DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
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OF RICHMOND

CAPITAL MARKET DEVELOPMENTS ABROAD

I. Switzerland
II. Nine Charts on Financial Markets Abroad

I. Switzerland: Money and Capital Markets in March

Concern over inflationary pressures in Switzerland has led to measures to restrict the expansion of bank credit. The measures are to be carried out under an agreement effective April 1, 1962 between the Swiss National Bank and commercial banks and finance companies which accept deposits from the public. In the period April-December 1962, increases in bank credit will be limited either to specified percentages of the increases in 1960 or 1961, or, in some circumstances, to specified percentage increases over the amount of credit outstanding at the end of 1960 or 1961. Before the end of 1962, negotiations will be held to determine permissible rates of credit expansion in 1963. Certain terms of the agreement appear to indicate that the Swiss National Bank intends to press for more restrictive permissible rates of expansion in 1963 than have been set for 1962.

The Swiss franc continued to decline on the exchange markets during March, and in the latter half of the month the Swiss National Bank intervened to slow down the decline. Selling pressures on the franc resulted from an unusually high level of imports, increasing outflows of private short-term capital, and a contraction of private short-term capital inflows. Funds moved to London, and some repatriation of French capital from Switzerland was reported. However, the gold and foreign exchange reserves of the Swiss National Bank have not been greatly drawn down by these developments. Although these reserves decreased $44 million in March, $23 million of the decline was not related to commercial payments or private short-term capital flows, and only $15 million of central bank support of the franc -- in the third week of March -- has been reported.

To relieve some pressure on the franc, long-term foreign borrowing on the Swiss capital market has not been permitted during the month of April. The exchange rate for the Swiss franc showed little change between end-March and April 24. In the first half of April, central bank reserves declined $9 million.

The discount on the 3-month forward dollar in Switzerland, which had increased in January and February and reached 1.09 per cent per annum on March 2, narrowed in March and April and was 0.41 per cent per annum on April 24.

Long-term bond yields rose very sharply in March and April. The yield to maturity on one representative long-term government bond rose from 2.99 per cent on March 9 to 3.30 per cent on April 13, the highest since

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early 1960. The fall in bond prices could be related to fears of a "shortage" of liquidity consequent upon the bank credit restriction measures, and may also be related to recent capital outflows.

The short-term money market tightened in March and April under the influence of strong demand for foreign exchange. However, the balance-of-payments developments of recent weeks appear to have had little impact as yet upon the Swiss money market. Rates on 3-month deposits were 2-1/4 to 2-3/8 per cent in mid-April compared with 1-7/8 to 2 per cent in mid-February.

Governor Schwegler of the Swiss National Bank has replied to critics who charged that large inflows of foreign exchange had imported inflation into Switzerland and that Switzerland should therefore have a freely-fluctuating exchange rate system. At the stockholders meeting of the Bank, Governor Schwegler stated that freely-fluctuating exchange rates would have serious disadvantages for the conduct of both foreign trade and capital movements, and would lead to a rise in speculation. He denied that the Swiss franc was overvalued, and doubted that a floating rate would have held down the heavy capital inflows of the past two years which he said were largely motivated by political conditions.

The Federal Government budget results for 1961 show a surplus of SF 328 million ($78 million), compared with a budgetary balance in the initial estimates and a somewhat smaller surplus in 1960. The surplus was one of several developments which last year offset much of the impact on the Swiss economy of massive inflows of capital from abroad. To keep funds obtained from the surplus from re-entering the economy, the Government limited its debt repayments. At present the Government has liquid funds of about $350 million which it is keeping sterilized in order not to add to inflationary pressures. Part of these funds are invested at short-term, some of them abroad, and earning an average return of 1.4 per cent, while the average rate of interest which the Government is paying on its debt is 2.9 per cent.

Money market. During March and early April, the short-term money market was continuously influenced by the unusually strong demand for foreign exchange that had begun in early February. This heavy demand, arising out of high imports and some capital outflow, caused the money market to tighten. In addition, demand for liquid Swiss franc funds for end-of-quarter window-dressing purposes served further to tighten the market in late March.

However, although the recent deterioration in the Swiss balance of payments has had a decided effect on the exchange rate, the impact on the domestic money market appears to have been small. Rates paid by banks on 3-month deposits have risen only fractionally, from 1-7/8 to 2 per cent in mid-February to 2-1/4 to 2-3/8 per cent in mid-April, and in the call loan market the turnover has continued light and the rate has remained at 1-1/4 per cent. Freely-utilizable deposits of the banks with the Swiss National Bank declined from $555 million on February 15 (high for the year

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to date) to $475 million on April 14, but this can be accounted for entirely by a rise in the note circulation. Rediscounts and advances to banks by the central bank have undergone but a modest increase, from $13 million on February 23 (the low point for the year to date) to $16 million on April 14.

Measures to restrict the extension of bank credit were taken effective April 1, by agreement between the Swiss National Bank and all banks and finance companies which accept deposits from the public and which have a balance sheet total of SF 10 million ($2.3 million) or more. This step reflects the concern of the Swiss authorities over the strong demand pressures in the economy which in the past year and one-half have caused a very large increase in imports and an appreciable rise in prices in Switzerland.

