to acquire a further \$266 million of the new 1968 bonds in exchange for an equal par value of 3-3/4 per cent Bonds due September 1, 1965, thereby reducing the outstanding amount of that issue to \$1.0 billion.

During September, the banks added \$68 million to their holdings of Treasury bills and reduced their bond holdings by \$10 million. (See Table 4.) Both the Bank of Canada and Government Accounts were net sellers of bills. In the week ending October 2, the general public added \$46 million to their bill holdings, as the Bank of Canada and Government Accounts continued to be net sellers. The general public also held \$163 million more in bonds by the end of the week, or more than the net increase attributable to the September 18 new issues.

Table 4. Holdings of Outstanding Government of Canada Direct and Guaranteed Securities, August-September 1963
(millions of dollars)

	August 28			September 26			October 2		
	Treas. Bills	Other Secs.	Can. Sav. Bonds	Treas. Bills	Other Secs.	Can. Sav. Bonds	Treas. Bills	Other Secs.	Can. Sav. Bonds
Bank of Canada	391	2,655	--	374	2,655	--	354	2,642	--
Chartered Banks	1,168	2,531	--	1,236	2,521	--	1,239	2,518	--
Govt. Accounts	113	417	--	67	432	--	38	435	--
General Public	568	7,134	4,411	568	7,146	4,388	614	7,309	4,382
Sub-totals	2,240	12,737	4,411	2,245	12,754	4,388	2,245	12,904	4,382
Grand Total		19,388			19,388			19,531	

On September 27, the Minister of Finance reported relatively unsatisfactory budget figures for the first five months of the current fiscal year (April-August): revenues amounted to \$2,416.7 million and expenditures were \$2,466.6 million, producing a cumulative deficit of \$49.9 million, up \$44.3 million from the preceding year. The deficit in August alone was \$102 million. A further rise in expenditures was in store as a result of the government's commitment to raise old-age pension benefits in the session of Parliament that convened on September 30.

Bonds and stocks. Average bond yields on provincial, municipal, public utility, and industrial bonds declined during the month of September paralleling trends in government securities markets. Earlier, these yields had declined irregularly from a peak of 5.89 per cent per annum at the end of July 1962 to 5.32 per cent by the end of May 1963. (See Table 5.) But a steady rise from June through August had carried the average index up to 5.66 per cent by the end of August. Yields on municipal and provincial bonds, which had climbed considerably more than those on public utility and industrial bonds during the period of rise, also registered the relatively greater volatility during the September decline.

Table 5. Canada: Bond Yield Averages 1962-63

	(per cent per annum)							
	1962		1 9 6 3					
	July 31	Sept. 28	Jan. 31	Mar. 29	May 31	July 31	Aug. 30	Sept. 30
10 Provincials	5.87	5.69	5.36	5.39	5.29	5.44	5.67	5.50
10 Municipals	6.17	5.87	5.54	5.51	5.39	5.59	5.88	5.67
10 Public utilities	5.74	5.61	5.43	5.49	5.34	5.50	5.61	5.56
10 Industrials	5.77	5.66	5.29	5.42	5.26	5.43	5.49	5.44
40 Bond Yield Average	5.89	5.71	5.41	5.45	5.32	5.49	5.66	5.54

Source: McLeod, Young, Weir and Company.

The stock market also rose smartly during September, after languishing in the doldrums from mid-July through the end of August. (See Table 6.) The index of industrial stock prices in Canada was at 137.7 (1956=100) in late September. At that level, it stood 6 per cent higher than the low reached in late July, though it had not yet recovered the level of 140.6 prevailing during the week ending May 10. By contrast, the Standard and Poor's price index for industrial stocks in the U.S. reached a record high of 76.93 in the week of September 20, from which level it had receded slightly by the month's end.

Table 6. Canadian and U.S. Stock Market Indexes, May-September 1963
(weekly averages)

	May	July		August	September		
	10	10	31	30	6	20	27
United States ^{1/}	73.49	73.27	72.43	75.56	76.43	76.93	76.57
Canada ^{2/}	140.6	135.9	129.8	131.8	133.0	137.3	137.7

^{1/} Standard and Poor's 425 Industrials, 1941-43 = 10.

^{2/} Dominion Bureau of Statistics 76 Industrials, 1956 = 100.

