DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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CAPITAL MARKET DEVELOPMENTS ABROAD

I. Germany
II. Nine Charts on Financial Markets Abroad

I. Germany: Money and Capital Markets in September

Money and capital markets were unsettled in Germany during September and early October. The stock market was particularly weak and prices of industrial shares were sharply lower following a mid-October shake-out. Bond yields continued to advance. On October 9, Dr. Adenauer announced a three-point economic program to combat inflation and to strengthen Germany's competitive position in world trade.

Money market rates rose in September from a range of 2-7/8 to 3 per cent to a range of 3 to 3-1/4 per cent. Conditions in the money market tightened as a result of the September tax date. The Bundesbank also took steps to discourage short-term capital exports by the commercial banks on investments maturing during December. To this end, on October 2, the Bank raised by 1/8 of 1 per cent the rates on 90-day Treasury bills and other money market paper. The Bank also decided not to enter into swap exchange engagements for U.S. dollars maturing during the month of December. These steps will reduce the shifts of funds by the commercial banks for year-end window-dressing and, to that extent, add to the current availability of funds on domestic financial markets.

On the bond market, prices continued to decline during September and the long-term market yield exceeded 6 per cent for the first time since early 1961. Prime market names have found it difficult to place loans at a 6 per cent rate even 1/4 of a point below par. The weak state of the market led the monetary authorities to postpone the tranche of the Federal loan scheduled for early October. The loan is expected to be offered to the market at the end of October on revised terms to make the securities more attractive.

German industrialists are reported to be concerned about their contracting sources of liquidity. With reduced profits, internal resources are estimated to be able to finance 56 per cent of investment spending in 1962 compared with 62 per cent in 1961 and 72 per cent in 1960. At the same time, the banks are no longer providing accommodations as freely as in the recent past while the prospects of raising funds on the capital market, and especially by sales of shares, have not been encouraging in the past few months. The Berlin Economic Institute attributes the tight conditions on the capital market to three factors: (a) the additions to liquidity due to the foreign-exchange inflow have been balanced by withdrawals of liquidity by the public sector; (b) the banks have found the ratio of their liquid assets to deposits reduced from 10.4 per cent in September 1961 to 8.5 per cent in June 1962 and the central bank has not taken steps to ease this position; and (c) industrial firms appear to have shifted from short-term to longer-term credits since 1960.

On October 11, after drifting slowly downward almost continuously since mid-August, German stock prices broke sharply. On that day, the industrial stock index fell from 139 to 135 on a heavy turnover. Trading was reported to be limited to professionals. But the index fell further on October 12 under the impact of sustained selling by frightened small-scale private investors. Between October 16 and 19, the market rallied after one of the German banks had made arrangements to finance a Bremen merchant and, thereby, kept a large block of privately-held shares from being sold on the market.

During the period under review, the Federal Government took further steps to reduce inflationary pressures. The Federal budget for 1963 was drastically cut back to DM 56.8 billion from an estimated DM 62 billion previously being considered. Under this budget, DM 200 million has been allocated to the housing program compared with DM 290 million in 1962.

In the second place, Chancellor Adenauer announced on October 9 to the Bundestag in a formal policy statement the Cabinet's economic proposals to bring demand pressures under control. The principal measures included:

a. The building boom is to be restrained by suspending for two years facilities for writing off the cost of new housing (except for owner-occupied dwellings) and Government subsidies are to be cut back;

b. Anti-cartel legislation is to be tightened up and other steps taken to encourage reductions in retail prices; and

c. Employers and brokers were asked to reach "sensible" collective bargaining agreements.

Money market. The money market was relatively easy during the first half of September; call rates ranged between 2-7/8 and 3 per cent. (See Table 1.) Rates for call money rose to 3 - 3-1/4 per cent in the last half of the month, reflecting a tightening of liquidity which stemmed from additions by commercial banks to their balances at the Bundesbank. The money market remained relatively tight through the first three weeks in October. There is heavy demand for money maturing in December; the December inter-bank loan rate now stands at 4 - 4-1/2 per cent. Treasury mobilization of the Laender contribution to the 1962 budget and the release of the final tranche of the "Blessing Billion" are expected to ease liquidity somewhat toward the end of October and in November.

Table 1. Money Market Rates in Frankfurt, August and September
(in per cent per annum)

	Day-to-day money	Three-month loans
Aug. 1-7	2-5/8 - 3	3-3/8
8-15	2-3/8 - 2-5/8	3-1/8 - 3-1/4
16-23	2-3/8 - 3	3-3/8
24-31	2 - 2-7/8	3-3/8 - 3-1/4
Sept. 3-7	2-7/8 - 3	3-1/8 - 3-1/4
10-14	2-7/8 - 3-1/8	3-1/4
17-21	3 - 3-1/4	3-1/8 - 3-1/4
24-28	3 - 3-1/4	3-1/8 - 3-1/4

On October 2nd the Bundesbank increased Treasury bill rates by 1/8 of 1 per cent, thereby raising the rate on three-month bills to 2-5/8 per cent, (see Chart 3) and announced it would not enter into swap engagements maturing in December. This action appears to be an attempt to keep funds in Germany until the end of the year and thus to give support to the bond market and to avoid large-scale window-dressing operations in December.

