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FEDERAL RESERVE BANK
OF ST. LOUIS**CAPITAL MARKET DEVELOPMENTS ABROAD**

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

I. Germany: Money and Capital Markets During May

The money market in Frankfurt tightened somewhat in May as industry sought short-term loans to complete its subscription to the foreign aid loan and as funds continued to move abroad in response to incentives offered by the German Federal Bank. The expected tightening of the market in connection with the June 10 major tax deadline did not materialize, and the money market was surprisingly easy during the first half of June, the rate on day-to-day money falling on June 14, to 1-3/4 per cent, the lowest rate since October 1959. A major factor in the easing was the June 1 action of the German Federal Bank further reducing the ratio of reserves required of commercial banks against their resident deposits. The Bank has sought to keep sufficient liquidity in the market to relieve the commercial banks of the need to repatriate funds only recently exported. The policy seems to be working successfully as the commercial banks preferred to rediscount both Treasury obligations and commercial paper rather than repatriate such funds before the June tax deadline.

Foreign exchange continued to flow into Germany in May, but at a somewhat reduced rate. German commercial banks moved additional funds outward to take advantage of the favorable spread between the rates for Euro-dollar deposits in London and the lower rates prevailing in the German money market. The spot dollar remained generally at or near the lower intervention point during May but strengthened somewhat in June following reports of the Bank for International Settlements annual meeting and Mr. Jacobsson's Basle speech denying the possibility of further revaluations. There are reports that some speculators, having revised their expectations of a further revaluation of the mark, are liquidating their maturing contracts for forward DM's. These contracts were entered into shortly after the revaluation of the mark when they expected a further revaluation.

The bond market was relatively quiet in May but continued to benefit from the actions of the Federal Bank intended to reduce the entire German interest rate structure. Foreign demand for German bonds remains strong.

After marking time in April, the German stock market moved steadily upward during May and continued its advance into June. The June reduction in reserve requirements strengthened the rising tendency which was shared by almost all classes of stocks, but was especially marked in chemical and engineering shares. Continued favorable dividend announcements increased the strength of the market.

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DECONTROLLED AFTER SIX MONTHS

After appearing to stabilize in early May, Volkswagen share prices soared almost phenomenally as reports leaked out of a highly favorable balance sheet and annual statement, and the Constitutional Court ruled against an action which had delayed the issuance of additional shares. The continued rise is said to be due mainly to the scarcity of share offerings in the market, a scarcity which is expected to continue as most German initial subscribers seem inclined to hold their shares despite the windfall gain which they could secure by selling.

Money Market. During May, relatively tight conditions generally prevailed in the German money market, because of the continued outflow of bank funds which had developed in previous weeks as the banks responded to Federal measures designed to encourage such outflows. With rates of about $3\frac{1}{2}$ per cent prevailing in the London Euro-dollar market for 90-day money, as against 3 per cent or less in the German money market, the German banks were immediately investing abroad their accumulation of liquid funds. The decline in German money-market rates associated with the May 5 reduction in the German Federal bank's discount rate from $3\frac{1}{2}$ to 3 per cent stimulated the flow of bank funds abroad. High note and coin circulation, and payment of the second tranche of the industry foreign-aid loan, also contributed to tightness in the money market.

Because of these factors, and a major tax deadline on June 10, a further tightening of the market in June had been expected. To forestall such tightening the Central Council of the Federal Bank, after consultation with Economics Minister Erhard, reduced reserve ratios against resident deposits, effective June 1, for the fifth time this year.

During most of May, day-to-day money at around 3 per cent had been close to the Federal Bank's discount rate level. Late in the month it dropped to around $2-3/8 - 2\ 1/2$ per cent, or about $1/2$ per cent under the discount rate, partly in anticipation of further easing action on the part of the Federal Bank. Following the lowering of the reserve requirements, money market rates eased markedly, day-to-day money falling on June 14 to $1-3/4$ per cent, its lowest point since October 1959. The Federal Bank's policy of providing sufficient market liquidity to prevent a repatriation from abroad of recently exported short-term assets was successful as the commercial banks preferred to avail themselves of rediscounting facilities, presenting for rediscounting not only open-market securities but also commercial paper, rather than to repatriate funds.

In early June, as a result of the discount rate reduction of May 5, almost all maximum interest rates on deposits were reduced by $1/2$ a percentage point. Certain savings deposit rates were reduced by only $1/4$ per cent as a concession to the savings banks, which urged the need for maintaining higher rates on savings deposits. As a result of these reductions, which normally follow a discount rate reduction after consultations between banking supervisory authorities and the Federal Bank, actual bank lending rates are expected to decline; it is hoped that these lower rates will reduce borrowing abroad by German industry. However, the recently established practice of

German exporters of borrowing abroad may continue so long as it is to their advantage to use this means to protect themselves against assumed exchange risks. During May the rate on commercial credits in general fell from a maximum of 8 per cent to $7\frac{1}{2}$ per cent. Prime borrowers often arrange loans at preferred rates below the maxima, but even these preferred rates remain above rates obtainable abroad, some foreign banks charging around 5 per cent for such commercial credits. Thus further credit-easing measures may still be necessary if German commercial borrowing abroad is to be appreciably reduced.