The agreement is valid from April 1, 1962 to December 31, 1963. The banks and finance companies have undertaken not to allow increases in credit to Swiss debtors in the months April-December 1962 to exceed the following percentages of the increase in the full year 1960 or 1961, whichever was the greater:

1. In April-June 1962, 25 per cent for discounts and advances and 30 per cent for mortgages.

2. In April-December 1962, 65 per cent for discounts and advances and 85 per cent for mortgages.

However, the agreement provides that in the months April-December 1962, total credit outstanding to Swiss debtors may in any event increase at a monthly rate of one-half per cent of the outstanding amount at the end of 1960 or 1961, whichever was the higher. This works out to 4-1/2 per cent over the full 9 months.

Within the limits of the permissible rates of expansion, preference is to be given to loans for subsidized and other nonspeculative housing, to agricultural credit, and to import credits, and mortgages should be reserved primarily for new loans for the consolidation of housing credits. Advances to public corporations and building credits for specific building projects or land purchases which banks had agreed to make prior to April 1 are not subject to the restrictions otherwise laid down. Before the end of 1962, new negotiations will take place to set permissible rates of credit expansion in 1963. The banks are asked to exercise restraint in undertaking new credit commitments "in order that a further cut in the permissible rates of growth in bank credit can be made in 1963."

Bond market. The most abrupt change in long-term bond prices in nearly three years caused yields to rise very sharply during the period under review. The yield to maturity on the Swiss Confederation 3 per cent bond of 1967-74, which had been 2.99 per cent for four weeks, rose from that level on March 9 to 3.17 per cent on March 30, and by April 13 stood

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at 3.30 per cent. (See Table and Chart 6.) At this level the yield on this issue was well above the 1961 high of 3.12 per cent registered last July, and was the highest since early 1960. The fall in bond prices may stem, at least in part, from a fear of a "shortage" of liquidity consequent upon the measures taken on April 1 to restrict the expansion of bank credit. The recent higher rate of capital outflow from Switzerland may also have had its counterpart to some extent in a liquidation of bond holdings, although bond prices did not turn downward until some time after the acceleration of capital outflow.

Although long-term bond yields had already begun to rise, there was no change in the first half of March in the yields on medium-term deposit certificates.

Stock market. After reaching a new record high o March 9 of 292.5 (1958 = 100) the industrial stock price index declined during most of the remainder of the month to 278.6 on March 30. (See Chart 7.) During the early part of the last week of March, stock prices fell sharply on the news of the bank credit restrictions, but later rallied to close the week with little net change. Some observers believed that an outflow of foreign capital may have contributed to falling stock prices in March. However, the prevailing opinion was that consolidation of earlier gains caused lower prices in March as well as the further declines which occurred in early April and which brought the industrial index to 269.7 on April 13.

New issues. According to a press report, the Swiss authorities in early April decided that no foreign loans would be allowed on the Swiss capital market in the month of April. In the light of the recent weakness of the Swiss franc on the exchange markets, this action would appear to be designed temporarily to relieve the franc of the selling pressures attendant upon the conversion of foreign loan proceeds. The report stated that foreign loans were scheduled to be resumed after April.

New public issues of securities were unusually large in February, even net of a substantial amount of reimbursements, and for January and February together the amount of new money raised, both net and gross, was well above the comparable period of 1961. The volume of new issues in March was said to be "considerable." To date there have been no reports concerning either the effect (if any) of capital outflow on the demand for new issues, or the significance for the new issue market of the very sharp rise in long-term government bond yields in March and April.

Three foreign bond issues totaling $21 million were floated in March by Cinzano Ltd. of Montreal, Rheinkraftwerk Saeckinge A.G. of Baden, Germany, and Mannesmann A.G. of Duesseldorf. All three were reported to have been oversubscribed. For the first quarter of 1962, foreign bond issues averaged $19 million per month. This was less than in the first quarter of 1961 (when foreign issues were deliberately speeded up in March to soak up funds that came to Switzerland in expectation that a Swiss

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currency revaluation might follow the DM and guilder revaluations), but was about equal to the 1961 average. (See Table, page 8 .)

Foreign Borrowings in February-March

	Amount (mil. $)	Term	Coupon rate	Issue price	Yield to maturity
February					
Bowater Paper Corp. Ltd. (London)	13.95	1970-77	4.5	100	4.5
Kingdom of Denmark	13.95	1972-77	4.5	100	4.5
March					
Cinzano Ltd. (Montreal)	2.3	1970-74	5.0	100	5.0
Rheinkraftwerk Saeckingen A.G. (Baden)	7.0	a/1968-77	4.0	100	4.0
Mannesmann A.G. (Duesseldorf)	11.6	1977	4.5	100	4.5

a/ Serial bonds maturing 1968-77, callable 1972.

Foreign trade. Seasonally-adjusted imports totaling $268 million in February were very high for the second consecutive month. The seasonally-adjusted trade deficit in February of $76 million was down from the January level, largely because of a rise in exports, but was still well above the 1961 average of $55 million per month. The exchange market registered the effects of the unadjusted deficit which, amounting to $65 million in February, was less unfavorable in comparison with the 1961 average. However, in February Switzerland's net receipts from foreign travel, which probably averaged about $20 million per month in 1961, were seasonally low.