Bond market. Total gross bond placements in August amounted to DM 971 million. (See Table 2.) The bond market remained weak and lethargic during September and most of October. According to preliminary Bundesbank data, gross bond placements in September totaled only DM 817 million and gross stock placements only DM 44 million. Since mid-September a number of good market names have experienced difficulties in placing 6 per cent issues even at 99-3/4 of par. Bond prices continued to drift downward in September, bringing the long-term interest rate above 6 per cent for the first time since early 1961. (See Chart 6 and Table 6.) Investors held back in September in expectation of higher interest rates.

Table 2. Gross Placements in German Security Markets
(in millions of DM, monthly or monthly average)

	1961				1962				
	I	II	III	IV	I	II	June	July	Aug.
"Occasional" borrowers' bonds:									
Industrial	39	16	--	50	112	72	78	258	25
Public authority	441	78	84	79	314	136	20	638	360
Foreign issuers	--	--	4	--	32	--	--	--	--
Other bonds a/	101	117	53	84	89	132	109	157	56
Total occasional borrowers' bonds	581	211	141	213	547	340	207	1,253	441
Mortgage and communal bonds	526	525	464	503	665	453	440	640	530
Total gross bond placements b/	1,107	736	605	716	1,212	793	647	1,693	971
Gross share placements	354	263	352	130	185	205	64	312	148
Total security placements at issue value	1,461	999	957	846	1,397	998	711	2,005	1,119

a/ Mostly bonds of specialized credit institutions, especially in 1961.
b/ Includes medium-term notes (Kassenobligationen).

The weak condition of the bond market forced postponement of the Federal loan scheduled for early October. The terms of the issue were revised: the size of the tranche was reduced from DM 300 million to DM 250 million and the time to maturity is now 10 years rather than the usual 15 or 20. The Government has waived its right to terminate or convert the loan and the issue will be non-redeemable for the entire span to maturity. The investor thereby receives a guarantee of receiving 6 per cent interest per annum for the entire life of the loan.

The inability of the bond market to satisfy the needs of the economy for long-term financing has produced an increasingly lively interest in Kassenobligationen, medium-term notes issued by banks and other borrowers for periods from 3 to 5 years. According to Bundesbank data, DM 515 million of such medium-term notes were negotiated in the first half of 1962 alone as compared to a total of DM 389 for all of 1961.

Stock market. On October 11th the German stock market fell 3 per cent in one day of trading to a postwar low of 135. (See Chart 7.) At 135 the stock index stood 40 per cent below its level at the beginning of the year and 50 per cent below the index peak of 264 registered in August 1960. Investors continue to feel that there will be continued pressure on profits from increased foreign competition, from rising wage costs and from the three-point economic stabilization program passed on October 9th. On October 11th a number of large firms were forced to sell large blocks of securities. Some creditors, including commercial banks, thereupon began to sell securities they had been holding as backing for loans. By selling while some profit could still be realized, the banks were trying to cover the losses they had already suffered. Foreign investors were also big sellers. The general public, although not a participant in the October 11th selling wave, entered the market as a large-scale seller on the 12th.

By October 12th, the stock index had reached the low of 133. Prices had risen 7 per cent by October 19 but the market remained weak and uneasy. Action by the Dresdener Bank in buying large blocks of shares from a well-known Bremen timber merchant helped to eliminate one possible source of selling which had added to market uncertainty. The merchant reportedly used the cash to cover credits due to other banks. This particular deal had been discussed in May but the bank found the offer price at that time too high.

Federal budget for 1963. The increase in the Federal budget for 1963 has been tied to an estimated real increase in the gross national product of 3.5 per cent. The volume of the budget was held to DM 56.8 billion. This represents a drastic cut-back in size from the originally proposed DM 62 billion. The budget is to be financed by expected tax receipts of DM 52.8 billion, loan flotations in the order of DM 1.8 billion and Laender contributions totaling DM 2 billion. This last, however, is double the size of the Laender contribution in 1962 and so far the Laender have refused all demands to increase further the modest supplementary sum finally obtained from them in 1962 by the Federal Government. In the light of this fact and the current weakness of the bond market, it appears very uncertain whether or not Minister of Finance Starke can keep his promise of no tax increases in 1963.

Recent price trends. The most notable increase in costs in the German economy has been in the wage sector. Hourly wage rates in manufacturing rose by 7 per cent between the end of 1960 and 1961 and by a further 5 per cent by the end of June 1962. (See Table 3.) During this period, retail prices have increased by 6 per cent but wholesale prices have remained remarkably stable, with only a 2 per cent rise recorded. It would appear that producers' profit margins have absorbed a great part of the wage increases. The export price (unit value) index has not changed since the fourth quarter of 1961 but the cost to foreigners of German exports was raised by 5 per cent as a result of the exchange revaluation in March 1961.

