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July 29, 1964.

CAPITAL MARKET DEVELOPMENTS ABROAD

I. Switzerland
II. Nine Charts on Financial Markets Abroad

I Switzerland: Money and Capital Markets, January-June 1964

Heavy demand for all types of credit, coupled with increasingly tighter supply conditions, pushed interest rates on Swiss money and capital to new recent highs during the January-June period. (See Table 1.) Rates paid by large Zurich banks on 3-month deposits increased from 2.94 per cent in early January to 3.25 per cent by early July. Medium-term funds, acquired through the issue of 3-8 year deposit certificates, have been in very short supply, and the large Zurich banks are now paying 4.14 per cent on their certificates, up from 3.85 per cent in January. In the capital market, exceptionally heavy bond flotations put outstanding issues under pressure; yields on long-term Confederation bonds, for example, rose from 3.56 per cent at end of January to 4.04 per cent in early July. Almost all current new issues carry a 4-1/2 per cent coupon rate, compared with 4-1/4 per cent in January, while some early July issues were put on the market with 4-3/4 per cent coupons.

Table 1. Switzerland: Selected Financial Indicators

	1964				
	January 31	March 27	April 24	May 15	July 10
Interest rates					
3-month yields:					
Zurich banks a/	2.94	3.19	3.37	3.32	3.25
Euro-dollars b/	3.44	3.82	4.51	4.16	3.37
U.S. Treasury bills b/	2.80	3.09	3.75	3.36	2.44
Euro-Swiss francs	3.12	3.62	4.12	4.12	3.88
Deposit certificates (3 to 8 years):					
12 cantonal banks	3.88	3.88	3.90	4.11	c/ 4.25
5 large banks	3.85	3.85	3.85	4.14	c/ 4.14
Long-term government bonds	3.56	3.90	3.85	3.94	4.04
Stock prices (1958=100)	249.5	246.2	238.7	235.4	234.7
Exchange rates					
Spot francs (U.S. cents)	23.16	23.11	23.18	23.17	23.16
Forward premium (+) discount (-) on franc d/	+0.68	+0.43	-0.32	+0.09	+1.01

a/ Most frequently quoted rates of the five large Swiss banks in Zurich.
b/ Return in Swiss francs after cost of exchange cover.
c/ Preliminary figures subject to adjustment.
d/ Per cent per annum.

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In what was termed a "technical adjustment" to higher interest rates, on July 3 the Banque Nationale Suisse (BNS) raised its official discount rate from 2 to 2-1/2 per cent, and its official rate for collateral loans from 3 to 3-1/2 per cent. Although the official discount rate is not an effective instrument of monetary policy in Switzerland, the recent change--the first in over five years--was more significant as a signal of official determination to master tendencies toward overheating of the Swiss economy than as a technical money market move. The discount rate increase followed closely the adoption in March of extraordinarily new control powers on foreign fund inflows, capital issues, domestic credit, and construction, which are considerably more restrictive than the earlier gentlemen's agreements.

Externally, the Swiss franc responded quickly to tightening money market conditions, remaining at its ceiling against the dollar throughout most of the spring. Since July 1 the rate has eased slightly as liquidity improved following the mid-year window-dressing operations of the banks. (See Table 1.) Reflecting customary seasonal patterns, official reserves declined $123 million between January and June, despite the fact that the BNS acquired substantial amounts of dollars in April and May.

Anti-inflationary controls restrict credit and foreign funds

Over the winter, advancing imports and rising prices heightened concern over the danger that Switzerland's four-year-old boom might culminate in a serious bout of overheating. On March 13 Parliament granted the monetary authorities unprecedented new powers, aimed at controlling the main sources of inflationary pressures. This action replaced the earlier Swiss stabilization program based on two voluntary agreements (one on foreign funds and one on domestic credit) concluded between the BNS and the commercial banks.

Under the parliamentary authority granted in March, controls have been put into effect in four general areas.

(a) Foreign funds. New controls on foreign funds became effective on March 31 for banking institutions subject to BNS regulation and were extended to all handlers of foreign money effective May 1. Although interest may now be paid on foreign-owned term deposits received after June 30, 1960 (prohibited by the first Gentlemen's Agreement on foreign funds), it may not be paid on any deposits received after January 1 of this year except for central bank deposits, savings deposits of SF 20,000 or less, and assets representing the unused portion of loans issued in Switzerland or credits granted by Swiss banks. Financial institutions are required to report foreign liabilities and assets (in foreign currency and Swiss francs) to the BNS on the 10th of each month and to pay into a frozen account at the central bank any increase since January 1, 1964 in Swiss franc assets belonging to foreigners, less the increase in investments abroad in foreign currency. The BNS may in exceptional cases, treat the investment of Swiss francs abroad as equivalent to investment in foreign currency. Financial institutions may sell Swiss securities to foreigners only to the amount of purchases from foreigners during the same month, and may not undertake any new investments in domestic assets for foreign accounts.

(b) Capital issues. On May 1 all new stock and bond issues of SF 5 million or more became subject to authorization by a newly created capital issues commission which will program the total permissible value of new issues on a quarterly basis. (This is the first time in recent Swiss history that domestic issues have been regulated.)

(c) Domestic credit. A new set of credit ceilings, replacing the old Gentlemen's Agreement on bank credit also became effective on May 1. For most types of bank credit the maximum increase in credit outstanding allowed for individual banks during 1964 is 79 per cent of their increase during either 1960 or 1961, whichever was greater. However, in no case need the 1964 increase in credit outstanding be limited to less than 6 per cent of the credit outstanding at the end of either 1960 or 1961.