Seasonally-adjusted Foreign Trade
($ millions; monthly average or month)

	1960	1961				1962	
	Year	I	II	III	IV	Jan.	Feb.
Imports c.i.f.	187	221	217	229	232	273	268
Exports f.o.b.	158	166	168	171	174	179	192
Balance	-29	-55	-49	-58	-58	-94	-76

Foreign exchange reserves. For the month of March there was a $44 million decrease in the gold and foreign exchange reserves of the Swiss National Bank. In the first half of the month, reserves fell $23 million because of (1) an increase of about $11 million in the short-term foreign investments of the Swiss Federal Government, and (2) foreign exchange requirements of the Government, and conversion of the proceeds of long-term foreign loans on the Swiss capital market. The second half of the month showed a further decrease of $21 million. Of this amount, at

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least $15 million was the result of Swiss National Bank sales of dollars to the market in support of the Swiss franc during the week of March 16-23. However, during the last half of March U.S. authorities purchased from the Swiss National SF 45 million of Swiss francs (about $10 million) to cover maturing forward contracts with Swiss investors. Adjusted for this transaction, the March reserve loss was $54 million. Swiss National Bank support of the franc in the market in the latter half of March may therefore have been as much as $31 million. But no basis exists for assuming that such support exceeded the $15 million that has been reported.

The deterioration in the Swiss balance of payments in February and March, which produced a sharp impact on the exchange rate for the franc, was the result of a rise in the trade deficit, a slowing of private short-term capital inflow, and a step-up in private short-term capital outflow. However, the loss of Swiss National Bank reserves in these two months which can be attributed to the developments on these accounts 1/ does not appear to have exceeded $31 million and was perhaps only $15 million. Consequently, any deterioration on trade and private short-term capital accounts in excess of this figure has been absorbed by the net foreign assets of the Swiss commercial banks.

The central bank's reserves declined $9 million in the first two weeks of April.

Swiss National Bank Reserves
($ millions)

	Gold	Foreign exchange	Total
1960 - Dec. 31	2,185	137	2,322
1961 - Feb. 28	2,162	138	2,300
Mar. 31	2,165	372	2,538
Sept. 23	2,453	327	2,780
Dec. 31	2,560	198	2,758
1962 - Jan. 31	2,505	181	2,686
Feb. 28	2,482	163	2,645
Mar. 15	2,457	171	2,628
Mar. 30	2,444	163	2,607
Apr. 15	2,429	169	2,598

Foreign exchange rates. High commercial demand for foreign exchange, reduced private short-term capital inflow, and an acceleration of private short-term capital outflow caused the Swiss franc to decline further on the exchange markets in March. (See Table and Chart 8.) The spot U.S. dollar in Switzerland rose from SF 4.333 on February 28 to SF 4.342

1/ The $35 million decrease in the National Bank's reserves in February was caused by additions to the Federal Government's short-term investments abroad.

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on March 15. To slow down the decline in the franc, the Swiss National Bank intervened in the market in the latter half of March. After falling briefly, the dollar rose further to 4.346 on March 30. The spot pound was only temporarily depressed by the two reductions in Bank Rate in the United Kingdom, and closed the month of March at SF 12.230 compared with SF 12.194 at the end of February.

In early April, the trade deficit and capital export continued to generate strong demand for foreign exchange, while capital inflow was believed to have slowed down still further. After weakening slightly in mid-April, the dollar recovered to SF 4.347 on April 24.

After rising in January and February, the discounts on forward dollars and forward sterling diminished in March and April. (See Table and Chart 9.) The discount on the 3-month forward dollar declined from 1.09 per cent per annum on March 2 to 0.78 per cent on March 30 and fell further to 0.41 per cent per annum on April 24, while the discount on 3-month forward sterling was reduced from 3.70 per cent per annum on March 2 to 2.34 per cent on April 14. The narrowing of the forward discounts occurred during a period when capital outflow from Switzerland was not reported to be diminishing, and capital inflow was thought to be contracting. The narrowing would, however, be consistent with reduced capital outflow, and increasing capital inflow, on a covered basis. Such changes in covered capital flows may have taken place because of expectations that the spot franc, which was already weakening, would continue to fall.

The "Vreneli" gold coin, which had been traded at SF 37.25 in January, fell to as low as 35.50 on February 23, but then rose in the next three weeks to SF 36.50 before declining to SF 36.25 on March 30, or SF 1.00 below the January level. (See Table.)

At the shareholders meeting of the Swiss National Bank on March 24, Governor Walter Schwegler replied to critics who charged that large inflows of gold and foreign exchange into Switzerland had imported inflation from abroad, and that Switzerland should therefore have freely fluctuating exchange rates. Governor Schwegler denied that the Swiss franc was presently undervalued. He pointed to the current-account deficit, and said that the large influx of capital in the past two years was due not to economic factors but to political conditions that cuased fears of war, expropriation, or currency losses. There is no evidence, he said, that freely-fluctuating rates would have halted this inflow, much of which was repatriation of Swiss capital, but it would have aggrevated the current deficit. Governor Schwegler maintained that a freely-fluctuating exchange rate system has disadvantages. Foreign traders "would lose every reliable basis for price-fixing and costing," and large exchange rate fluctuations "would also make the covering of forward exchange risks virtually impossible." Floating rates, he said, would "give an almost free reign to speculation." Governor Schwegler observed that "the experience of last year shows clearly that speculation can be held in check only by a policy of fixed exchange rates."