Table 3. Selected Price Indices for Germany
1953 = 100

	End-of-Period									
		1961				1962				
	1960	I	II	III	IV	I	II	June	July	Aug.
Industrial production	186	191	190	188	192	195	199	198	196	
Hourly wages in manufacturing	151	152	153	161	163	169	172	173		
Consumer prices	112.0	113.0	114.1	114.9	115.3	117.0	118.9	119.5	120.0	118.2
Wholesale prices	104.2	104.8	104.7	104.9	105.3	105.7	106.1	106.2	106.2	106.2
Export prices	101	100	101	101	102	102	102	102	102	

Source: OECD

Foreign aid financing. In a statement on September 27, Minister for Economic Cooperation Scheel stated that in the future 1 per cent of Germany's GNP would be set aside for assistance to underdeveloped countries. For 1961, German aid totaled DM 30 billion of which DM 2.1 billion came from public sources. However, he stated that Germany could not provide additional aid funds out of the budget and that the World Bank would have to undertake "much financing" on the capital market. He indicated that the Federal Republic might find it necessary to require that aid recipients spend part of their money in West Germany.

On September 20, a consortium of German banks, headed by the Deutsche Girozentrale, granted a DM 80 million credit to Egypt to pay for goods and services from Germany. The credit is guaranteed by the Federal Government and is the German share of a World Bank financing program. In addition, DM 20 million was granted as development aid to finance a river fleet to transport iron ore from Aswan to the Helvan Steel Mills.

On October 21, it was announced that Spain would receive a DM 200 million credit from the Reconstruction Loan Corporation to finance irrigation projects. The loan is at 3-1/4 per cent interest and is repayable over 15 years beginning on December 31, 1967.

Restrictions have been placed by the German government on guarantees of private credits to Brazil. The private creditors' share of the risk has been increased from 10 to 25 per cent. As a result, the press expects that private investment in Brazil will drop sharply. The unsuccessful attempts by a German official delegation last spring to agree on the extension of DM 250 million in development aid to Brazil and recent steps taken by the Brazilian government (restricting the transfer of profits to 10 per cent and the fixing of the valuation of future capital investment at the value of the cruziero at the time of the investment) contributed to the decision to reduce Government guarantees of private credits.

Foreign trade. Trade results for July and August were very disappointing. Even though agricultural imports began to decline as expected, the year-to-year growth of total imports remained high (11 per cent in July and 14 per cent in August). A possible contributing factor was the July 1st reduction of tariffs within the Common Market. Seasonally-adjusted exports declined in July by 4 per cent but rose 2 per cent in August on a year-to-year basis. (See Table 4.) Preliminary estimates for September seem to indicate that German trade has recovered and moved away from the unusually low trade surpluses registered in July and August. The September trade surplus was generally in line with those recorded in the last quarter of 1961 and the first two quarters of 1962.

Table 4. German Foreign Trade
(seasonally adjusted, monthly or calendar month in millions of U.S. dollars)

	Calendar Year		1961				1962				
	1960	1961	I	II	III	IV	I	II	July	Aug.	Sept. a/
Exports	952	1,057	1,037	1,071	1,085	1,052	1,080	1,110	1,052	1,088	1,109
Imports	847	912	863	917	918	947	989	1,019	1,033	1,035	1,005
Surplus	105	145	174	154	167	105	91	91	19	53	104

a/ Preliminary estimate based on partial data.

The rate of increase of imports was more moderate; September 1962 imports were only 6 per cent higher than last year's.

Chancellor Adenauer announced, in conjunction with the 3-point economic stabilization program, that the Federal Government would support justified demands for the removal of distortions in international trade. Behind this lay complaints from the shipbuilding and motor industries that the German turnover tax placed them at a disadvantage with their foreign competitors. As another counter-measure against price increases in the construction field, the Government reduced intra-EEC tariffs for selected building materials.

Reserves and swap rates. Gross gold and foreign exchange reserves of the Bundesbank rose $20 million in August; commercial bank holdings of foreign exchange decreased by $59 million. The resulting decrease in combined reserves was $39 million for August.

Table 5. German Foreign Exchange Reserves
(in millions of U.S. dollars)

	1961				1962				
	I	II	III	IV	I	II	July	Aug.	Sept.
Bundesbank	+300	-282	-570	+ 68	-463	+48	-19	+20	+211
Comm. banks a/	+479	+404	- 74	-427	+601	-89	+44	-59	n.a.
Total	+799	b/+122	-644	-359	+138	-40	+25	-39	

a/ Balances with foreign banks and money market investments abroad.
b/ After special debt prepayments of $776 million to the United States and the United Kingdom. The total would be a reserve gain of $898 million, if adjusted for these transactions.

In September commercial banks repatriated $260 million net of swap engagements. On September 24th the Bundesbank reduced swap charges by 1/2 of 1 per cent in order to stem the large-scale repatriation of banking funds but repatriations continued in September despite the reduction in rates and commercial banks entered into relatively few ($40 million) new engagements. Bundesbank gross gold and foreign exchange reserves rose $211 in September. Preliminary estimates therefore would seem to indicate a moderate decline in combined German reserves for September.