Money-market arbitrage flows. There has been an incentive for short-term funds to flow from the United States to Canada on the basis of comparative finance paper and, to a lesser extent, of Treasury bill computations. During late August and early September, Canadian prime commercial paper was being offered by one U.S. bank at about 30 basis points above the yield for U.S. paper. (See Table 7.) The differential in favor of Canada in early October was only half as high as in early August. So far as three-month Treasury bills are concerned, the covered interest arbitrage opened the month of September slightly in New York's favor. It rose to a high of 50 percentage points (annual basis) in favor of Canada during the week beginning September 16, when the forward Canadian dollar shifted to a slight premium, but by the end of the month there was no incentive for funds to move in either direction on a covered basis.

Table 7. Canada-U.S. Covered Interest Arbitrage on 90-Day
Prime Commercial Paper, August-October 1963 1/
(per cent per annum)

	August			September				October
	2	9	16	6	13	20	27	4
Canadian Finance Cos. (Canadian dollars)	4.00	4.13	4.25	4.25	4.25	4.00	3.88	4.00
Canadian Finance Cos. (Fully hedged)	3.88	3.62	3.80	3.80	3.90	4.00	3.80	3.85
U.S. Finance Cos.	<u>3.38</u>	<u>3.50</u>	<u>3.50</u>	<u>3.50</u>	<u>3.63</u>	<u>3.63</u>	<u>3.63</u>	<u>3.63</u>
Differential (in favor Canada)	+ .50	+ .12	+ .30	+ .30	+ .27	+ .37	+ .17	+ .22

1/ Opening rates.

Bank assets and liquidity. Aside from the increase in holdings of Treasury bills previously referred to, shifts in the composition of chartered bank assets between August 28 and September 25 were quite minor. There was an over-all increase of \$168 in their major Canadian and net foreign assets, of which the investment in Treasury bills alone account for more than 40 per cent, general loans for a further 25 per cent, and holdings of provincial securities almost 20 per cent. A \$21 million decrease in loans to grain dealers was almost exactly offset by an increase in loans to municipalities, though holdings of municipal securities remained unchanged.

The over-all liquidity position of the banking system improved moderately in the course of the month. The cash ratio of the chartered banks in September averaged 8.12 per cent, as compared with 8.10 per cent in August. Augmented by Treasury bills, total liquid assets rose from an average of \$2,488 million to \$2,524 million between the two months, and the liquid asset ratio accordingly increased from 16.96 per cent to 17.22 per cent.

Europe and British Commonwealth Section.