(d) Construction. A program licensing new building according to type (residential, recreational, industrial, etc.) and limiting total new construction in each canton to a ceiling fixed by the federal authorities went into effect on March 17.

Heavy demands for credit push interest rates to new highs

In January, comfortable liquidity conditions in the Swiss money market allowed short-term rates to ease from their year-end highs, and the short-term pattern remained relatively stable in the early months of this year. However, the money market ease which customarily follows money market stringency around the end of the first quarter and the Easter holiday did not develop this year; money market tightness was, in fact, unexpectedly severe and commercial banks, hard pressed for funds, increased 3-month deposit rates progressively in the March-June period. The 3-month deposit rate at the large Zurich banks rose to 3.56 per cent at the end of June; in April the Zurich banks even raised their discount rate on commercial paper--unchanged for five years--from 2 to 2-1/2 per cent. The Swiss banks engaged in early and quite extensive preparations for anticipated mid-year window-dressing requirements, which produced a considerable liquidity after-effect in early July and allowed deposit rates to drop back to early March levels. (See Table 5.)

Although some market observers attribute the recent tightening tendency in the money market to the new restrictions on foreign funds, the situation undoubtedly reflected the general stringency in European money markets. The rate on 3-month Euro-Swiss francs, for example, moved up from 3.12 per cent on January 31 to 4.12 per cent by mid-May (compared to 3.32 per cent on local deposits), at which level Swiss franc deposits were attracted to foreign banks. This movement of funds reduced domestic bank liquidity, as did unseasonally large increases in note circulation, and forced the banks to borrow intermittently at the BNS. Even though the Euro-Swiss franc rate fell after mid-year, it is still 65 basis points above the local rate and continues to attract funds from Switzerland. (See Table 1.)

In response to a shortage of <u>medium-term funds</u> the banks raised the rate paid on 3- to 8-year certificates of deposit (Kassenobligationen) several times during the first six-months of 1964. Most of the new sales of these certificates, however, appeared to reflect the conversion of savings deposits. In June this development forced some major banks to begin paying 3-1/4 instead of 3 per cent on savings deposits. (See Table 1.) At times, some of the major banks even found themselves offering higher rates than the smaller cantonal banks, a reverse of the normal situation. In addition, a continued shortage of funds received from deposit certificates in maturities of 5 years or longer made many banks reluctant to grant new mortgages, even at higher rates. The mortgage market tightened further as institutional investors switched from mortgages to bonds to take advantage of higher yields.

Exceptionally heavy new <u>bond issues</u> during the first quarter, followed by slightly larger than usual issues in the second quarter, caused increasingly more attractive terms to be offered on new flotations and pushed yields on outstanding bonds to new highs. The yield on federal government long-term bonds rose from 3.45 per cent at the end of December to 4.04 per cent on July 10. (See Table 6.) New issues totalled $308 million in the January-June period this year, 45 per cent more than in the same period of 1963 and 12 per cent more than in the last half of 1963, when the current new issue boom began to gain momentum. (See Table 6.)

Coupon rates on <u>new issues</u> edged up from between 4- to 4-1/4 per cent at the beginning of the year to an almost universal 4-1/2 per cent at mid-year, with two of the four domestic issues opened for subscription in the first ten days of July carrying 4-3/4 per cent coupons. A measure of the increase in costs to borrowers in the period under review is the rise registered since January in the gross effective yield to maturity (excluding security and dividend taxes) on new issues: the average gross effective yield on new issues of SF 10,000 million or more opened to subscription during the first two weeks of June was 4.62 per cent, compared with 4.29 per cent on those offered in January. Demand remained generally firm throughout the period, receiving some support from funds repatriated from Germany following a proposal in April to tax income from foreign-held bonds. However, the fact that some issues were undersubscribed in early March and again in early May suggests that terms offered by borrowers at times lagged behind the demands of lenders.

<u>Foreign issues</u> during the first half of the year have been held down to $48.2 million, $34 million below the first half of 1963. (See Table 6.) This tighter control on foreign issues has kept interest rates from moving up as fast as on domestic issues, tending to eliminate the gap between the two. The BNS allowed no foreign issues in February and April, and there was some speculation that following the Badische Anilin (German chemical firm) issue in May, the BNS would not authorize any foreign issues until the fall. However, the increasing probability of private placements of foreign issues in Switzerland has apparently convinced the BNS, rather than to cut off foreign issues altogether and risk losing

control over the market, to permit a reduced volume of foreign bonds. In early July it approved a $15 million Imperial Chemical Industries (U.K.) 4-1/2 per cent issue. Also, in early July the Swiss Credit Bank joined an international syndicate in underwriting a $20 million loan to Portugal, placing its share of the issue privately. This was the first foreign currency loan underwritten by a Swiss bank since 1961.

The Swiss stock market was in the doldrums throughout the period under review because of the relatively low level of stock yields, uncertainty regarding the government's anti-inflationary program, strong competition from the booming new bond issues market and, finally, the effective elimination of foreign demand with the imposition of control on foreign funds. By the end of June share prices were about 12 per cent below their January high. More recently, however, prices have shown a strong upswing; market opinion tends to regard the recovery as based on the improved yield position of stocks resulting from the preceding decline in stock prices. (See Table 2.)