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

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Switzerland: Money Rates, Exchange Rates, and Gold Price

	Forward Swiss franc (3-mo.)	US Tr. bill		Euro-dollar deposit		Swiss bank deposit (3-mo.)	Exchange rates		Gold coin[a] in SF
		Bill yield	Net return in SF	London rate	Net return in SF		Spot $ in SF	Spot £ in SF	
Jan. 5	+0.53	2.72	2.19	3.63	3.10	2.13	4.319	12.136	37.25
12	+0.76	2.78	2.02	3.56	2.80	2.13	4.318	12.135	37.25
19	+0.85	2.71	1.86	3.56	2.71	2.13	4.317	12.137	37.25
26	+0.88	2.67	1.79	3.56	2.68	2.13	4.317	12.137	37.25
Feb. 2	+0.99	2.67	1.68	3.50	2.51	2.13	4.318	12.143	36.75
9	+0.76	2.72	1.96	3.56	2.80	2.06	4.323	12.164	36.25
16	+0.69	2.83	2.14	3.44	2.75	1.94	4.326	12.178	36.25
23	+0.83	2.69	1.86	3.56	2.73	1.94	4.331	12.192	35.50
Mar. 2	+1.09	2.69	1.60	3.56	2.47	2.06	4.336	12.205	36.00
9	+0.94	2.76	1.82	3.69	2.75	2.13	4.336	12.206	36.25
16	+1.00	2.72	1.72	3.69	2.69	2.06	4.341	12.228	36.50
23	+0.71	2.70	1.99	3.63	2.92	b/ 2.06	4.339	12.205	36.25
30	+0.78	2.75	1.97	3.69	2.91	b/ 2.31	4.346	12.340	36.25
Apr. 6	+0.56	2.70	2.14	3.63	3.07	b/ 2.25	4.346		
13	+0.34	2.74	2.40	3.50	3.16	b/ 2.31	4.341		
20	+0.37	2.73	2.36	3.50	3.13		4.347		

a/ "Vreneli" 20-franc piece (0.1867 troy ounces; $6.53 at $35 per ounce).
b/ Reported.

Switzerland: Selected Capital Market Statistics

	Capital market yields			New issues (millions $'s, monthly ave. or month)				
	Long-term govt. bonds	Deposit cert's 12 cantonal banks	Deposit cert's 5 large banks		Swiss bonds	Swiss stocks	Fgn. bonds	Total
1961				1960	17.3	3.8	10.8	31.8
High	3.12	3.34	3.34	1961	19.8	7.2	18.6	45.7
Low	2.83	3.29	3.25	Qtr. I	24.0	14.3	25.9	64.2
1962				II	17.6	6.8	15.5	39.9
Jan. 5	3.00	3.34	3.27	III	19.6	1.2	18.6	39.5
12	2.99	3.35	3.29	IV	18.2	6.6	14.3	39.1
19	2.98	3.35	3.29	April	16.2	4.9	11.6	32.7
26	2.98	3.35	3.29	May	13.0	12.6	17.0	42.6
Feb. 2	2.97	3.35	3.29	June	23.3	2.7	18.0	44.0
9	2.98	3.35	3.29	July	17.7	2.2	42.0	61.9
16	2.99	3.35	3.29	Aug.	7.4	0.9	7.0	15.3
23	2.99	3.35	3.29	Sept.	33.7	0.6	7.0	41.3
Mar. 2	2.99	3.35	3.29	Oct.	38.3	1.2	20.9	60.2
9	2.99	3.35	3.29	Nov.	14.1	2.1	10.5	26.6
16	3.02	3.35	3.29	Dec.	2.1	16.3	11.6	30.0
23	3.15			1962				
30	3.17			Jan.	13.9	2.1	23.3	39.3
Apr. 6	3.17			Feb.	39.4	21.1	14.0	74.5
13	3.30			Mar.			20.9	

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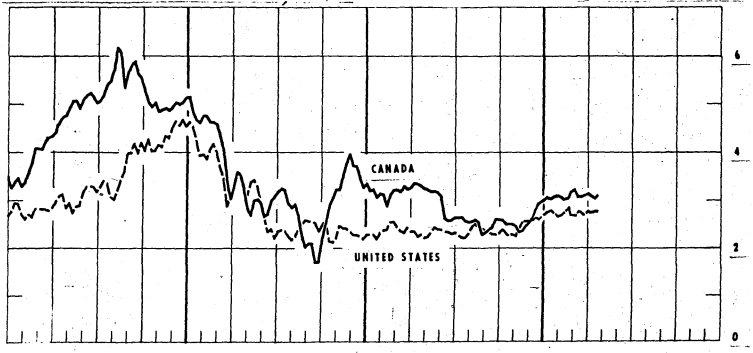
Chart I