INTEREST ARBITRAGE, UNITED STATES / CANADA

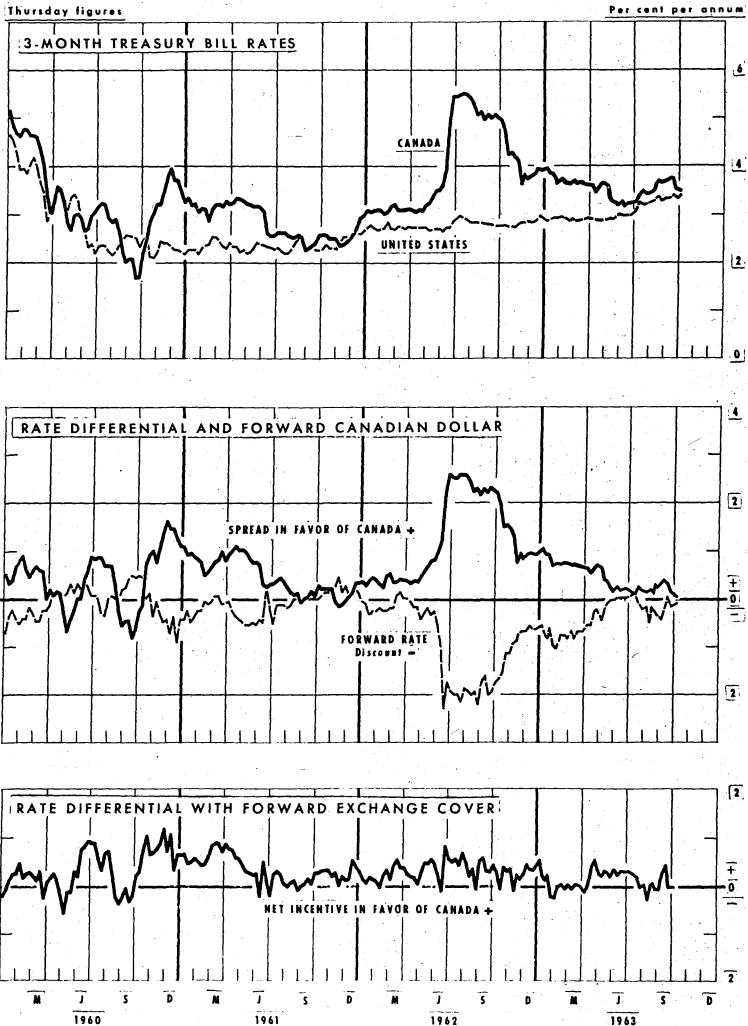


Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

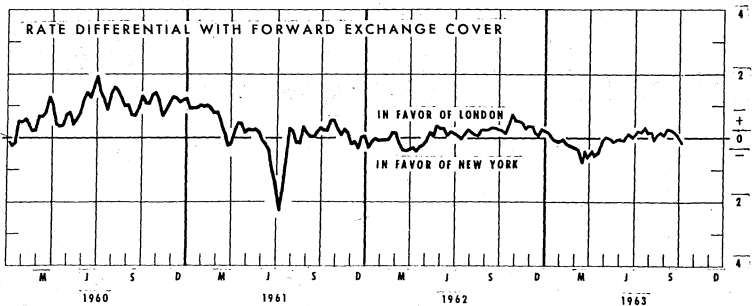