Table 2. Switzerland: Industrial Share Index
(1958 = 100)

1963			
September 27	266.4	May 1	236.8
October 25	256.4	8	234.5
November 29	259.4	15	235.4
December 30	253.1	22	234.5
		29	229.1
1964		June 5	221.0
January 17	250.8	12	226.6
31	249.5	19	231.6
February 14	242.7	26	228.5
28	245.8	July 3	232.0
March 13	245.8	10	234.7
26	246.2	17	247.4
April 10	242.5	24	248.0
24	238.7		

Source: Swiss Bank Corporation.

Tight credit raises demand for Swiss francs; official reserves down seasonally.

The Swiss franc responded quickly to the tightening money market conditions in April and moved back to the ceiling of 23.178 U.S. cents per franc, to remain there through June's window-dressing operation. (See Table 5.) Since early July, however, it has eased slightly as a result of the relatively easier money market liquidity conditions that developed following these mid-year transactions. The resumption of investment of short-term funds abroad also accounts for the sharp increase in the premium on the forward franc that has developed as investors seek protection against exchange risks.

In late January, after the government announced its anti-inflationary program, the Swiss franc began to decline in value, particularly against the U.S. dollar and the German mark. The decline reflected a combination of influences. Prior to the announcement of an anti-inflationary program, the market was unsettled by rumors of revaluation; but when it became obvious that the government program would not entertain revaluation, speculation apparently shifted from the Swiss franc to the German mark. Increasing investment demand for marks, especially from Swiss managed foreign funds--probably in response to the government's proposed limitation on foreign funds--also contributed to weakness of the franc in the exchange market.

In April, however, tightening money conditions forced large scale conversion of commercial bank foreign holdings into francs. Moreover, funds were repatriated from Germany in response to the proposed withholding tax in Germany on foreign-held bond income. Offerings of U.S. dollars were so heavy from late April through June that the BNS had to intervene in the market at times to keep the franc below its ceiling. In June it also undertook extensive dollar/SF swaps with the commercial banks to meet their window-dressing requirements.

BNS official holdings of gold and foreign exchange declined $123 million between January and June, or by slightly less than the decrease during the comparable period last year. (See Table 3.) Swiss reserves usually decline during the first half of the year because of the winter drop in exports and because most of the earnings from tourism, a very important item in the balance of payments, do not begin coming in until summer. Gold declines in March and April were due to reversing dollar/gold swaps made with the BIS in December, while increased foreign exchange holdings in April reflected BNS dollar/SF swaps with commercial banks, most of which were reversed in May.

Table 3. Switzerland: Official Gold and Foreign Exchange Reserves
(end-of-period figures, in millions of U.S. dollars)

	Gold	Foreign Exchange	Total	Change
1962	2,668	204	2,872	+114
1963				
Qtr. I	2,461	177	2,638	-234
II	2,530	178	2,708	+ 70
III	2,501	200	2,701	- 7
IV	2,820	254	3,074	+627
1964				
January	2,550	224	2,774	-300
February	2,551	202	2,753	- 21
March	2,543	201	2,744	- 9
April	2,525	280	2,805	+ 61
May	2,526	267	2,793	- 12
June	2,599	352	2,951	+158

Source: Banque Nationale Suisse.

June's $76 million increase in BNS gold holdings resulted from a swap operation involving three central banks: the Federal Reserve, the BNS, and the Banca d'Italia. The BNS exchanged $100 million equivalent Swiss francs for Italian lire with the Banca d'Italia. (Current BNS requirements for lire are quite high because of the payments made to Italy by Italian workers resident in Switzerland.) With this amount of Swiss francs the Banca d'Italia purchased an equivalent amount of dollars from the Federal Reserve Bank of New York (FRBNY) in June and the FRBNY in turn used the Swiss francs to liquidate outstanding credits under the System's swap agreement with the BNS. The BNS then swapped a large part of the lire to the BIS for gold. A small amount of lire was kept on its own books, but a larger share was swapped (with cover) to Swiss commercial banks in order to reduce their liquidity. The Banca d'Italia's Swiss franc obligation will be reduced as the BNS needs additional lire. The Swiss Confederation has guaranteed in a repurchase agreement the BNS obligations that run longer than three months.

Trade deficit eases after record first quarter

Although the high level of imports has served to ease demand pressures within Switzerland, official concern over the large trade deficits earlier in the year gave added impetus to the government's anti-boom program. (See Table 4.) The seasonally adjusted first quarter deficit of $252 million, $78 million above a year ago, was an all-time high. The April-May deficit, however, averaged only slightly more than the monthly average for second quarter 1963, and import increases are expected to taper off as the anti-inflationary program takes effect.

Table 4. Switzerland: Foreign Trade
(Seasonally-adjusted monthly average or month, million U.S. dollars)

	1963				1964					
	I	II	III	IV	I	Jan.	Feb.	Mar.	Apr.	May
Imports, c.i.f.	249	273	278	280	296	292	301	293	301	286.6
Exports, f.o.b.	191	204	200	210	212	207	215	214	226	215.9
Deficit	-58	-69	-78	-70	-84	-85	-86	-79	-75	-70.7

Source: OECD, Main Economic Indicators; Neue Zürcher Zeitung.

Europe and British Commonwealth Section.