There has been no change since May 5 in the rates at which the bank is prepared to sell Treasury bills and short-term bonds in the open market. These rates are down $\frac{1}{2}$ per cent since the beginning of the year.

<u>From</u>	<u>60-90 days Treasury bills</u>	<u>6-month Treasury bonds</u>
Dec. 20, 1960	3.75	4.00
<u>1961</u>		
Jan. 20	3.25	3.50
Mar. 23	2.50	2.75
Apr. 26	2.38	2.63
May 5	2.25	2.50

Frankfurt Inter-bank Money Rates

	<u>Day-to-day money</u>		<u>One-month loans</u>	<u>Three-month loans</u>
	<u>Lowest rate</u>	<u>Highest rate</u>		
<u>1961</u>				
February (monthly range)	2.63	4.13	2.75 - 4.13	3.88 - 4.38
March "	2.50	4.25	3.25 - 4.00	3.38 - 4.00
April "	2.38	3.50	3.00 - 3.25	3.25 - 3.38
May (weekly range)	1-7	2.88	3.13	2.88 - 3.00
	8-15	2.88	3.00	2.75 - 3.00
	16-23	3.00	3.13	3.00
	24-31	2.38	3.13	2.75 - 3.13
June (weekly range)	1-7	2.38	2.88	2.88 - 3.13
	8-15	1.75	2.50	2.75 - 3.00

The spread between Treasury bill yields in the United States and Germany shifted during mid-May to favor slightly the U.S. bill over the German bill on a net incentive basis. There was little change in the spread between the U.S. bill and the German inter-bank loan rate with the German rate still favored on a net incentive basis (see charts 3 and 4); on June 9 there was an incentive of about 0.72 per cent per annum on the basis of the Frankfurt inter-bank loan rate.

	German Inter-bank loan rate vs. U.S. bill rate					Bundesbank's Treasury bill selling rate vs. U.S. bill rate		
	German		Net			Spread		Net
	3 mos. inter-bank loan rate	U.S. bill rate	Spread over U.S.	incentive on covered basis 1/		3 mos. bill rate	over U.S. bill	incentive on covered basis 1/
1961								
April	21	3.38	2.23	1.15	1.15	2.50	0.27	0.27
"	28	2.94	2.27	0.67	0.67	2.38	0.11	0.11
May	5	3.00	2.18	0.82	0.82	2.25	0.07	0.07
"	12	3.00	2.22	0.78	0.78	2.25	0.03	0.03
"	19	3.13	2.29	0.84	0.84	2.25	-0.04	-0.04
"	26	3.13	2.39	0.74	0.74	2.25	-0.14	-0.14
June	2	3.13	2.47	0.66	0.66	2.25	-0.22	-0.22
"	9	3.07	2.35	0.72	0.72	2.25	-0.10	-0.10

1/ To encourage capital outflow the Bundesbank provides forward dollars flat to German banks.

In terms of these alternatives, there was little or no incentive for a movement of German bank funds to the United States. There was, however, an incentive for a substantial movement of German bank funds into the Euro-dollar market in London. The banks are able to execute their transactions in the Euro-dollar market without a cost for forward cover as the German Federal Bank has been willing for some time to sell the commercial banks short-term dollars at the spot rate and simultaneously buy them back on a forward basis at the same price.

German money-market rates vs. London Euro-dollar rates

	Rate			Rate for			
	for U.S. dollars		Incentive	U.S. dollar		Incentive	
	Day-to-day money in Frankfurt	deposits at call in London	of London Euro-dollar call rate	3 months money in Frankfurt	deposits on 3 months basis in London	of London Euro-dollar 3-month rate	
April	7	3.19	3.00	-0.19	3.38	-3.63	0.25
"	14	3.00	3.00	--	3.38	3.63	0.25
"	21	2.75	3.00	0.25	3.38	3.63	0.25
"	28	2.63	2.88	0.25	2.94	3.56	0.62
May	5	2.82	3.00	0.18	3.00	3.56	0.56
"	12	2.88	2.88	--	3.00	3.56	0.56
"	19	2.88	2.88	--	3.13	3.44	0.31
"	26	2.75	2.88	0.13	3.13	3.44	0.31
June	2	2.50	2.88	0.38	3.13	3.44	0.31

The fact that the banks were able to offset their short-term assets abroad against their non-resident deposits for purposes of determining reserve requirements against the latter (this privilege having been restored effective April 20) was of major importance in stimulating the outward movement of funds, and German commercial banks are reported at the time of the June 10 tax deadline to have turned in German money market paper to the Federal Bank rather than repatriate their foreign funds.