Exchange rates. The D-Mark was weak against the dollar during the second half of September and most of October. (See Chart 8.) The rate of exchange quoted on the DM remained below par, fluctuating between 24.998 and 24.970. The continued strength of the dollar against the mark is attributed to the passive German balance of payments for July and to the conclusion of the IMF meetings.

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

Table 6. Germany: Selected Money Market Yields and Exchange Rates
(per cent per annum)

	3-mo. Euro-dollar deposits London	3-mo. inter-bank loans Frankfurt	Spread in favor London	3-mo. U.S. $ into Marks: Comm. bank[a]	3-mo. U.S. $ into Marks: Market	3-mo. Treas. bills: U.K.	3-mo. Treas. bills: Ger.	3-mo. Treas. bills: U.S.
1961-Oct. 6	3.25	4.00	-0.75	-0.25	-0.60	6.00	2.13	2.31
Nov. 10	3.31	3.63	-0.32	-0.25	-0.73	5.31	2.00	2.47
Dec. 22	3.88	3.75	+0.13	--	-1.30	5.28	2.00	2.60
1962-Jan. 5	3.63	3.00	+0.50	-0.25	-0.95	4.34	1.88	2.74
Feb. 16	3.44	2.75	+0.56	-0.50	-0.62	5.44	1.88	2.83
Mar. 30	3.69	2.63	+1.06	-0.25	-0.35	4.34	2.00	2.75
Apr. 27	3.50	2.94	+0.56	-0.25	-0.32	4.03	2.13	2.74
May 25	3.81	3.13	+0.68	-0.25	-0.35	3.69	2.13	2.69
June	3.66	n.a.	n.a.	-0.25	-0.21	3.78	2.25	2.74
July 27	3.94	3.31	+0.63	-0.50	-0.82	3.81	2.38	2.88
Aug. 24	3.72	3.38	+0.34	-0.75	-0.63	3.69	2.50	2.82
Sep. 7	3.84	3.19	+0.65	-0.75	-0.65	3.66	2.50	2.79
14	3.91	3.25	+0.66	-0.75	-0.69	3.63	2.50	2.78
21	3.94	3.19	+0.75	-0.75	-0.65	3.63	2.50	2.76
28	3.81	3.19	+0.62	-0.75	-0.48	3.56	2.50	2.74
Oct. 5	3.81	n.a.	n.a.	-0.75	-0.47	3.55	2.63	2.76
12	3.91	n.a.	n.a.	-0.75	-0.58	3.53	2.63	2.77

a/ Bundesbank special rate for 2 to 6 month deposits.

Germany: Selected Loan, Deposit and Security Rates
(per cent per annum)

	Comm. bank loans[a]	6-12 mo. deposits: Savings	6-12 mo. deposits: Time	Bond yields: 5-1/2% Railway 1958-83	Bond yields: Public authorities	Share yields	Yield gap
1959-March	7.25	3.25	2.50	5.4	5.6	3.22	2.4
Dec.	8.50	3.25	3.25	5.9	6.2	2.19	4.0
1960-March	8.50	3.75	3.25	6.3	6.4	2.27	4.1
Dec.	8.50	4.50	3.50	5.9	6.2	1.96	4.2
1961-March	8.00	4.25	3.25	5.8	5.9	2.11	3.7
Dec.	7.50	3.50	2.75	6.0	6.0	2.49	3.5
1962-Jan.	7.50	3.50	2.75	5.8	5.9	2.57	3.3
Feb.	7.50	3.50	2.75	5.7	5.7	2.61	3.1
Mar.	7.50	3.50	2.75	5.6	5.6	2.65	3.0
Apr.	7.50	3.50	2.75	6.6	5.6	2.77	2.8
May	7.50	3.50	2.75	5.7	5.8	3.23	2.6
June	7.50	3.50	2.75	5.8	5.9	3.49	2.3
July	7.50	3.50	2.75	5.8	5.9	3.71	2.1
Aug.	7.50	3.50	2.75	5.8	6.0	3.58	2.2
Sept.				5.9			

a/ Approved credits on current account.

Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

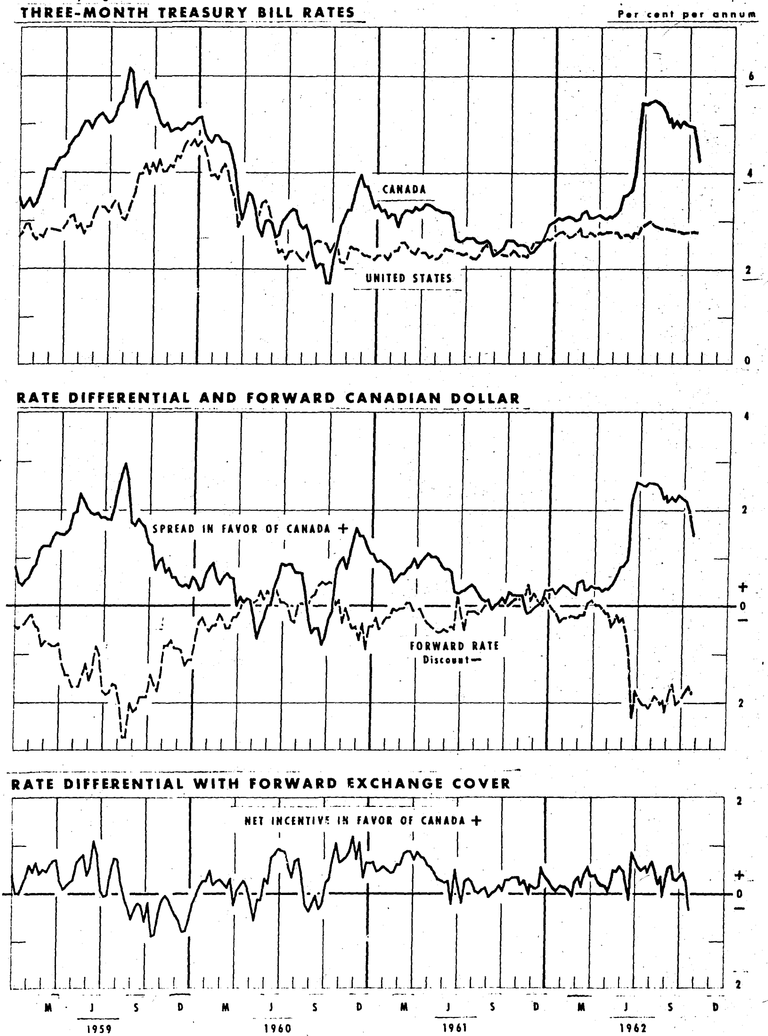

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Chart 2
INTEREST ARBITRAGE, NEW YORK/LONDON

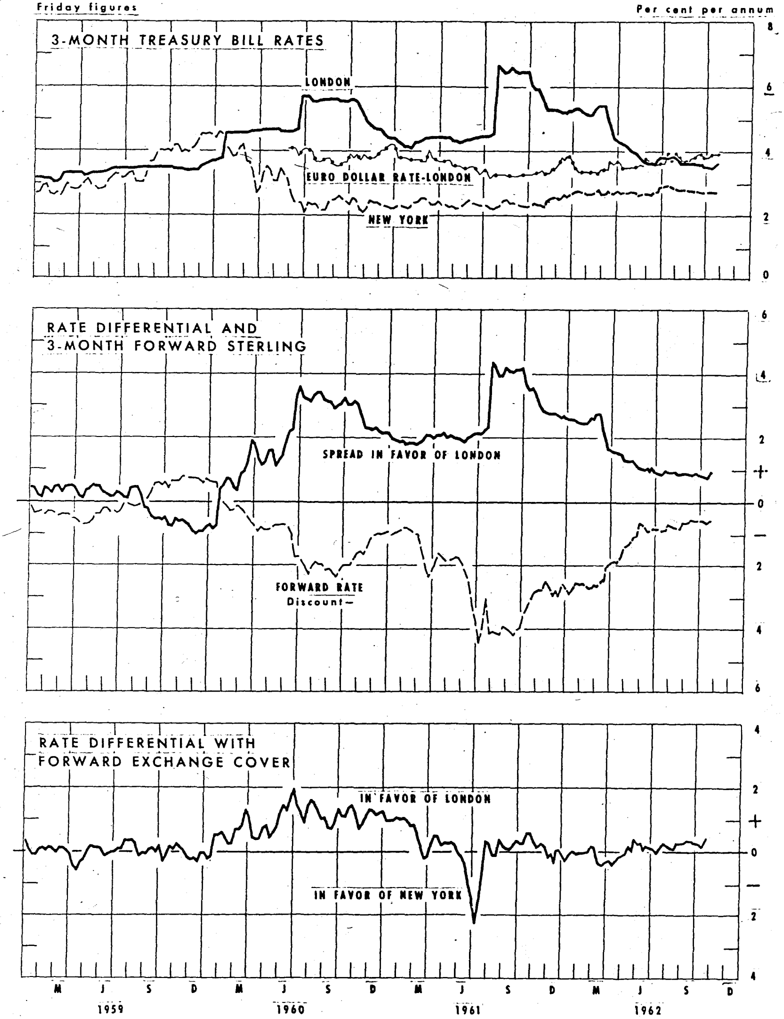
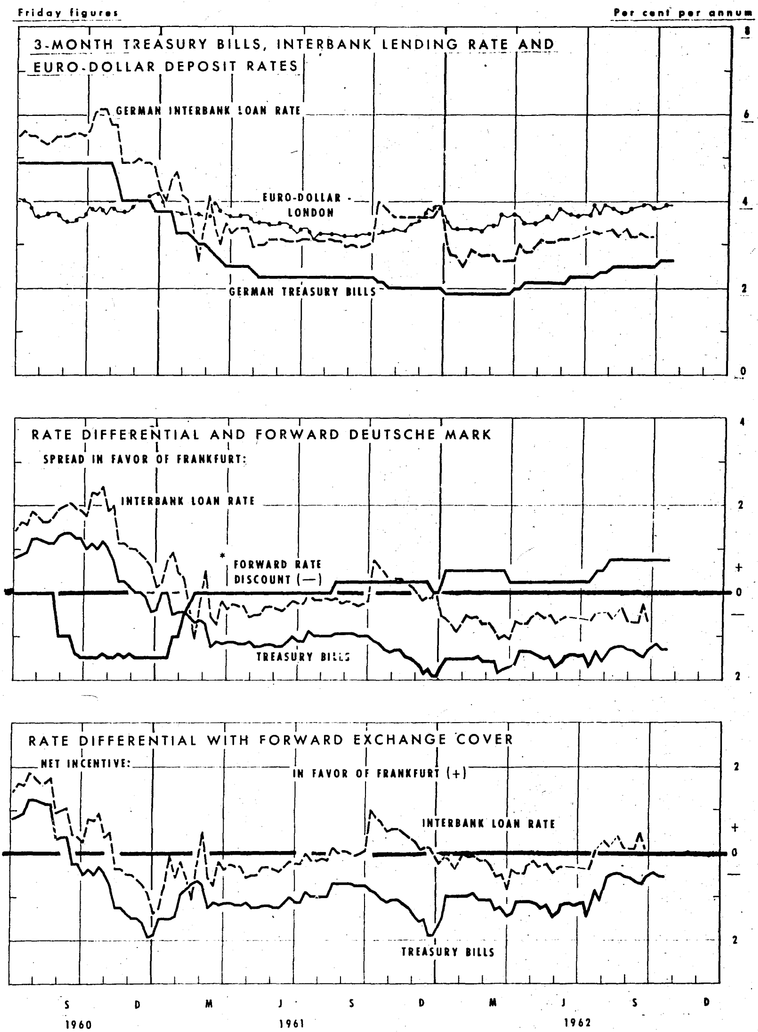