II. Nine Charts on Financial Markets Abroad

Chart 1 - International Money Market Yields for U.S. Dollar Investors
Chart 2 - Interest Arbitrage, United States/Canada
Chart 3 - Interest Arbitrage, New York/London
Chart 4 - Interest Arbitrage for German Commercial Banks
Chart 5 - Short-term Interest Rates
Chart 6 - Long-term Bond Yields
Chart 7 - Industrial Stock Indices
Chart 8 - Spot Exchange Rates - Major Currencies Against U.S. Dollar
Chart 9 - 3-month Forward Exchange Rates

Table 5 . Switzerland: Money Rates, Exchange Rates, and Gold Prices

	Forward Swiss franc (3-mo.)	US Tr. Bill: Bill yield	US Tr. Bill: Net return in SF	Euro-dollar deposit: London rate	Euro-dollar deposit: Net return in SF	Swiss bank deposit (3-mo.)	Spot SF in $ *	Spot £ in SF	Gold coin a/ in SF
1963 Dec. 27	+0.09	3.50	3.41	4.25	4.16	3.38	23.173	12.064	40.00
1964 Jan. 3	+0.42	3.51	3.09	4.12	3.70	n.a.	23.168	12.074	40.00
17	+0.71	3.52	2.81	4.00	3.29	2.94	23.176	12.076	40.50
31	+0.68	3.48	2.80	4.12	3.44	2.94	23.164	12.078	40.00
Feb. 14	+0.76	3.50	2.74	4.00	3.24	2.94	23.124	12.104	40.00
28	+0.79	3.56	2.77	4.12	3.33	3.12	23.103	12.112	40.00
Mar. 13	+0.62	3.53	2.91	4.25	3.63	3.19	23.129	12.097	40.50
27	+0.43	3.52	3.09	4.25	3.82	3.19	23.109	12.108	40.50
Apr. 10	+0.06	3.44	3.38	4.25	4.19	3.31	23.128	12.103	40.50
24	-0.32	3.43	3.75	4.19	4.51	3.31	23.178	12.080	40.50
May 8	-0.14	3.47	3.61	4.25	4.39	3.38	23.175	12.080	40.00
22	+0.14	3.45	3.31	4.19	4.05	3.38	23.175	12.081	40.00
Jun. 5	+0.20	3.45	3.25	4.31	4.11	3.44	23.176	12.062	40.00
26	+0.71	3.45	2.74	4.38	3.67	b/3.56	23.178	12.046	39.50
Jul. 10	+1.01	3.45	2.44	4.38	3.37	b/3.25	23.160	12.060	40.00
24	+1.25	3.43	2.18	4.31	3.06		23.123		

a/ "Vreneli" 20-franc piece (0.1867 troy ounces; $6.53 at $35 per ounce). b/ Preliminary figures. *Recent upper limit of 23.178 imposed by BNS in the Swiss market; however, the Swiss authorities are not committed to hold the rate below 23.283.

Table 6. Switzerland: Selected Capital Market Statistics

Capital market yields

	Long-term govt. bonds	Deposit cert's: 12 cantonal banks	Deposit cert's: 5 large banks
1964 - High	4.07	4.11	4.14
Low	3.43	3.44	3.39
1963 July 26	3.18	3.44	3.39
Oct. 25	3.26	3.63	3.64
1964 Jan. 3	3.43	3.88	3.85
17	3.45	3.88	3.85
Feb. 7	3.64	3.88	3.85
21	3.71	3.88	3.85
Mar. 6	3.78	3.88	3.85
20	3.86	3.88	3.85
Apr. 3	3.88	3.90	3.85
17	3.83	3.90	3.85
May 8	3.90	4.06	3.95
22	3.93	4.11	4.14
June 12	3.93	4.11	4.14
19	3.98	4.11	4.14
26	4.05		
July 3	4.07		
10	4.04		

New Issues ($ millions; monthly ave. or month) (New money raised)

		Swiss bonds	Swiss stocks	Fgn. bonds	Total: Gross	Total: Net a/
1960		17.3	3.8	10.8	31.8	26.6
1961		19.8	7.2	18.6	45.7	42.6
1962		21.8	12.8	12.7	47.3	38.3
1963		40.5	10.2	11.4	62.0	54.2
Qtr.	I	38.2	14.5	9.3	62.0	43.6
	II	32.3	10.0	18.1	60.2	49.5
	III	36.0	3.6	4.3	43.9	43.0
	IV	55.5	12.5	13.9	81.9	80.8
1964	I	66.9	11.9	7.6	86.4	85.8
	Jan.	36.5	8.0	11.5	56.0	55.4
	Feb.	76.6	1.7	----	78.3	78.0
	Mar.	87.7	25.9	11.4	125.0	124.0
	Apr.	37.9	24.4	----	62.3	48.7
	May	35.4	33.4	13.9	82.6	80.8
	b/June	33.7		11.4		
	b/Jul. (1-10)	12.6		16.0		

a/ Net of reimbursements. Amounts by type are gross.
b/ Preliminary figures.

Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

3-MONTH EURO-DOLLAR DEPOSIT VS. CERTIFICATE OF DEPOSIT

Wednesday figures

Per cent per annum

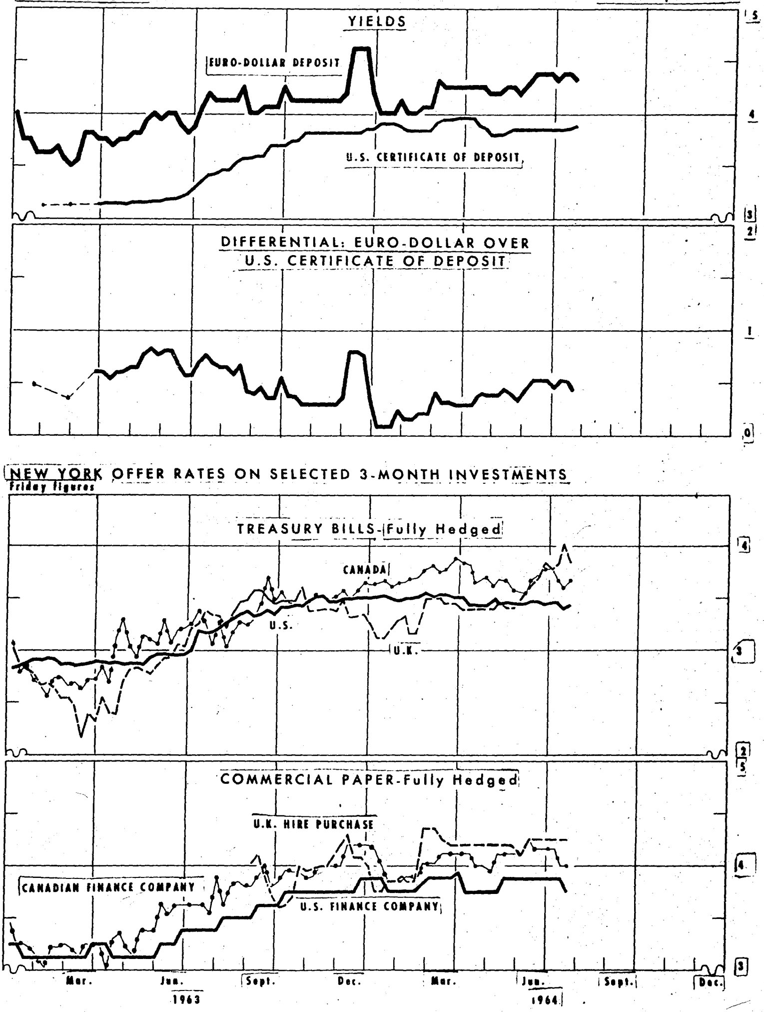

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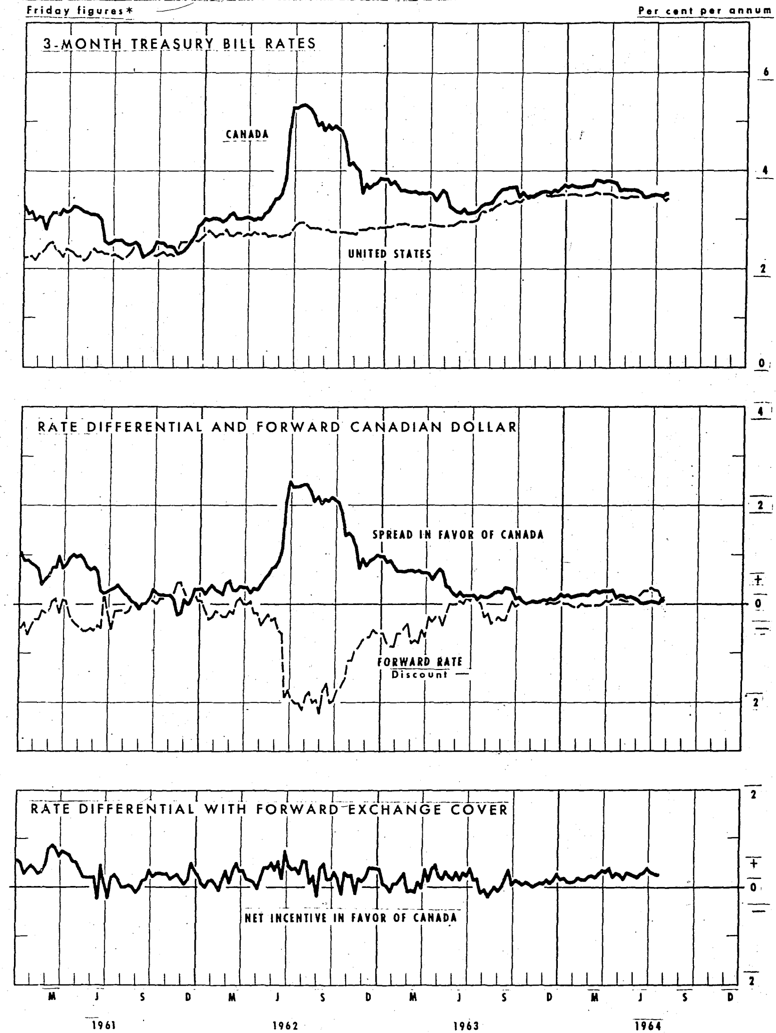
Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