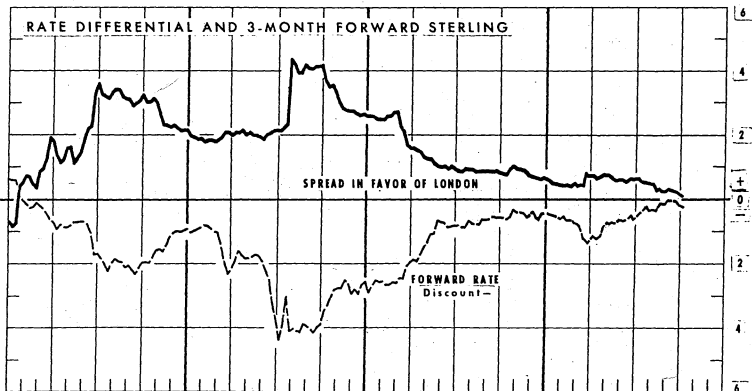
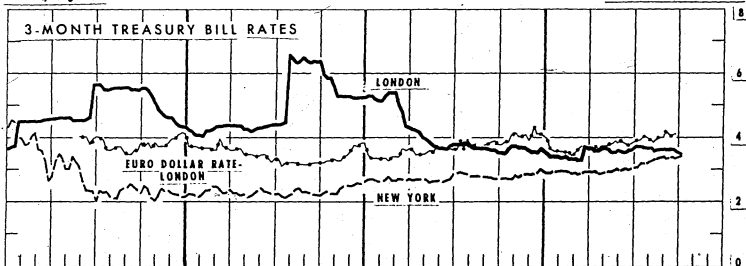
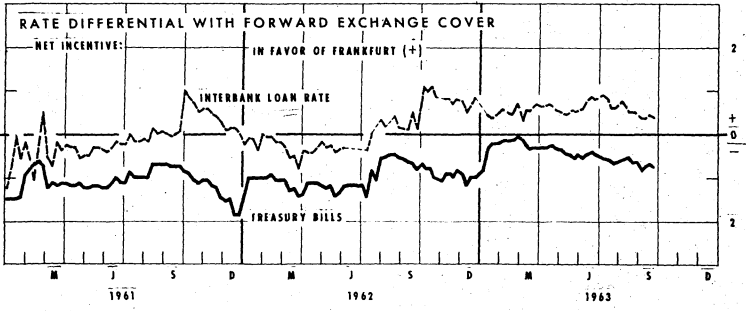
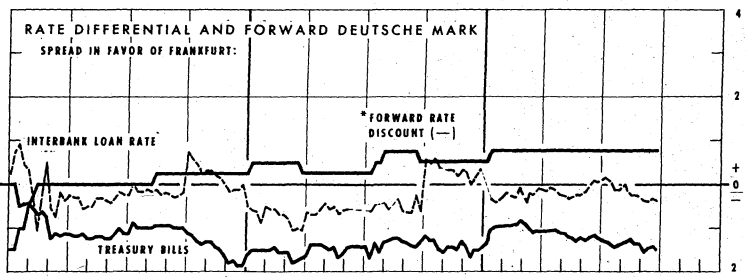
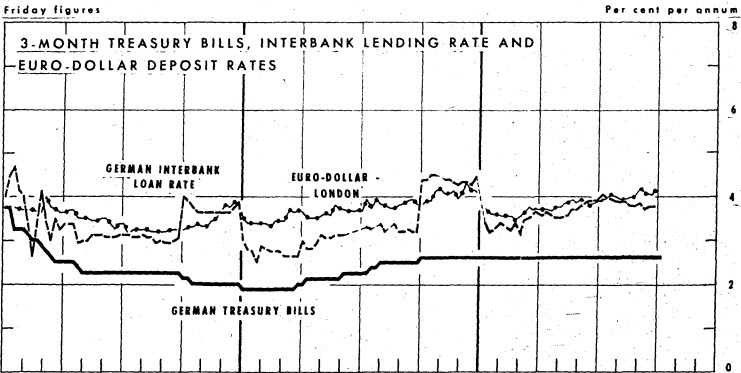