Chart 3

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

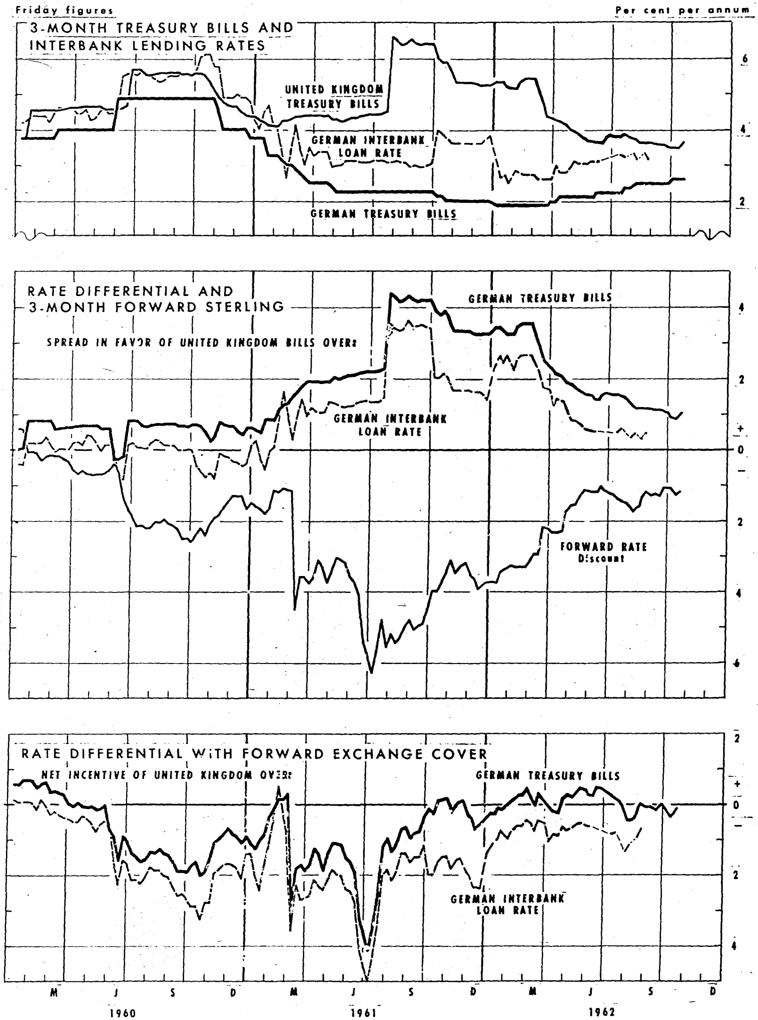
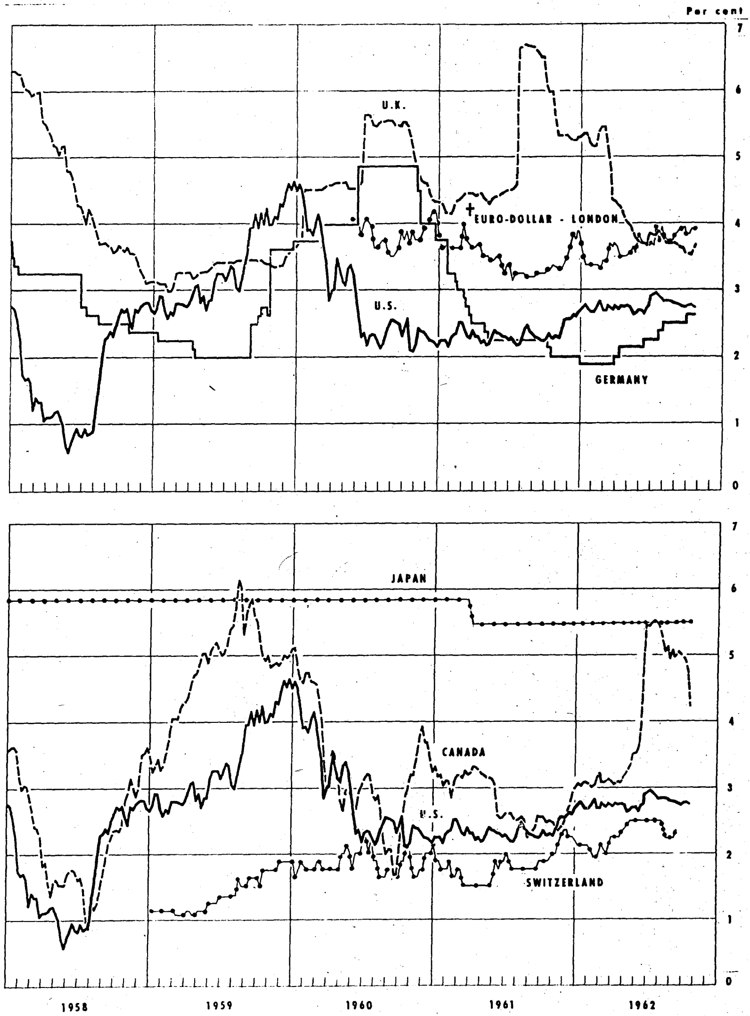