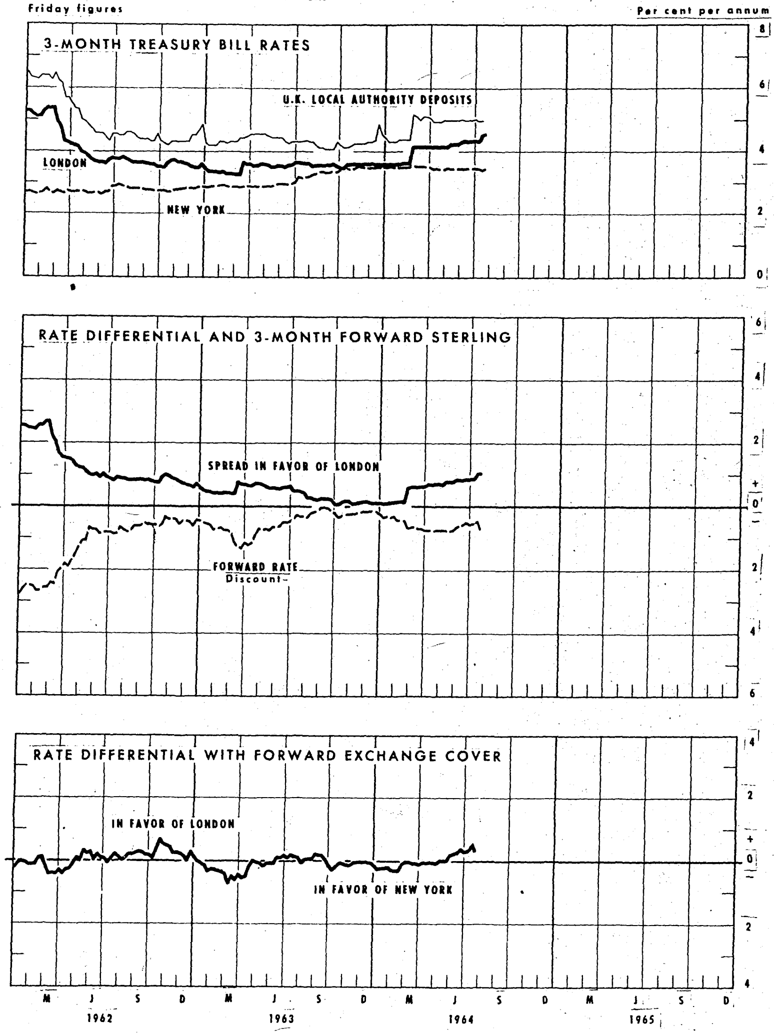


* Thursday figures 1961-1962, Friday thereafter

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures



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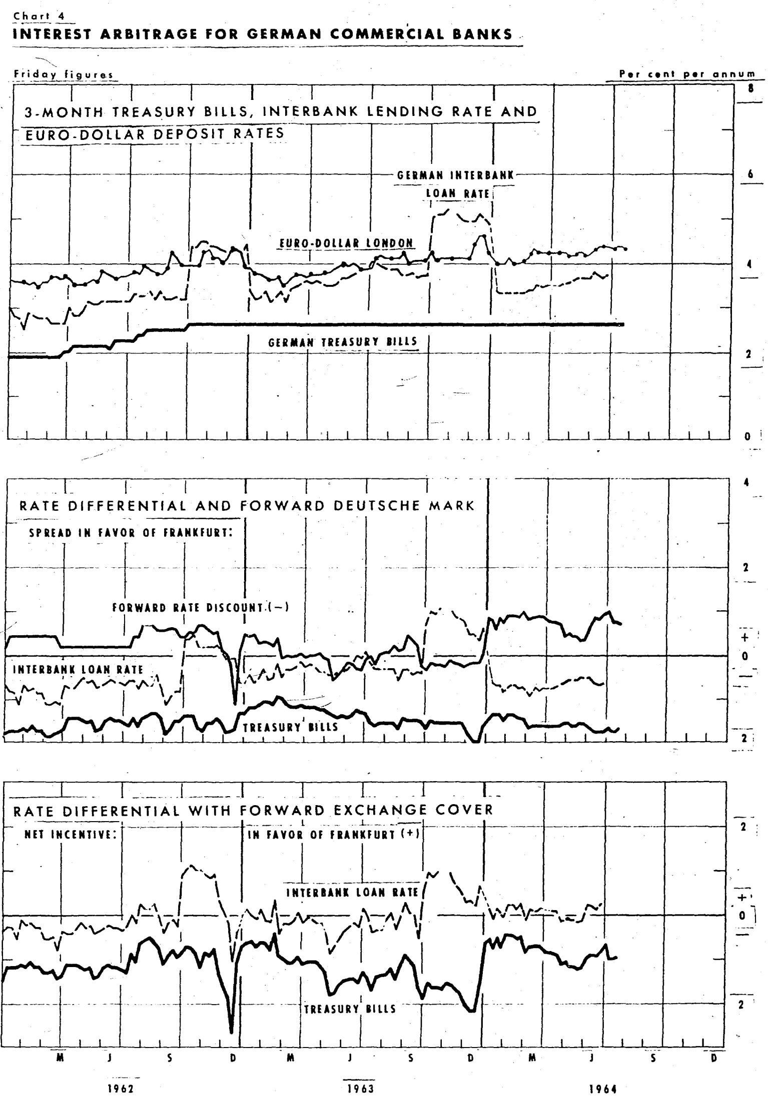
Chart 4
INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS
Friday figures
Per cent per annum
3-MONTH TREASURY BILLS, INTERBANK LENDING RATE AND EURO-DOLLAR DEPOSIT RATES
GERMAN INTERBANK LOAN RATE
EURO-DOLLAR LONDON