Foreign Exchange. For most of the month, spot dollars remained near or at the lower intervention point. The forward dollar was somewhat stronger, selling at times during the month as high as 3.9738. Ever since the revaluation of the German mark and Dutch guilder, the dollar and pound sterling have sold forward at discounts against the DM. On several occasions, German newspapers have reported that the German Federal Bank has from time to time sold forward DM's through a New York agent, the operation being intended as a support for the dollar. Following the reports of June 14 from Basle on the B.I.S. annual meeting and on the Jacobsson speech, spot dollars strengthened and were quoted at 3.9711, but 90-day dollars were at a 1.72 per cent discount. The interest of the German commercial banks in money exports, which are continuing in June, probably also aided the spot dollar. A further factor is the liquidation on the part of speculators of forward DM contracts. Following the revaluation of the mark and guilder, speculators bought marks forward in the expectation of a further revaluation of the mark. Apparently many speculators are not now renewing their forward DM contracts when they mature.

DM-Dollar middle rate par: (DM 4.00 = \$1)

April 28	3.9701
May 5	3.9700
" 12	3.9700
" 19	3.9701
" 26	3.9701
June 2	3.9701
" 9	3.9701
" 14	3.9711

Bond Market. Although relatively quiet in May, the bond market continued to benefit from the continued efforts of the Federal Bank to get short- and long-term interest rates down. The prevailing rate in the German capital market is now around $5\frac{1}{2}$ per cent with the continuing promise of some additional lowering of interest rates leading to a further modest rise in the prices of major issues. Foreign demand for German bonds remains strong in response to the favorable yield of German bonds over foreign bonds and the prospect for further capital gains, and continues as an important factor in the inflow of funds into Germany.

During May the average effective yield on long-term government bonds fell modestly below the April level of roughly 5.75 per cent (March level 5.9 per cent). During the month, several substantial mortgage institutions raised the issue price of their mortgage bonds on the Frankfurt exchange by a full point. There were no major flotations of public or industrial bonds as issuers anticipated a further fall in long-term rates.

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Yield of Fixed-Interest-bearing securities (per cent)

	<u>Mortgage bonds</u>	<u>Industrial bonds</u>	<u>Loans of public authorities</u>
1960 July	6.5	6.5	6.7
Oct.	6.4	6.1	6.3
Dec.	6.2	6.1	6.1
1961 Jan.	6.2	5.8	6.1
Feb.	6.2	5.7	6.0
Mar.	6.1	5.8	5.9
Apr.	5.9	5.7	5.7
May (est.)	5.8	5.6	5.6

A new World Bank issue is expected shortly on the German market. The loan will total DM 50 million (\$12.5 million), but the exact time and conditions of issue are not yet known. A 5 per cent nominal interest rate has been suggested as appropriate at this time to the German capital market. It has been observed, moreover, that the World Bank could not afford to pay a higher rate in view of lower rates prevailing elsewhere. Observers have suggested that the Bank's flotation in Germany is explained, at least in part, by the desire to encourage further exports of German capital.

West German bankers recently in Tokyo completed their discussions with Japanese bankers regarding the issue of Japanese bonds in Deutsche marks to finance the development of the Osaka harbor. Originally expected in June, the loan has now been postponed, partly to permit further discussions on technical details but also to await a period when the German capital market becomes less tight and interest costs lower.

Stock Market. The German stock market picked up momentum in May following a quiet April when the market marked time. The lowering of the German Federal Bank's discount rate on May 5, the continuing trend toward lower interest rates, and further announcements of dividends modestly above their 1960 levels stimulated the market. Further investment by foreign buyers--based more, it now appears, on the continuing strong industrial boom in Germany than on expectations of a further DM revaluation--also strengthened the market. The further reduction in the minimum reserve requirements of the banks against resident deposits, effective June 1, gave additional impetus to the market rise, and trading in shares during the first days of June was especially heavy. As in recent months, chemical and engineering shares were particularly strong, as were selected motor shares.

Frankfurt Allgemeine Zeitung Index of Industrial Share Prices
(Dec. 31, 1954 = 100)

<u>1961</u>	Feb. 28	432.96
	Mar. 30	417.29
	Apr. 28	426.88
	May 5	434.01
	12	447.97
	19	463.04
	26	465.69
	June 2	467.15
	9	472.20

The phenomenal rise in Volkswagen shares has been a highlight of the German stock exchanges in recent weeks. More than a million and a half Germans applied for Volkswagen shares when the company was denationalized. With only DM 360 million worth of shares available, applications for DM 667 million worth of shares (\$167 million), nominal value, were received. Applicants, who were entitled to request up to five shares, received two, with one out of every three applicant receiving three shares. Third shares were allocated by lot. Although a rise in share value from the sale price of DM 350 to between DM 600-700 was expected, the hectic speculative activity of recent weeks has come as quite a surprise to the authorities, who had not intended that the shares become highly speculative. The Volkswagen issue was part of a continuing government effort to arouse greater public acceptance of investing by means of issuing stock in some federally controlled companies. Sales were limited exclusively to individuals and families at the lower income levels. Banks, funds, and other credit institutions were not eligible to buy the shares, and only limited speculation was foreseen. However, after a pause in early May at around DM 700 per share, the stock was quoted as high as DM 1000 by the middle of the month. By the end of the month the stock was at DM 1050 per share after having been quoted on several occasions as high as DM 1100. As of mid-June the shares were still being quoted around DM 1050.