INTEREST ARBITRAGE, UNITED STATES / CANADA

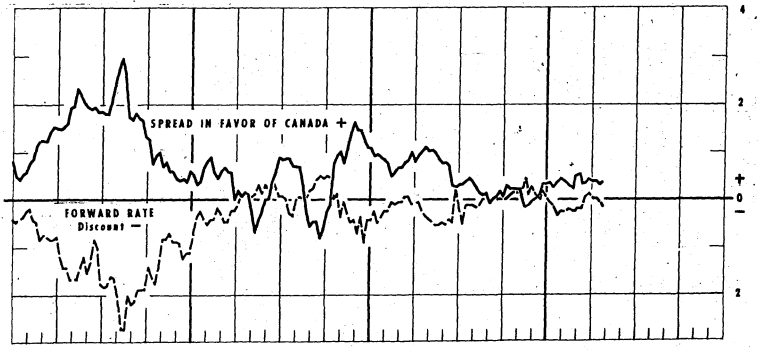
Thursday figures

THREE-MONTH TREASURY BILL RATES

Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

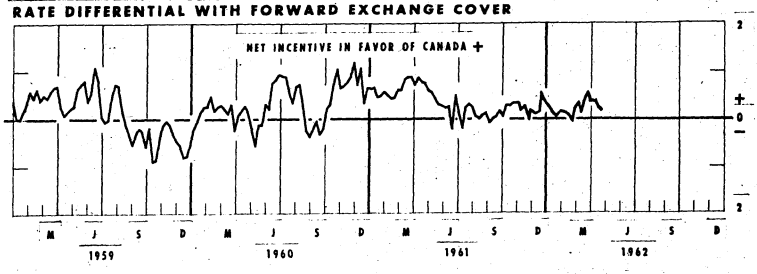


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Chart 2

INTEREST ARBITRAGE, NEW YORK/LONDON

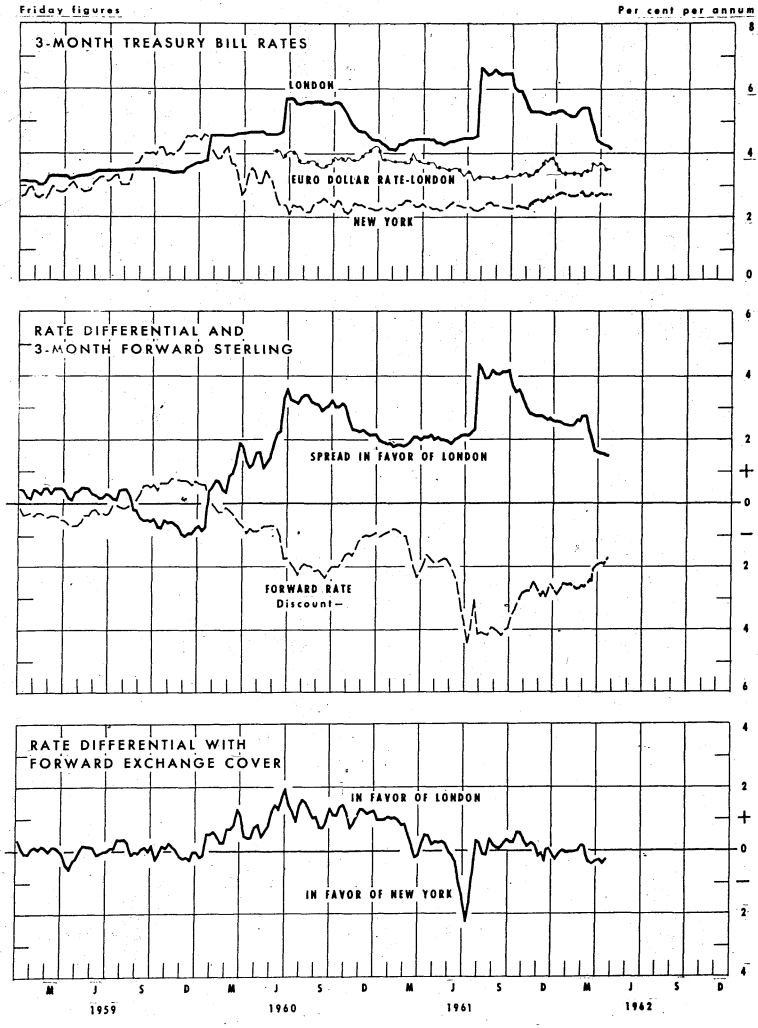

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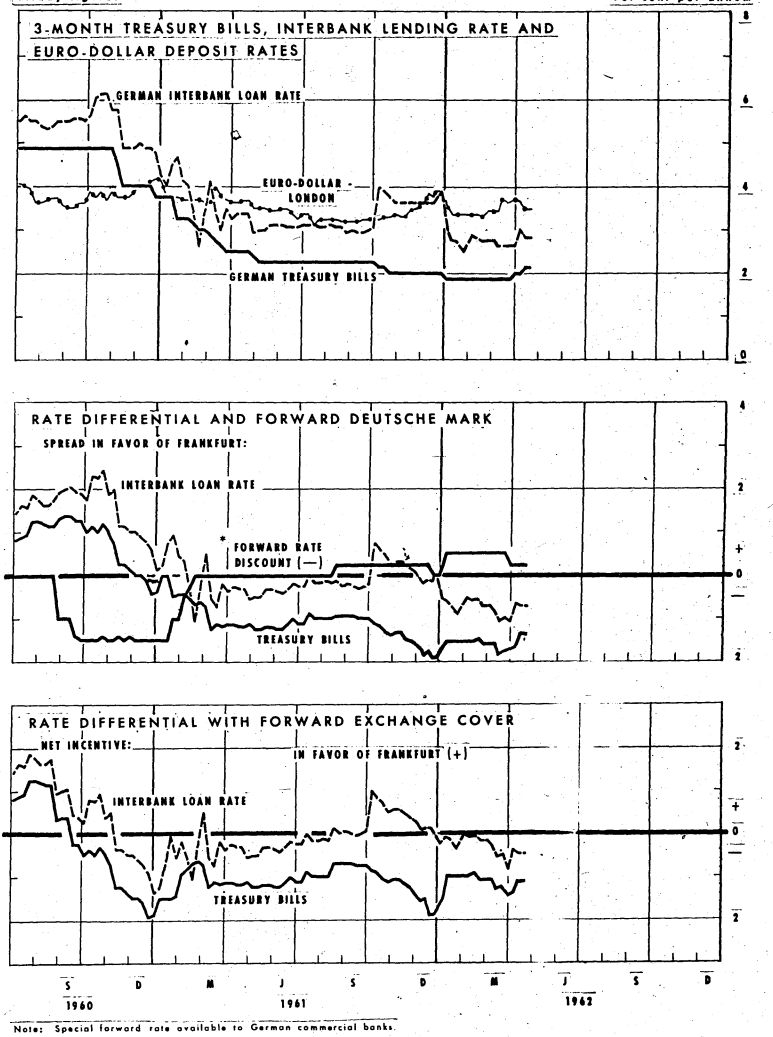
Chart 3

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

Per cent per annum



Note: Special forward rate available to German commercial banks.