Chart 3

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS



* Note: Special forward rate available to German commercial banks

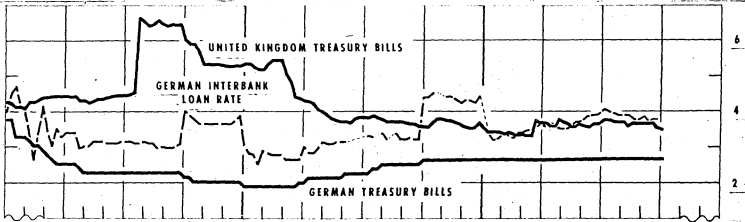
Chart 4

INTEREST ARBITRAGE, FRANKFURT / LONDON

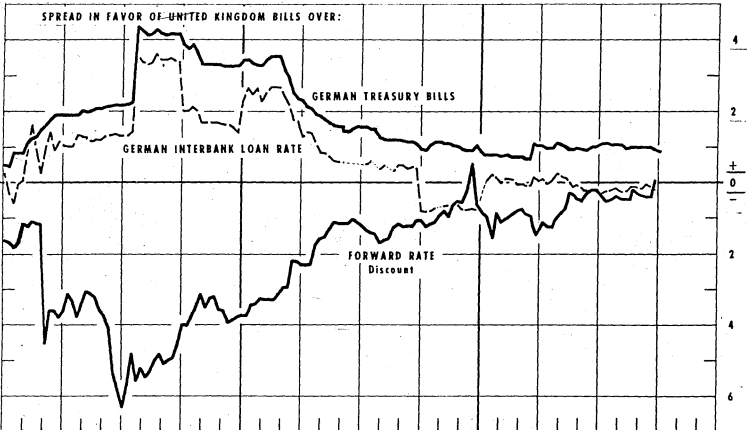
Friday figures

3-MONTH TREASURY BILLS AND INTERBANK LENDING RATES

Per cent per annum



RATE DIFFERENTIAL AND 3-MONTH FORWARD STERLING



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

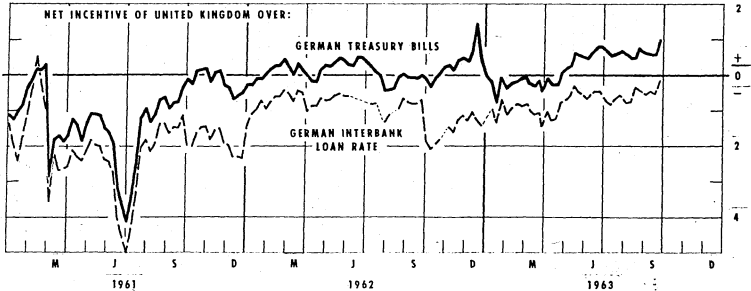
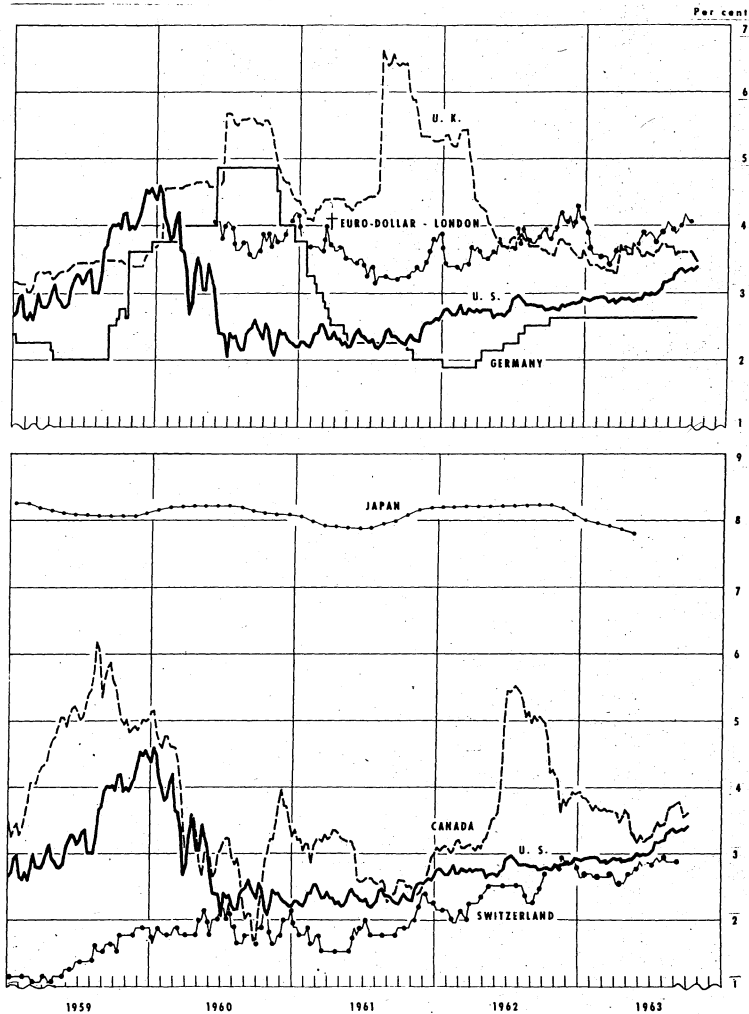