GERMAN TREASURY BILLS
8
6
4
2
0
RATE DIFFERENTIAL AND FORWARD DEUTSCHE MARK
SPREAD IN FAVOR OF FRANKFURT:
FORWARD RATE DISCOUNT (−)
INTERBANK LOAN RATE
TREASURY BILLS
4
2
+
0
−
2
RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER
NET INCENTIVE:
IN FAVOR OF FRANKFURT (+)
INTERBANK LOAN RATE
TREASURY BILLS
2
+
0
−
2
M
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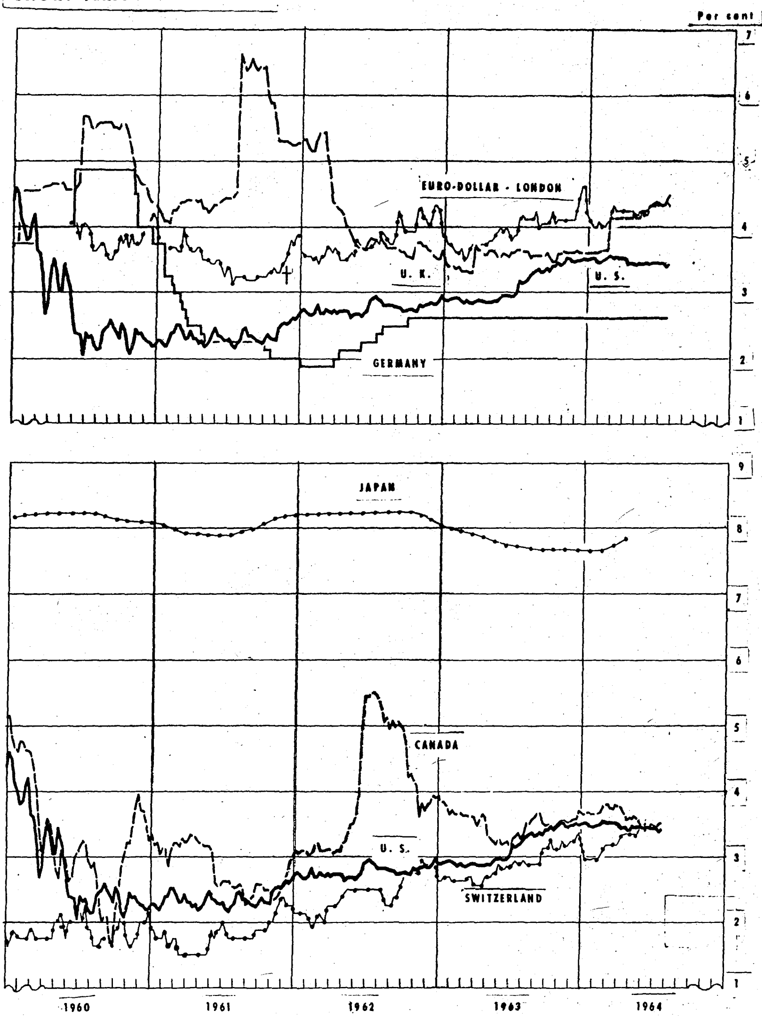
S
D
M
J
S
D
M
J
S
D
1962
1963
1964

