

appropriate technology. Market makers and liquidity are also essential for the smooth functioning of markets.

Today, the financial markets of industrialized countries, including Canada, are said to be integrated in the sense that capital is mobile and investors substitute assets with the expectation of similar returns. There are a number of more precise definitions of market integration focusing on interest parity.<sup>3</sup> In a recent Bank of Canada study, William White considered the evidence on the integration of Canada's financial markets with those of the United States. He concluded that the short-term markets are fully integrated, and we can not dismiss the possibility of long-term markets being integrated as well.<sup>4</sup>

## 2.2 The Importance of Financial Integration for Canada

Two examples illustrate the extent of foreign participation in Canadian financial markets, and the size of financial markets relative to the economy.

- By the end of 1992, foreign investment in Canadian bonds was C\$232 billion, over one-third of total bonds outstanding.<sup>5</sup> Not surprisingly, investors from the United States accounted for the largest share, with 38% of all Canadian bonds held by foreigners. Foreign holdings of Canadian stocks was lower, at C\$18 billion.
- As of the latest survey conducted in April 1992, the average daily volume of foreign exchange transactions involving Canadian institutions was about US\$22 billion.<sup>6</sup> This means that, on a yearly basis, turnover in the Canadian foreign exchange market amounts to over nine times the Gross Domestic Product.

---

<sup>3</sup> See A. Blundell-Wignall and F. Browne, *Increasing Financial Market Integration, Real Exchange Rates and Macroeconomic Adjustment*. OECD Department of Economics and Statistics Working Paper No. 96. Paris: February 1991, pp. 8-14.

<sup>4</sup> W. White, *op. cit.*, pp. 3-4.

<sup>5</sup> Statistics Canada, *Canada's International Investment Position Historical Statistics 1926-92 #67-202*. Ottawa: March 1993, p. 27.

<sup>6</sup> N. Close and C. Duenwald, "Survey of the Canadian Foreign Exchange Market." In *Bank of Canada Review*. October 1992, p. 23.