Chart 5

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

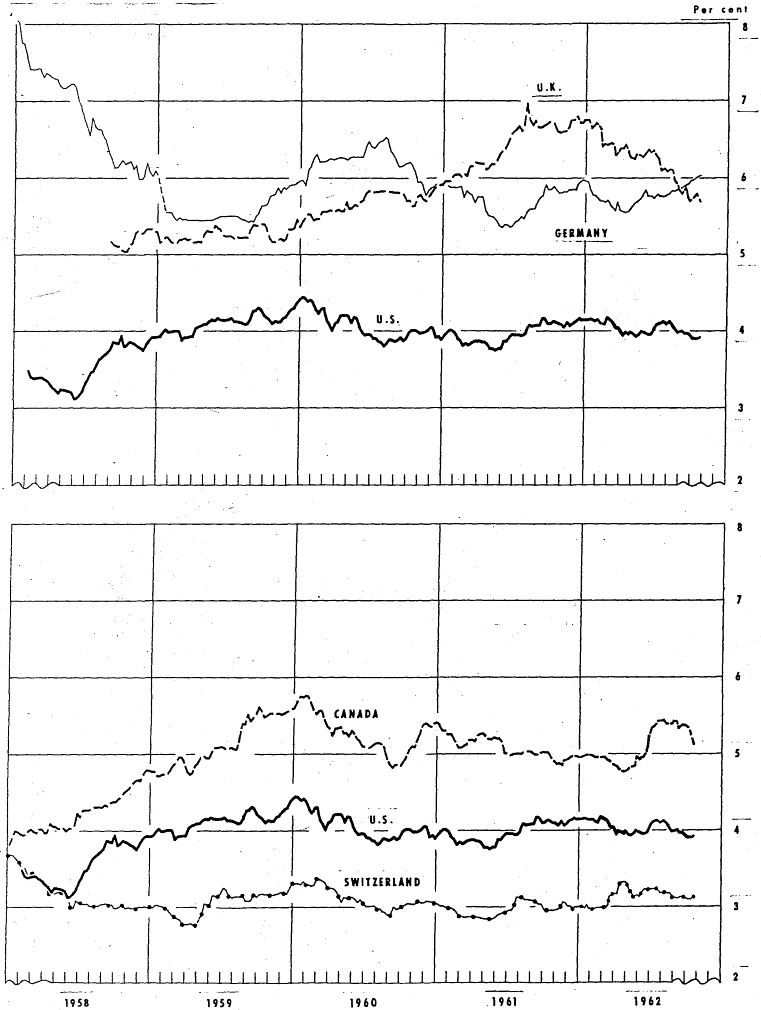
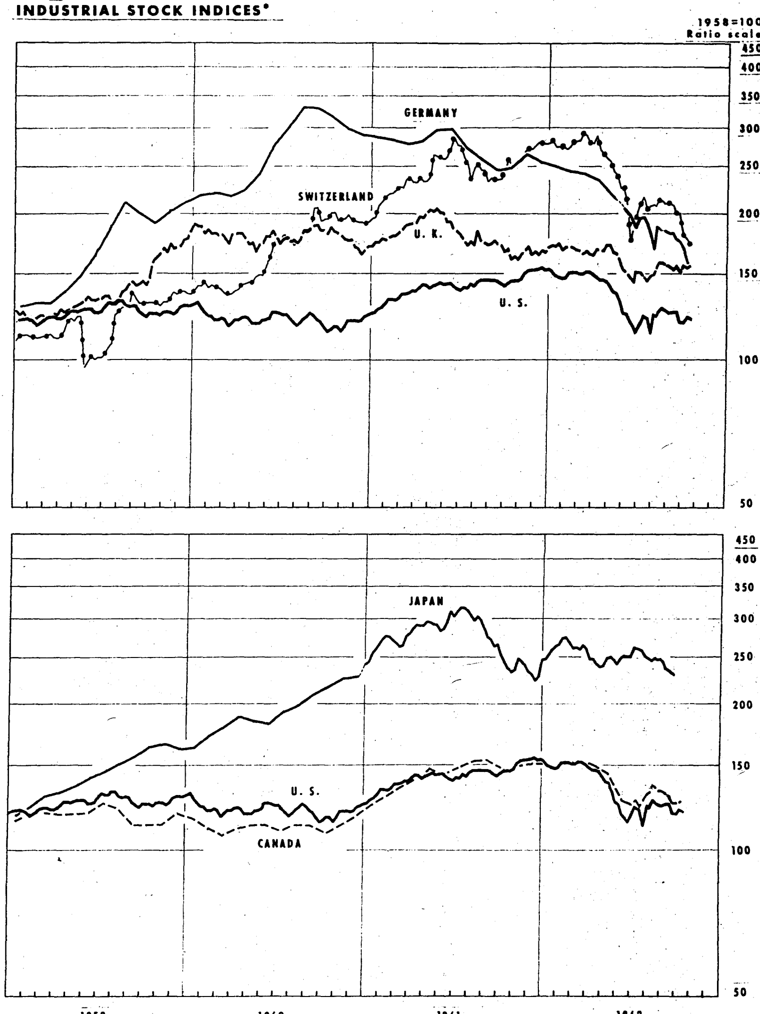