Several factors influenced the heavy rise. Reports of a highly favorable balance sheet and annual report leaked out before publication. The Constitutional Court approved the share distribution in turning down an action to prevent issuance on the basis that limitation to certain income groups was discriminatory. Finally, foreign buyers intensified the demand for shares. The management of Volkswagen, responding to the interest shown by foreign investors, expressed the desire that the shares be traded on foreign stock exchanges as soon as possible. The introduction of Volkswagen and other German shares on the London stock market may be facilitated by a decision of the British Stamp Duty Office ruling that depositary receipts issued in London in respect to German shares would be subject to a lower rate than was expected.

There is evidence, however, that the desires of the German authorities for a broadened share market are not to be entirely disappointed by speculative activity in Volkswagen shares on German and foreign exchanges. The sharp upward movement in the price is attributable principally to the extreme thinness

of the market, the number of Volkswagen shares available for trading on the German exchanges being very limited. This scarcity is heightened by the tendency on the part of the great majority of German holders to retain their shares rather than sell even at the inflated price.

As a further support of the German stock market, the Berliner Lombardkasse A.G., founded in Berlin in 1923 by the big banks with branches, in conjunction with certain private bankers, is shortly to resume operations. Its purpose is to make funds available, on terms favorable to stockbrokers, in the form of loans against securities. The Board of the Bank will meet in Frankfurt and the operations of the firm are to be nationwide, "Berliner" being henceforth dropped from the name. It is expected that the firm's operations will assist stock exchanges to "iron out" market fluctuations to a greater degree than heretofore has been possible.

European Section.

II. Nine Charts on Financial Markets Abroad

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Spot United States Dollar
- Chart 9 - 3-month Forward Rate--London Quotations

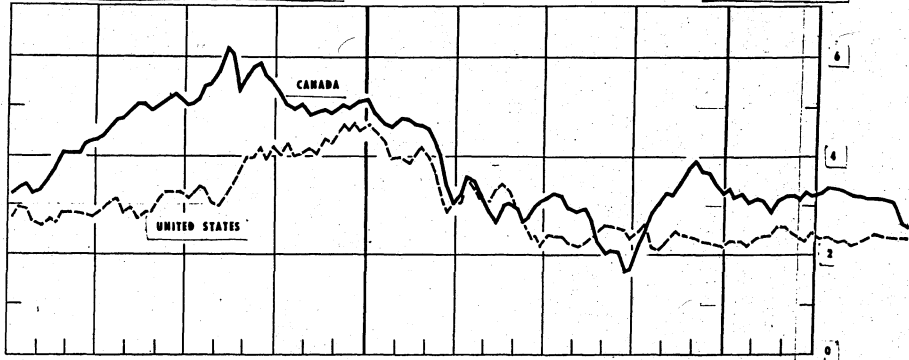
Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

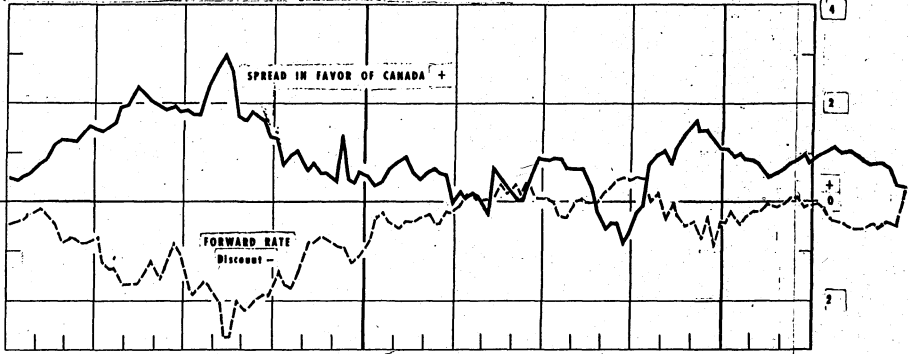
Thursday figures

THREE-MONTH TREASURY BILL RATES

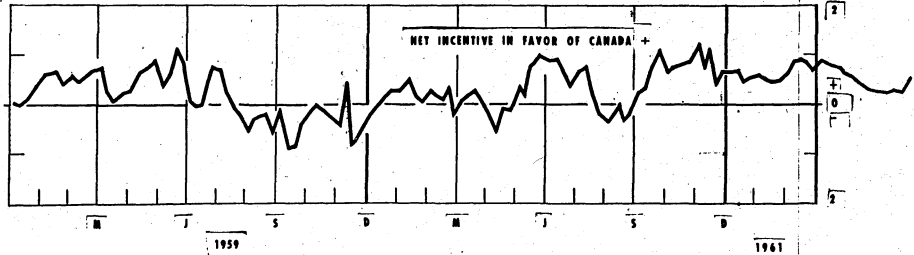
Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER



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Chart 2

INTEREST ARBITRAGE, NEW YORK / LONDON

Friday figures

Per cent per annum

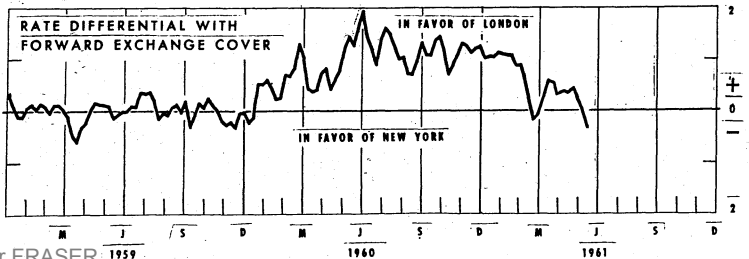
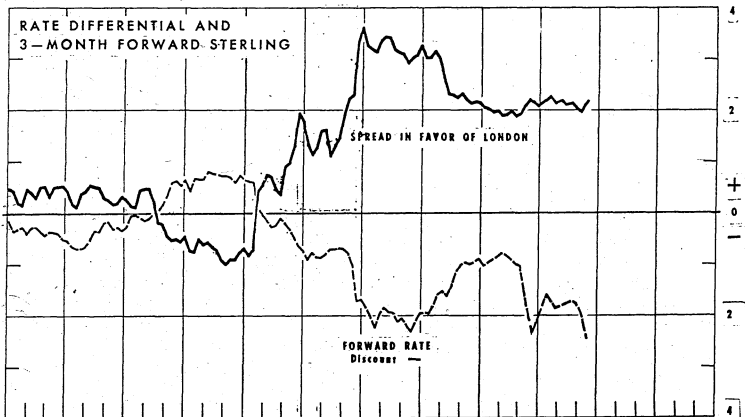
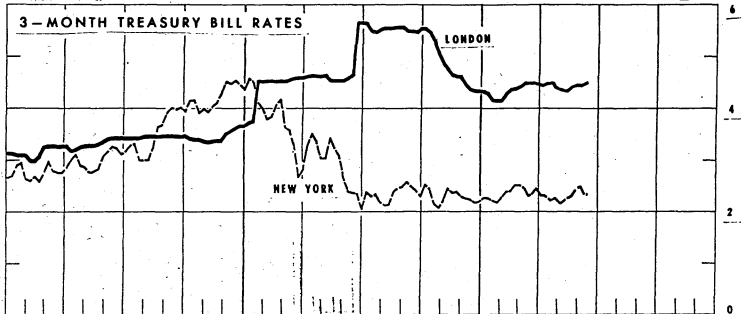