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Chart 4

INTEREST ARBITRAGE, FRANKFURT/LONDON

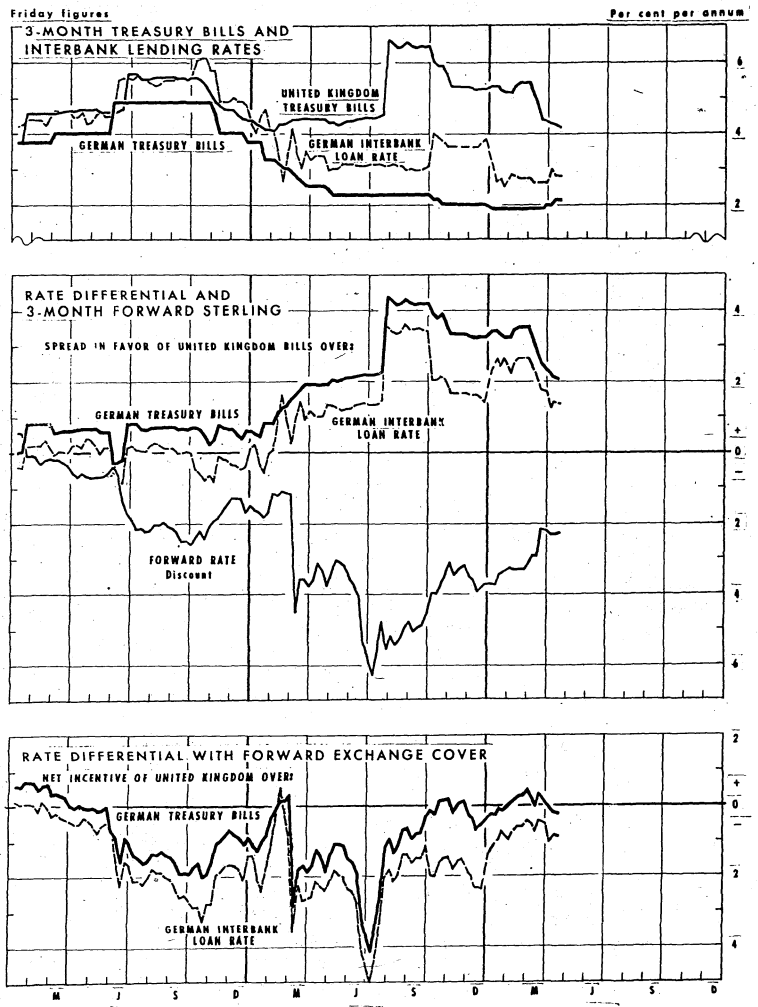

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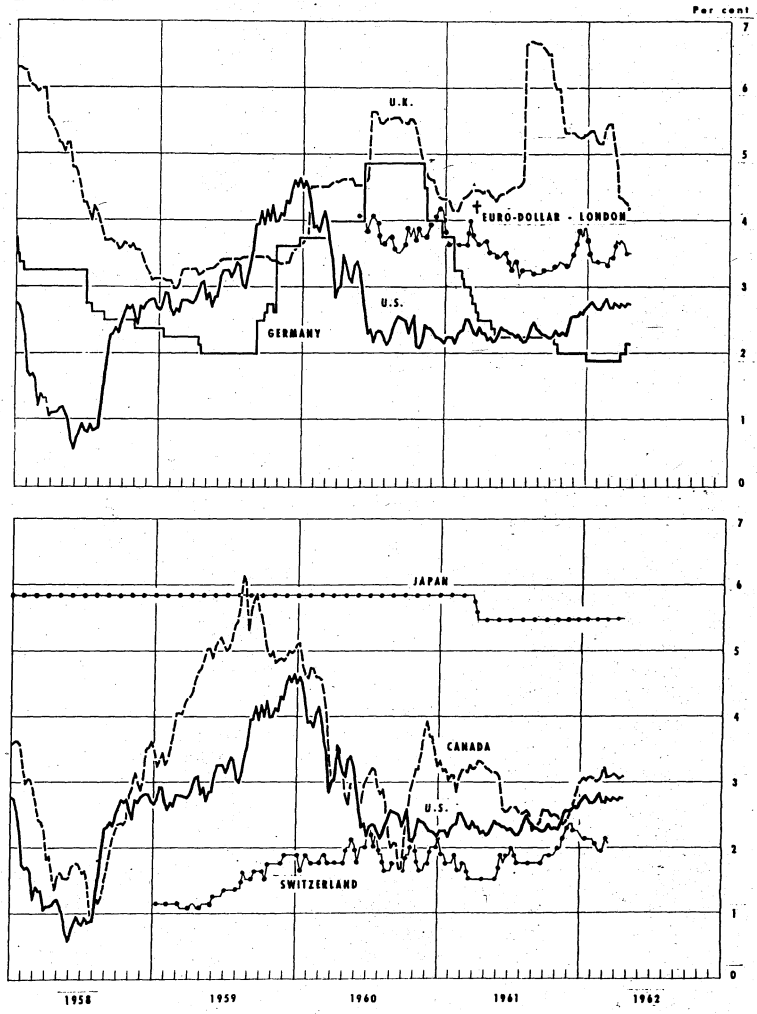
Chart 5