Chart 5

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

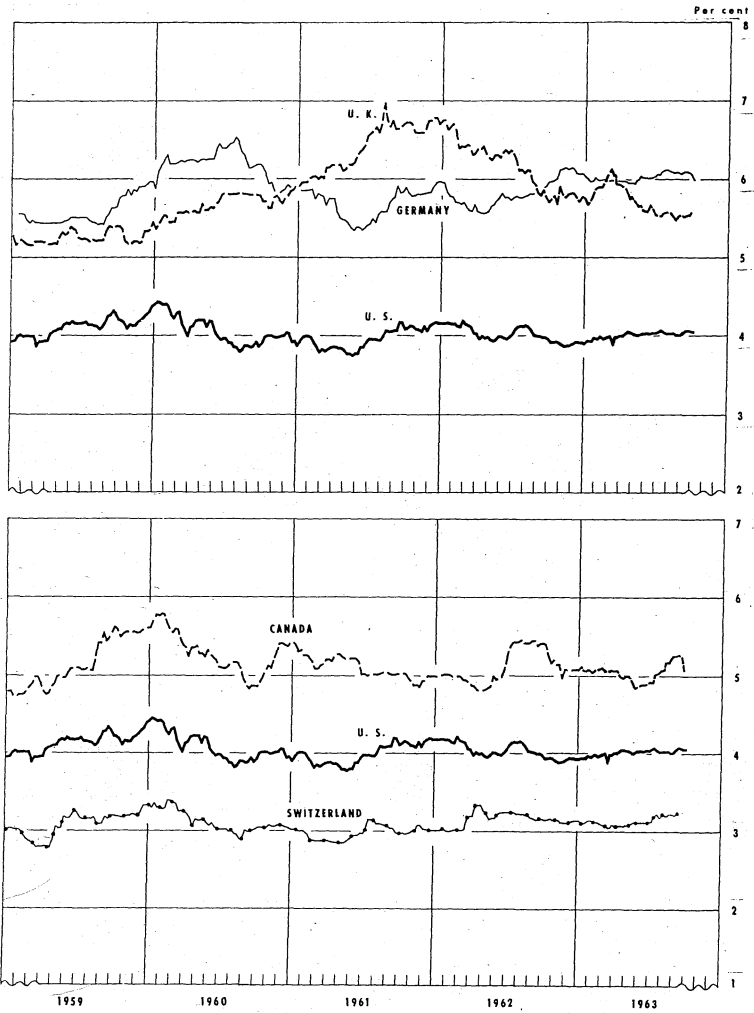
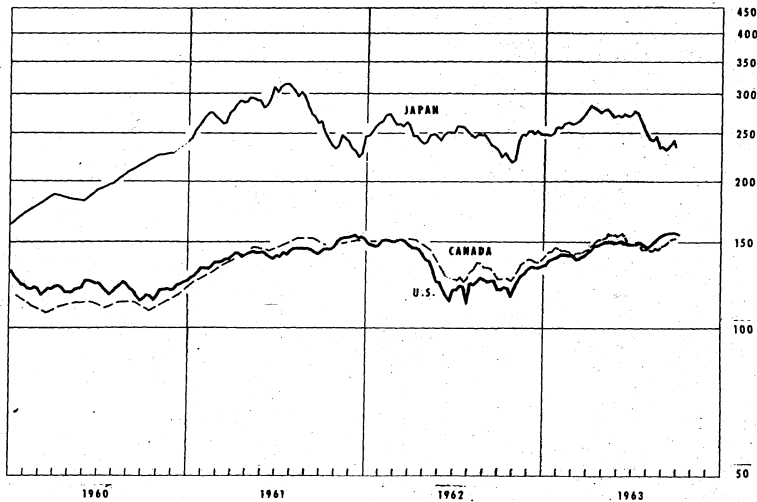
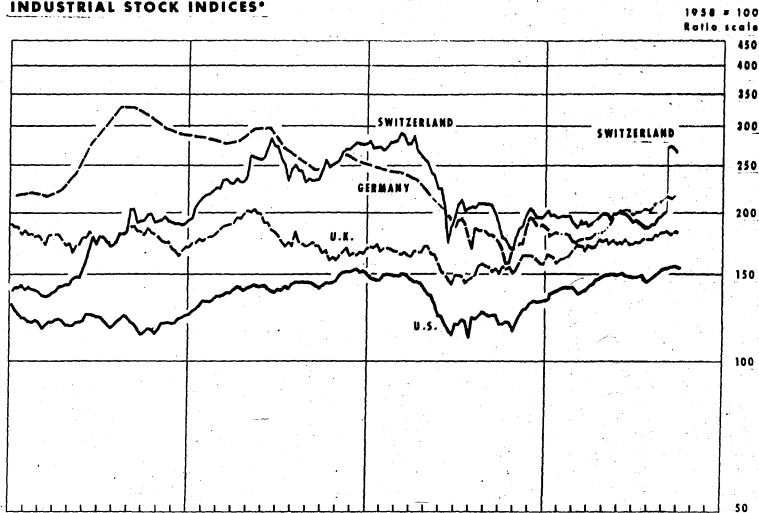