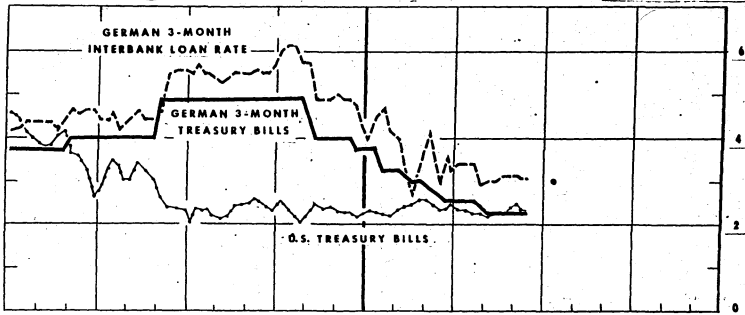
Chart 3

INTEREST ARBITRAGE, NEW YORK / FRANKFURT

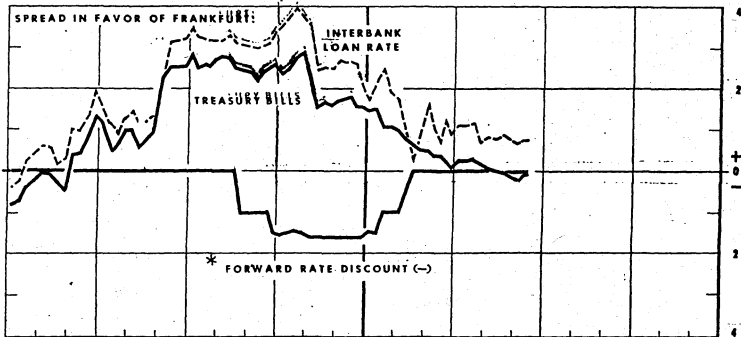
Friday figures

**3-MONTH TREASURY BILL RATES AND
GERMAN 3-MONTH INTERBANK LOAN RATES**

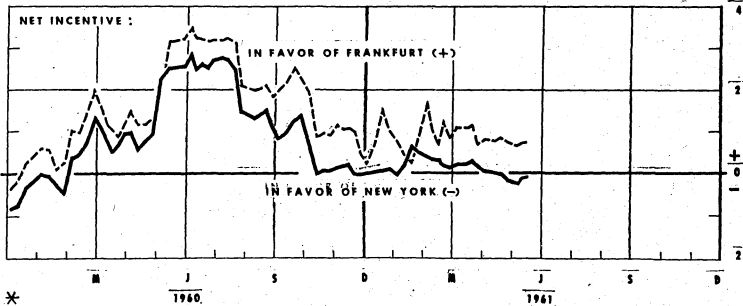
Per cent per annum



RATE DIFFERENTIAL AND FORWARD DEUTSCHE MARK



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER



* Special forward dollar rate (either flat or premium on spot) available to German commercial banks.

Chart 4

INTEREST ARBITRAGE, FRANKFURT/LONDON

Friday figures

Per cent per annum

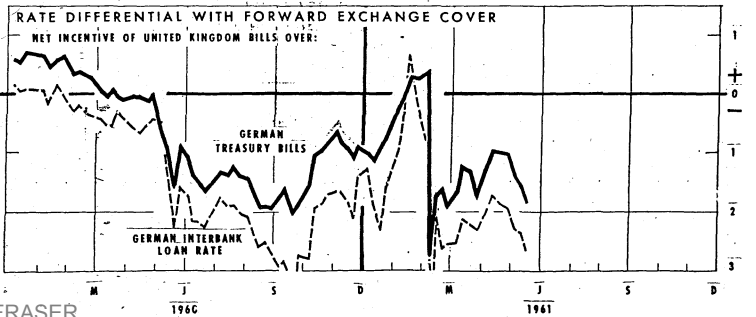
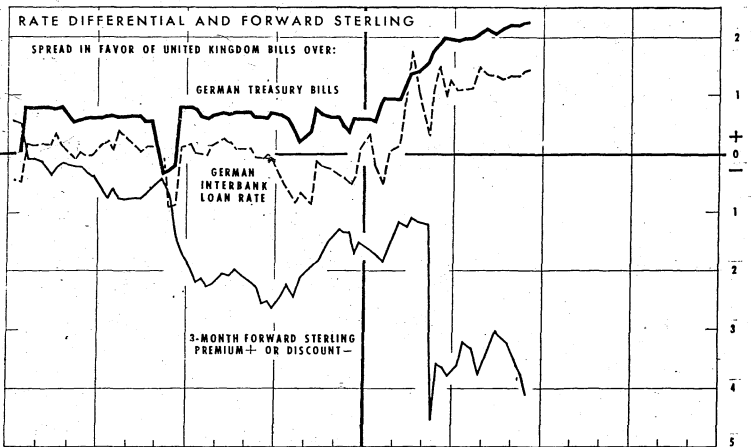
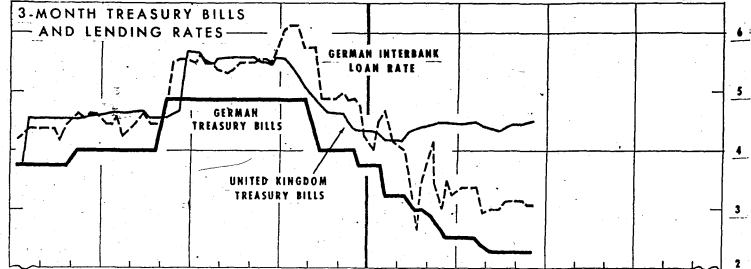
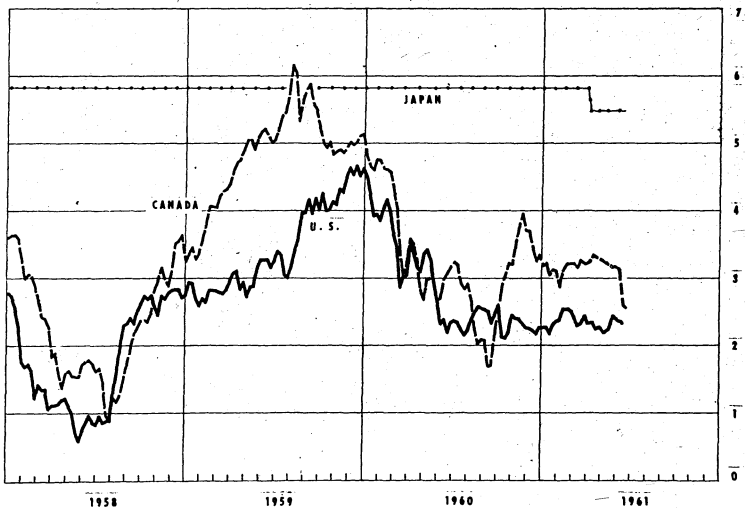
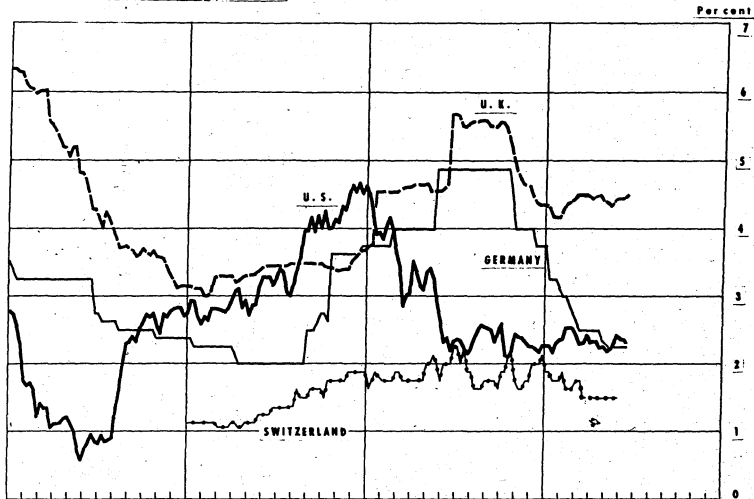