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

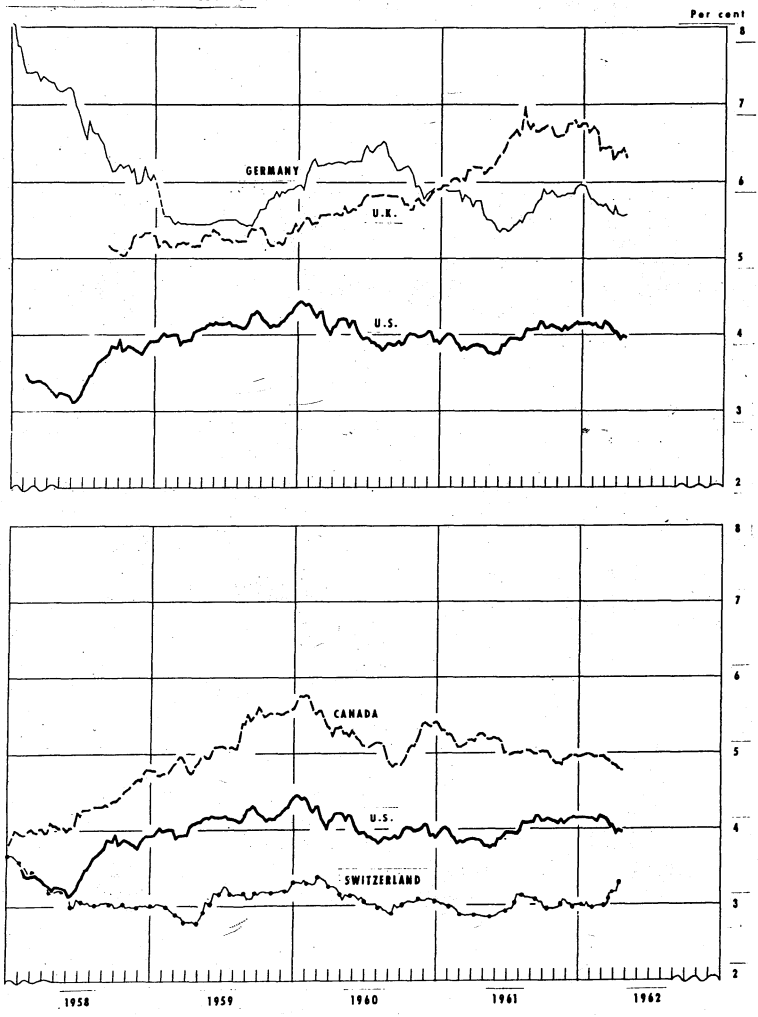

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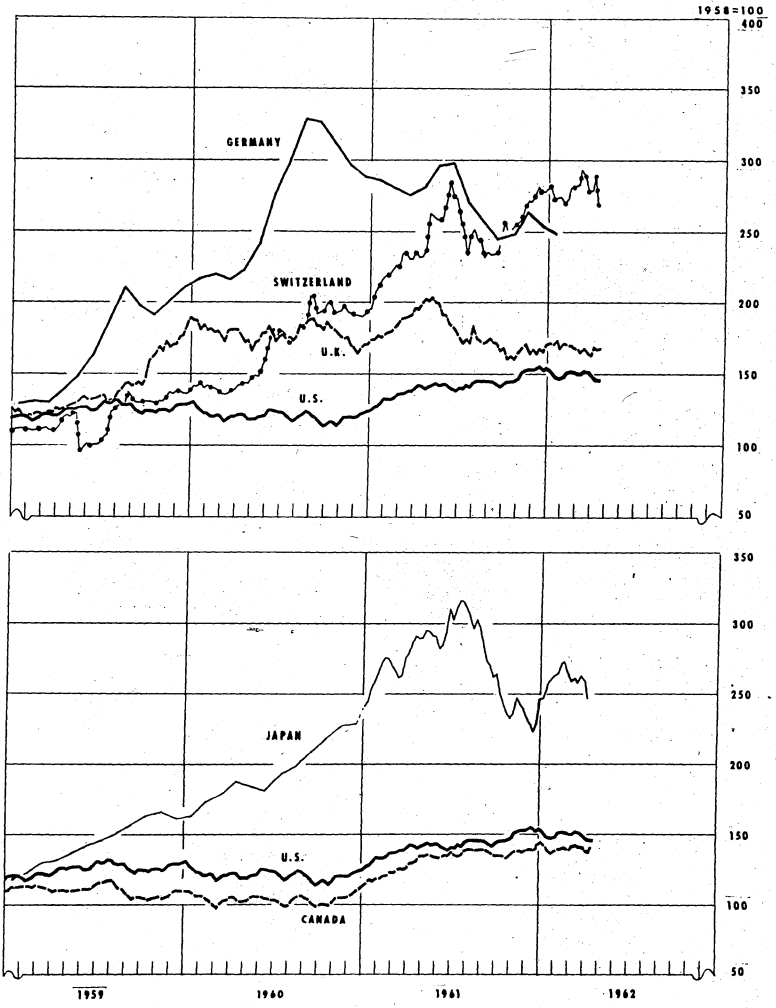
Chart 7