Chart 7

INDUSTRIAL STOCK INDICES*

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

Chart 8

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

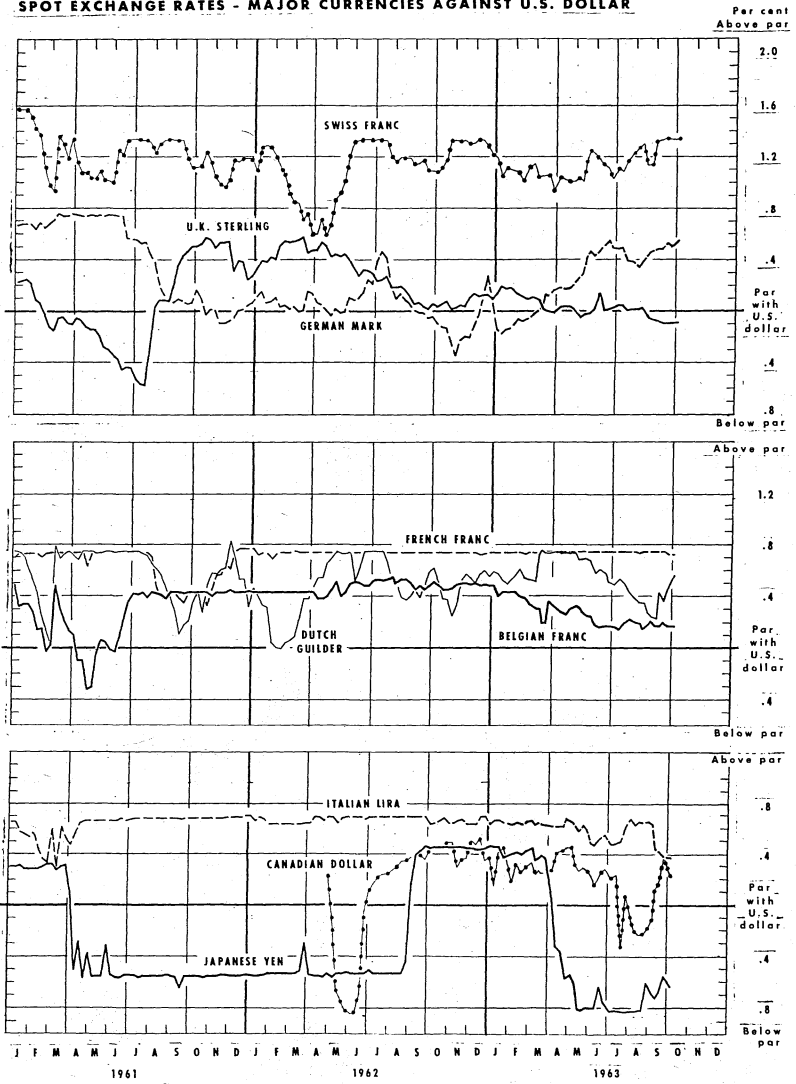


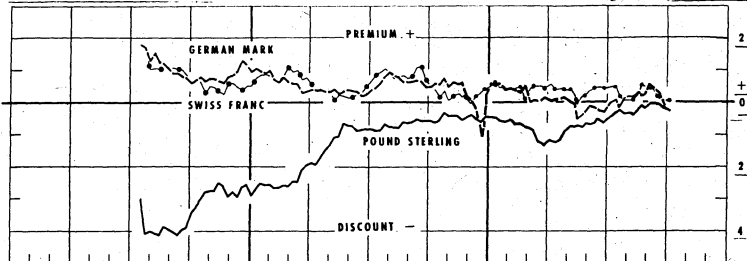
Chart 9

3-MONTH FORWARD EXCHANGE RATE

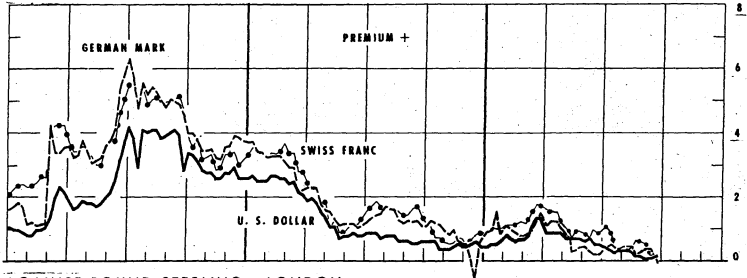
Friday figures

AGAINST U. S. DOLLARS

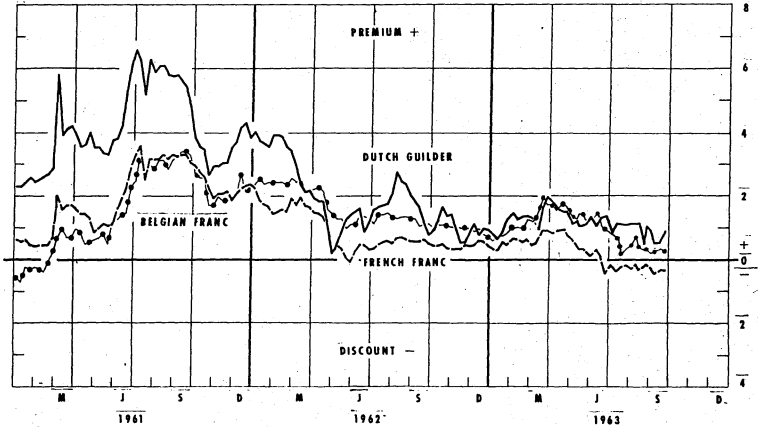
Per cent per annum



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON



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