Chart 7

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

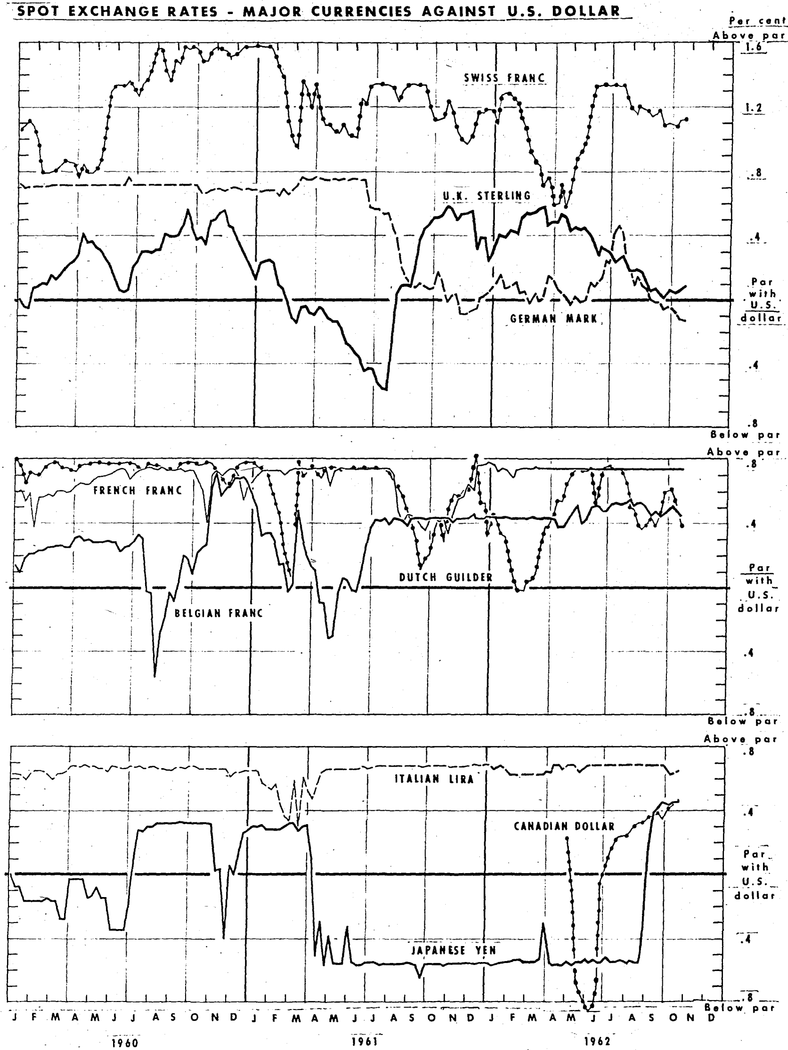

Chart 9

3-MONTH FORWARD EXCHANGE RATES