INDUSTRIAL STOCK INDICES*



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

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16

Chart 8

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

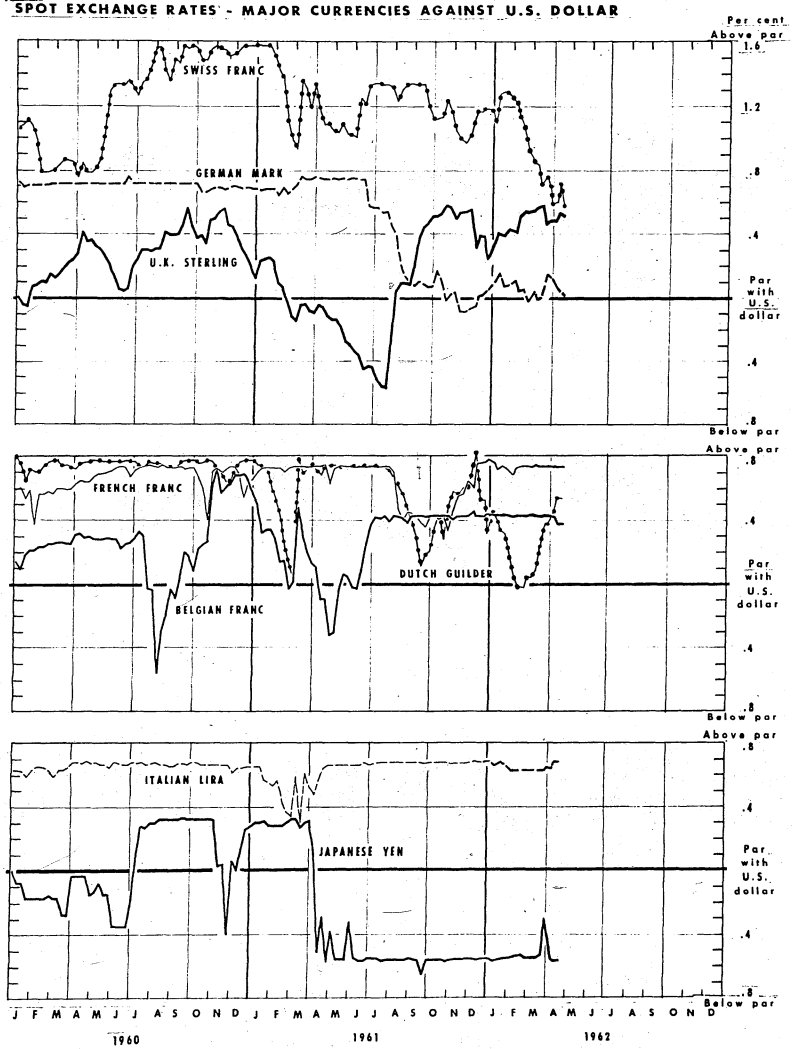

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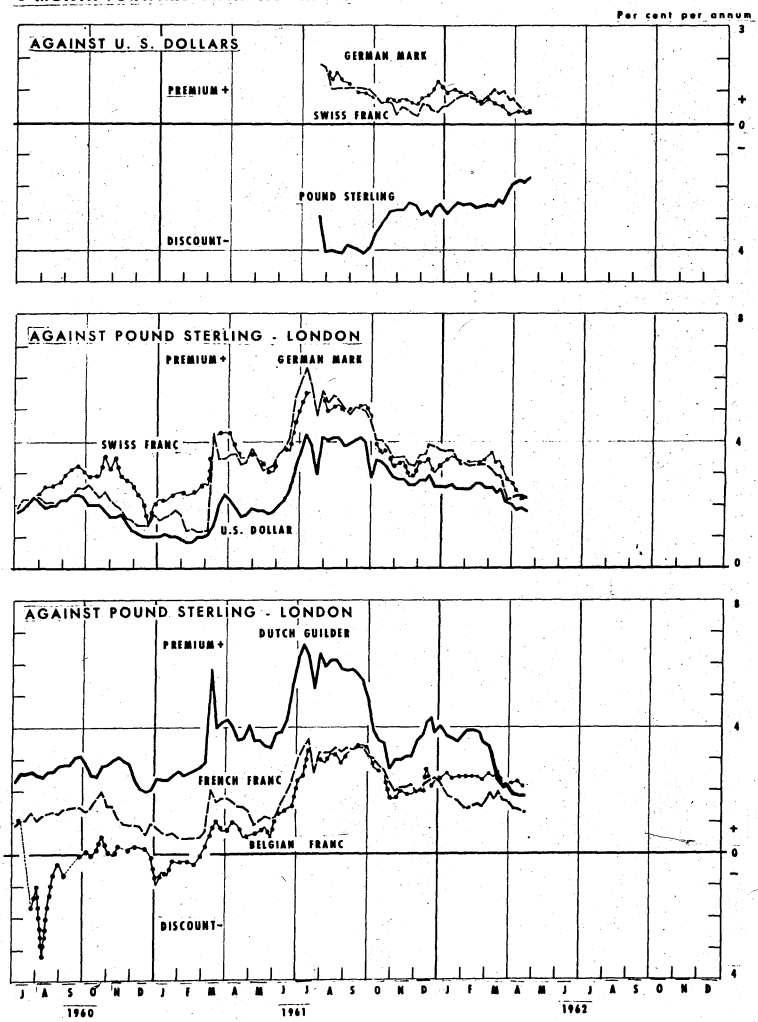
Chart 9

3-MONTH FORWARD EXCHANGE RATES



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