Chart 5

SHORT-TERM INTEREST RATES *



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Note: 3-month treasury bill rates for all countries except Japan (3-month interbank deposit rate) and Switzerland (3-month deposit rate).

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Chart 6

LONG-TERM BOND YIELDS

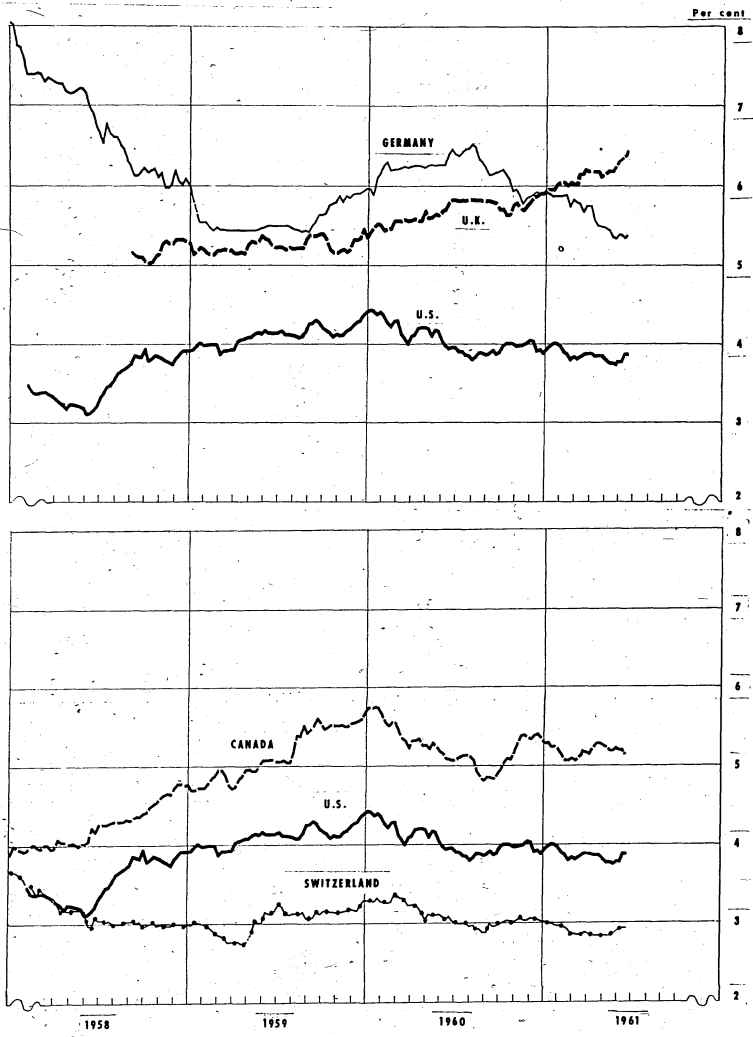
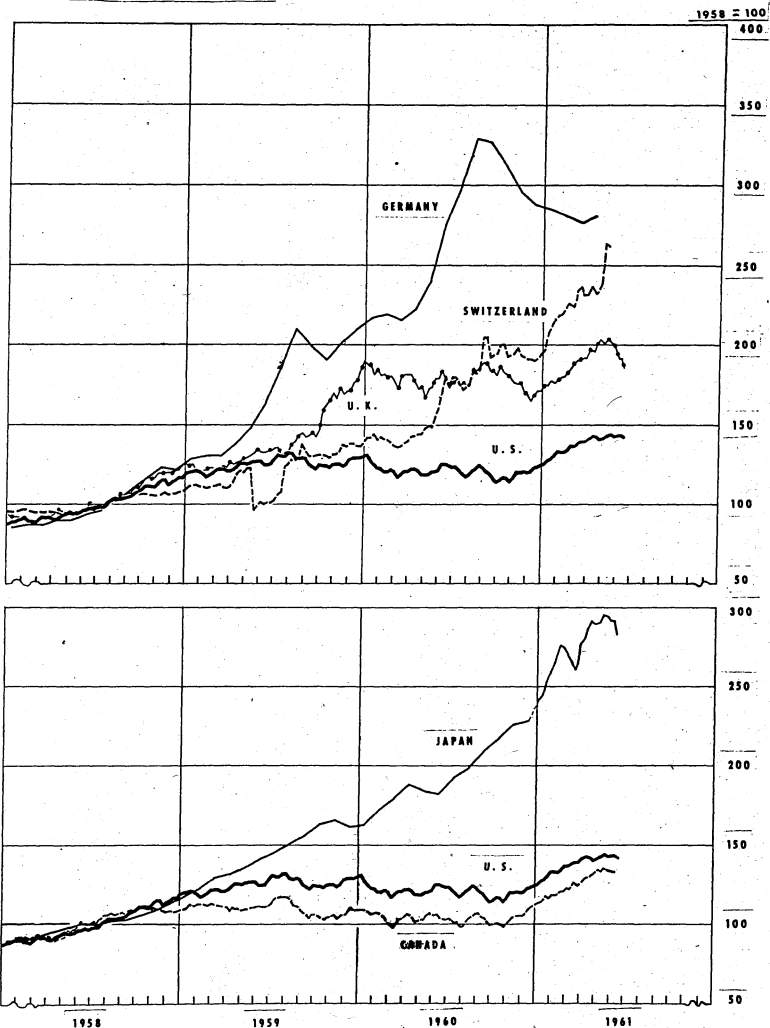


Chart 7

INDUSTRIAL STOCK INDICES *



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

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Chart 8

MAJOR CURRENCIES IN TERMS OF THE SPOT U. S. DOLLAR

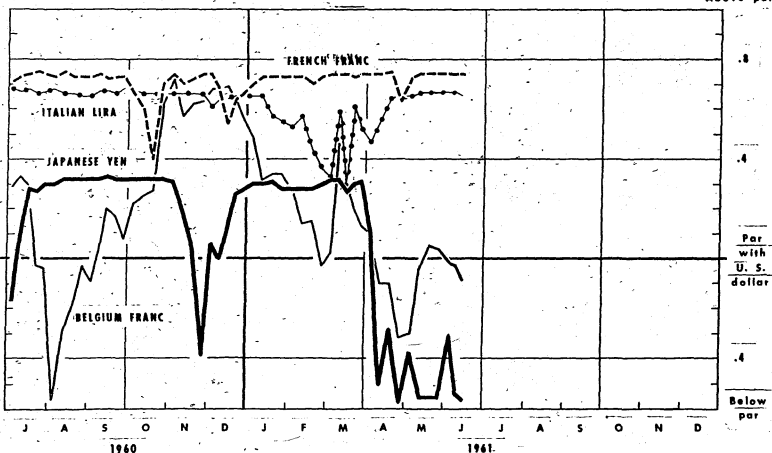
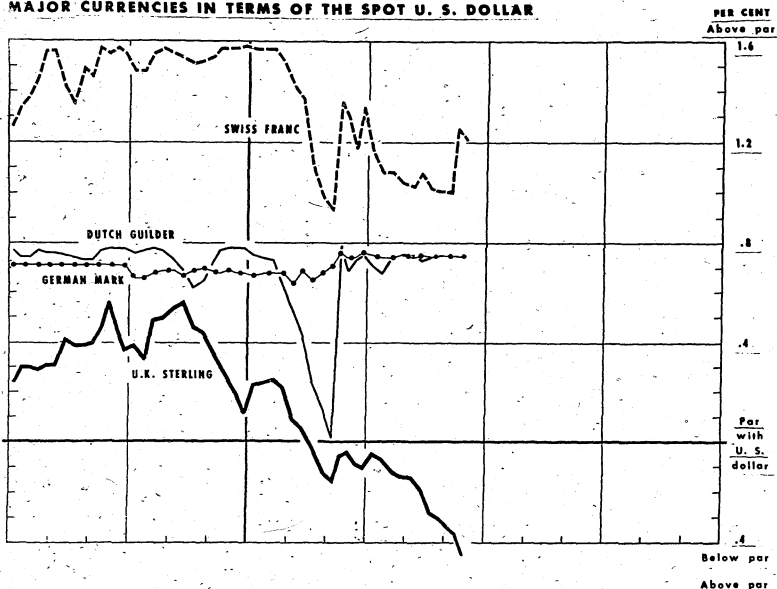


Chart 9

3-MONTH FORWARD RATES - LONDON QUOTATIONS