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

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Chart 6

LONG-TERM BOND YIELDS

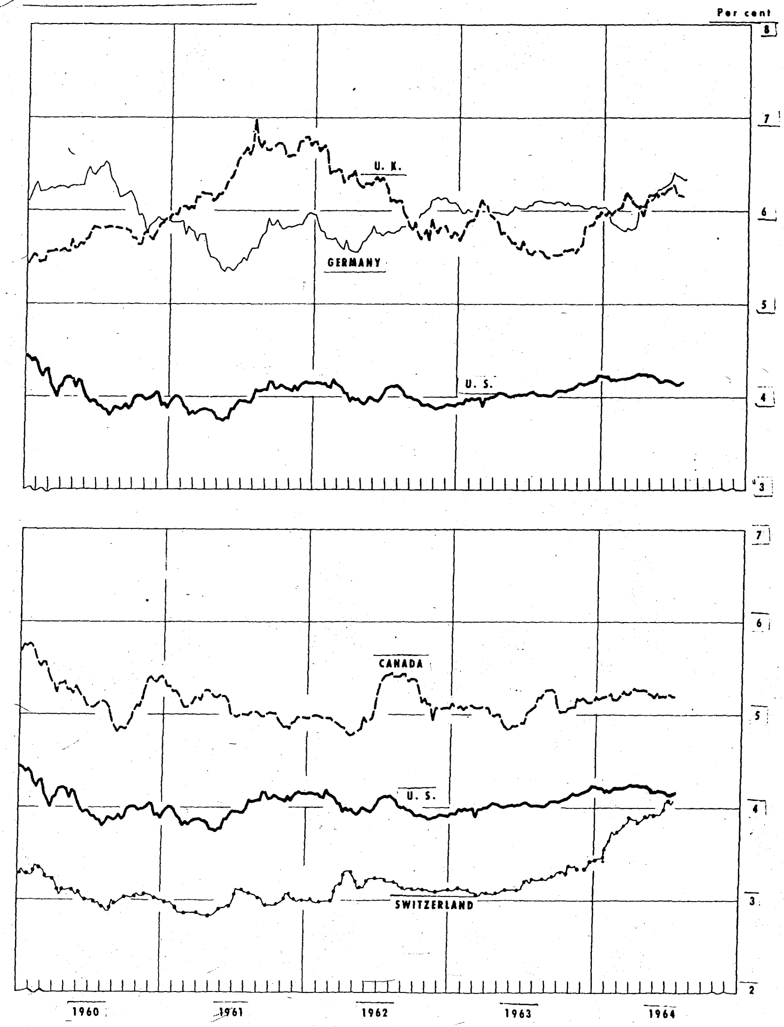

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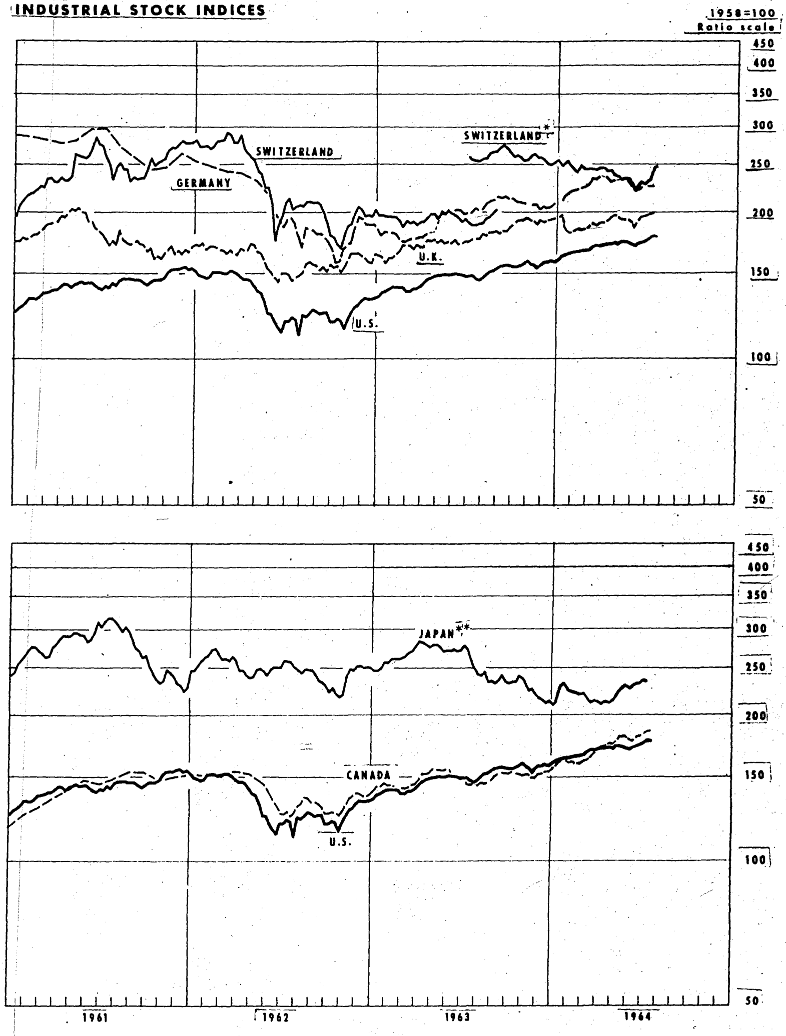
Chart 7

INDUSTRIAL STOCK INDICES



* New series. Swiss Bank Corporation industrial stock index

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

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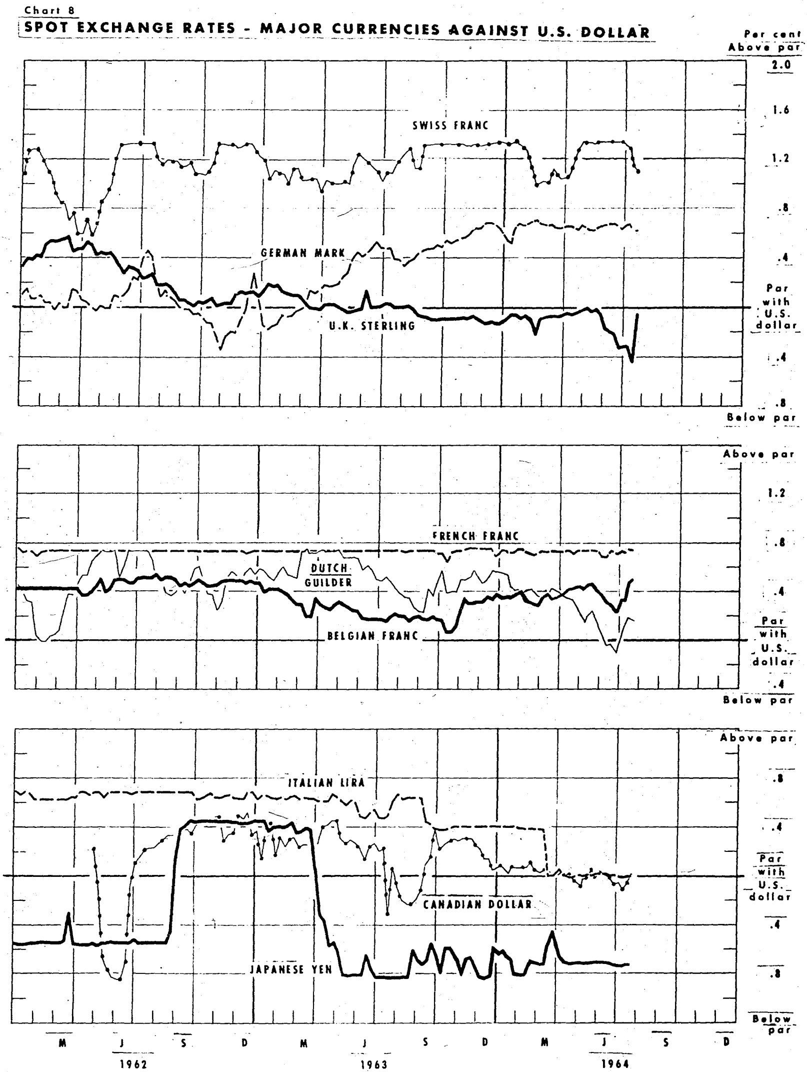
Chart 8
SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR
Per cent
Above par
2.0
1.6
1.2
.8
.4
Par with U.S. dollar
.4
.8
Below par
SWISS FRANC
GERMAN MARK
U.K. STERLING
Above par
1.2
.8
.4
Par with U.S. dollar
.4
Below par
FRENCH FRANC
DUTCH GUILDER
BELGIAN FRANC
Above par
.8
.4
Par with U.S. dollar
.4
.8
Below par
ITALIAN LIRA
CANADIAN DOLLAR
JAPANESE YEN
M
J
S
D
M
J
S
D
M
J
S
D
1962
1963
1964

Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures