

H. 13
No. 8

May 22, 1961

CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. Germany: Money and Capital Markets During April

Easy conditions prevailed in the German money market during April. A continued inflow of funds from abroad--much of it attributable to foreign borrowing on the part of German industrialists and exporters seeking to cover their foreign exchange risks--and further easing measures of the German Federal Bank contributed to market liquidity. During April and early May, the Bank further reduced commercial bank reserve requirements, rescinded its action of June, 1960 which had prohibited commercial banks from crediting their short-term foreign assets against minimum reserves required for non-resident deposits, and twice reduced by 1/8 per cent its selling rates for Treasury bills and short-term bonds (April 26 and May 5) bringing the rate on 3-months Treasury bills down to 2-1/4 per cent.

On May 5 the Federal Bank reduced discount rate from 3-1/2 to 3 per cent in an effort to reduce the continuing flow of funds into Germany. The action in itself will probably not appreciably lessen the influx, at least in the short-run, but should bring about a more rapid decline in long-term interest rates and increase pressure upon other German lending rates.

A continuing favorable trade surplus, the attractiveness of German bond yields, and speculation on a further DM appreciation encouraged further inflows of foreign exchange. The dollar remained near or at the lower intervention point during April and early May.

The bond market remained strong during April. This strength has continued into May. Bond prices have risen further by modest amounts and bond yields have further declined. Mortgage bonds at 5-1/2 per cent were being withdrawn from the market while applications at the Ministry of Economics for 5 per cent bonds were heavy. The first flotation of a Japanese bond in almost half a century is expected in June, a DM 400 million issue of the Osaka Municipal and Prefectures Governments.

The stock market, which had remained steady during April, rose rapidly after the May 5 change in the discount rate. All classes of stocks remained in good demand with chemicals, engineering and automotive stocks especially strong. Volkswagen shares which were traded in "regulated free trade," i.e. not on the exchange, reached a high of almost DM 800 by mid-April but declined to around DM 700 by early May. Foreign demand for the shares was very strong,

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especially in New York and Zurich, and quotations as high as \$201 were reported in mid-April in New York.

Money Market. During April easy conditions continued to prevail in the German money market. The inflow of foreign funds remained heavy and the German Federal Bank, continuing its effort to halt the heavy influx, pressed further in its campaign to get both short-term and long-term interest rates down. On April 6, for the fourth time this year, the Bank reduced minimum reserve requirements (retroactive to April 1) by 5 per cent, releasing approximately DM 400 million (\$100 million) of reserves.

On April 20, as a measure to encourage private banks to hold assets abroad, the Federal Bank allowed the commercial banks as of May 1 to credit their short-term foreign assets against the minimum reserve requirement for non-resident deposits. There are reliable reports that the action stimulated exports of money to Canada and to the Euro-dollar market in London during the first days of May. If this outflow reaches significant proportions, some tightening in the money market later in May is probable. Within Germany, this relaxation led to an actual easing in the market because the commercial banks' foreign holdings were large enough to bring about a release of reserves.

The Bank further reduced the rates at which it is prepared to sell Treasury bills and short-term bonds in the open market by 1/8 per cent on April 26 and again on May 5. These two cuts brought the rate for 3-months Treasury bills down to 2-1/4 per cent.

<u>From</u>	60-90 days	6-month
	<u>Treasury bills</u>	<u>Treasury bonds</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

On May 5, the Bundesbank reduced its rate from 3-1/2 to 3 per cent, as a major step in its campaign to lower German interest rates to the "international level." However, the immediate impact of this reduction upon the money market may be minor since short-term rates have been below the discount rate for sometime.

Frankfurt Inter-bank Money Rates

	<u>Day-to-day money</u>		<u>one-month</u>	<u>Three-month</u>
	<u>Lowest rate</u>	<u>Highest rate</u>	<u>loans</u>	<u>loans</u>
<u>1961</u>				
February (monthly range)	2.63	4.13	2.75 - 4.13	3.88 - 4.38
March (monthly range)	2.50	4.25	3.25 - 4.00	3.38 - 4.00
April (weekly range)	1-7	3.25	3.50	3.25
	8-15	3.13	3.25	3.38
	16-23	2.75	3.13	2.88 - 3.25
	24-30	2.50	2.63	2.75 - 2.88
May (weekly range)	1-7	2.88	3.13	2.88 - 3.00
	8-15	2.88	3.00	2.75 - 3.00
				2.88 - 3.13

Collection of the second tranche of the industry loan for foreign aid, which was shifted from April 15 to May 15, may exert a tightening influence on the money market in May. About DM 300 million is to be collected instead of DM 700 million originally scheduled because the German firms have stated their inability to raise more than DM 1.2 billion of the original commitment of DM 1.5 billion.

There was little change in the spread between short-term yields in the United States and Germany during April and early May. (See charts 3 and 4). On May 5, there was an incentive of about 0.82 per cent on the basis of the Frankfurt inter-bank loan rate and of about 0.07 per cent on the basis of the Bundesbank's selling price for Treasury bills.

	Inter-bank loan rates				Bundesbank's Treasury bill selling rate		
	German 3 mos. inter-bank loan rate	U.S. bill rate	Spread over U.S.	Net incentive on covered basis 1/	3 mos. bill rate	Spread over U.S. bill	Net incentive on covered basis 1/
1961							
Mar. 24	3.50	2.32	1.18	1.18	2.50	0.18	0.18
" 31	3.25	2.42	0.83	0.83	2.50	0.08	0.08
Apr. 7	3.38	2.30	1.08	1.08	2.50	0.20	0.20
" 14	3.38	2.30	1.08	1.08	2.50	0.20	0.20
" 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

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

Foreign Exchange. The inflow of foreign exchange into Germany continued in April but there were also substantial outflows after mid-April when a small interest differential (including the cost of forward cover) moved in favor of London for German banks. (See Chart 4). Because they could not obtain the swap rates available to banks, non-bank investors could not move funds. The differential might not have been sufficient to induce a significant outflow had the Federal Bank not permitted the banks to credit their short-term foreign assets to reduce required reserves held on non-resident deposits.

However, foreign exchange inflows continued because of speculation on further revaluation of the D-mark and the trade surplus, and exchange markets remained unsettled. The German Industries Federation made a plea to the Bundesbank to intervene on foreign currency markets to halt "the disquiet and upheaval" caused by the D-mark revaluation but the Federal Bank refused. At the insistence of foreign buyers, German exporters are invoicing in foreign currencies and they wanted the Bundesbank to act to reduce the discounts on foreign currencies because these discounts "were several times as high as before the revaluation." As an alternative means of covering these risks, German firms are borrowing heavily in foreign markets and in

Euro-dollars, and selling the currencies to the Bundesbank for D-marks for domestic financing.

Thus, for the first time in at least twenty years German industry is taking up foreign credits abroad on a systematic and considerable scale. Borrowers are firms of international reputation whose borrowings since the March 6 revaluation of the mark may exceed a \$300 million equivalent. One of the three major successors to the I. G. Farben A. G., the Farbwerke Hoechst, is a typical borrower, having recently made a \$25 million loan in a foreign country as a hedge against rate changes. Disruption of the forward market has made this the only means of obtaining cover for large amounts. The maturity of most of these credits abroad is reported to average between six and twelve months. It is a new foreign exchange situation which German bankers believe is likely to persist for some time.

Reflecting the current situation, the dollar remained near or at the lower intervention point during all of April and into the early part of May.

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

March 15	3.9700
" 30	3.9700
April 5	3.9701
" 14	3.9701
" 21	3.9700
" 28	3.9701
May 5	3.9700
" 12	3.9700

Bond Market. The improvement in the bond market continued into April and early May as the Federal Bank accelerated its efforts to get German interest rates down. The promise of lower interest rates led to a rise in prices of outstanding issues. Also feeding the price rise was heavy foreign investment in German bonds, either because German yields still remained well above yields on foreign bonds or because German bonds represented an excellent haven for funds still being attracted into Germany by hopes of a further revaluation of the mark.

As a result, interest rates in the German capital market have reached levels much lower than had been expected. Some observers are beginning to talk of a "new phase" in the bond market. Loans of recent months were issued at 5-1/2 to 6 per cent; during April, 5 per cent issues began to appear. Even mortgage bond rates are declining: mortgage banks have applied to the Federal Ministry for Economic Affairs for permission to issue 5 per cent mortgage bonds. The mortgage banks, which had ceased the sale of 6 per cent mortgage bonds in late March when quotations for these bonds had risen above par, also ceased the sale of 5-1/2 per cent mortgage bonds in mid-April. At the time, these bonds were selling at a price of 99. New 5 per cent issues are expected to sell at 96 or slightly higher.

However, the overall decline in bond yields during April was modest. Prices of public and industrial issues rose generally from one-half to one point during the month. Principal gains in prices were registered by some of the government issues, especially those with tax exemption features which showed gains of up to 1-1/2 points.

In a special study of the German capital market, the Federal Ministry for Economic Affairs has expressed its concern over the recent price increases for fixed-interest-bearing securities which it ascribes to large purchases by the banks. The Ministry advocates new issues on terms attractive to the private investor. Some suggested features of a more attractive bond are: shorter currency periods, renunciation of the right of the debtor to redeem bonds before maturity, payment of a premium in the case of premature repayment, and systematic redemption of an issue.

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

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

In April representatives of the Deutsche Bank negotiated with representatives of the Osaka Municipal and Prefectures governments the issue of a loan on the German market. The issue, amounting to around DM 400 million (\$100 million), is expected to be floated sometime in June and represents the largest foreign public loan issued in Germany since the war. It will be the first Japanese issue on the German market in almost 45 years. Terms and maturity of the loan have not yet been announced.

Stock Market. Share prices remained remarkably steady during the month of April. This tendency continued into May until the lowering of discount rate on May 5 brought about a strong rise in the market during the second week of May. The trend toward lower interest rates and the announcements during the month of additional dividend payments modestly above their 1960 levels contributed toward the maintenance of market strength. The market did not react adversely to political disturbances during the month, but political factors are accepted as the primary reason why stocks have not yet fully regained their pre-revaluation levels. Market sources still expect a good rise in 1961 although a repetition of the 1960 bull market is not foreseen.

The payment during May of already announced increased dividends and their reinvestment in the market are given as a major basis for a further rise

in stocks. German investors are reported to have ceased further shifts from stocks into bonds.

Almost all stocks shared in the general price rise. Chemicals and engineering stocks (especially Demag, the major mechanical engineering stock) were very strong, and automotive stocks gained several points on the strength of the excellent March production and export results announced in April.

Official trading in the Volkswagen shares began on April 7 with demand much heavier than had been anticipated. The shares were bought and sold in the "regulated free trade" which means that their prices were officially reported on the exchange but that all trading in the shares took place outside the exchange. By mid-April the price of a share was only slightly below DM 800 as against opening day quotations of DM 700-750 (average Government selling price 350, nominal price 100). Foreign demand, particularly from the United States and Switzerland, was especially strong. The Government has not yet issued shares to the Volkswagen employees although the Constitutional Court is expected to deny charges that the Government's preferential treatment of low-income groups is unconstitutional. Major public attention has been given to the Court proceedings and to the rapidly rising prices of the shares. The Government has been criticized for not permitting the banks to purchase the stock prior to the opening of official trading so that the banks might "stabilize" the market price of the shares. A Parliamentary question has been introduced asking the Government whether it intends to stabilize the share prices. However, no Government action is expected as prices tended to drop to around DM 720 by late April and to around DM 700 in early May. One New York brokerage house had quoted a price of around \$198 to \$201 in mid-April; this quotation declined to \$181 by the first week of May. The shares are not registered outside of Germany and are technically unquotable.

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

Dec. 31, 1958	189.05
Dec. 31, 1959	366.28
Aug. 8, 1960	596.63
Dec. 30, 1960	453.29

1961	Feb. 28	432.96
	Mar. 30	417.29
	Apr. 7	423.51
	" 14	425.20
	" 21	423.74
	" 28	426.88
	May 5	434.01
	" 12	447.97

Part II. Netherlands: First Foreign Flotation since Reopening of Dutch Capital Market for Foreign Issues

After announcing on April 18 that the Netherlands capital market would be reopened to foreign capital issues (see Capital Market Developments Abroad No. 7, May 15, 1961), the Dutch have lost no time in arranging for the first flotation, a 50 million guilder (\$13.8 million) bond issue of the International Bank for Reconstruction and Development. The bonds, with a 4-1/2 per cent coupon and a maturity of 20 years, were offered for public subscription during the week of May 15. Maturing in 1981, the loan is non-callable until June 15, 1972; beginning then the issue will be retired at par in ten equal annual installments. The bonds will also be subject to redemption in whole or in part at 101 1/2 from June 15, 1972 through June 14, 1976 and at 101 thereafter.

It is the first foreign loan floated on the Dutch capital market since 1955, and the third International Bank guilder loan (two Bank loans were made in 1954 and 1955). As in the case of the earlier Bank loans, a syndicate of 13 Dutch banks headed by the Netherlands Trading Society, Amsterdam will handle the underwriting.

European Section.

III. Nine Charts on Financial Markets Abroad

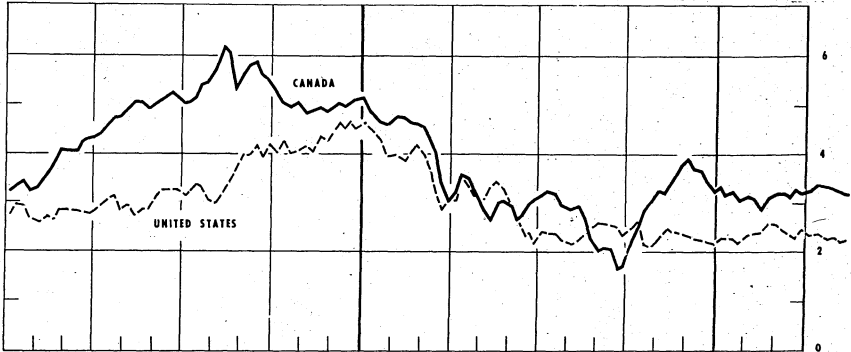
- Chart 1 - Interest Arbitrage U.S./Canada
- Chart 2 - Interest Arbitrage New York/London
- Chart 3 - Interest Arbitrage New York/Frankfurt
- Chart 4 - Interest Arbitrage Frankfurt/London
- Chart 5 - Short-term Interest Rates
- Chart 6 - Long-term Bond Yields
- Chart 7 - Industrial Stock Indices
- Chart 8 - Major Currencies in Terms of
Spot United States Dollar
- Chart 9 - 3-month Forward Rate--London Quotations

Chart 1

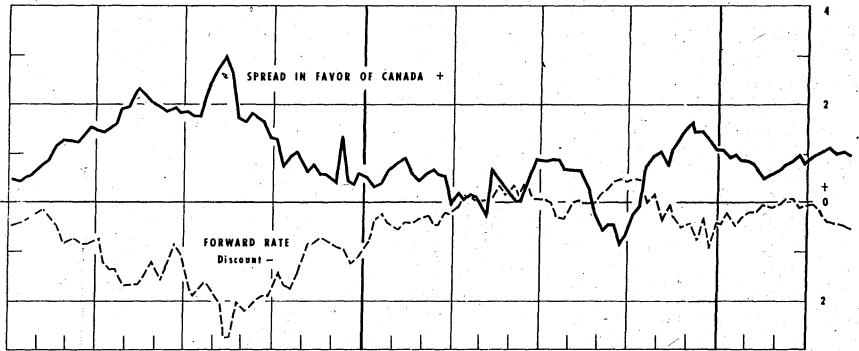
INTEREST ARBITRAGE, UNITED STATES / CANADA
Thursday figures

THREE-MONTH TREASURY BILL RATES

Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

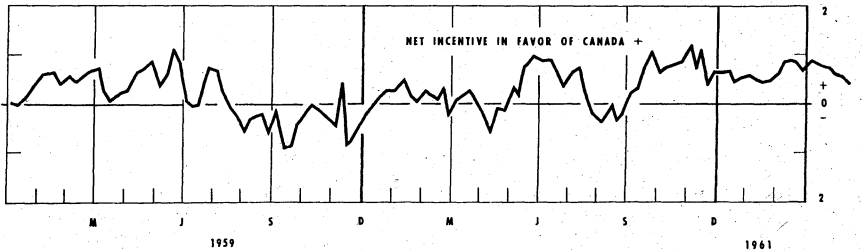
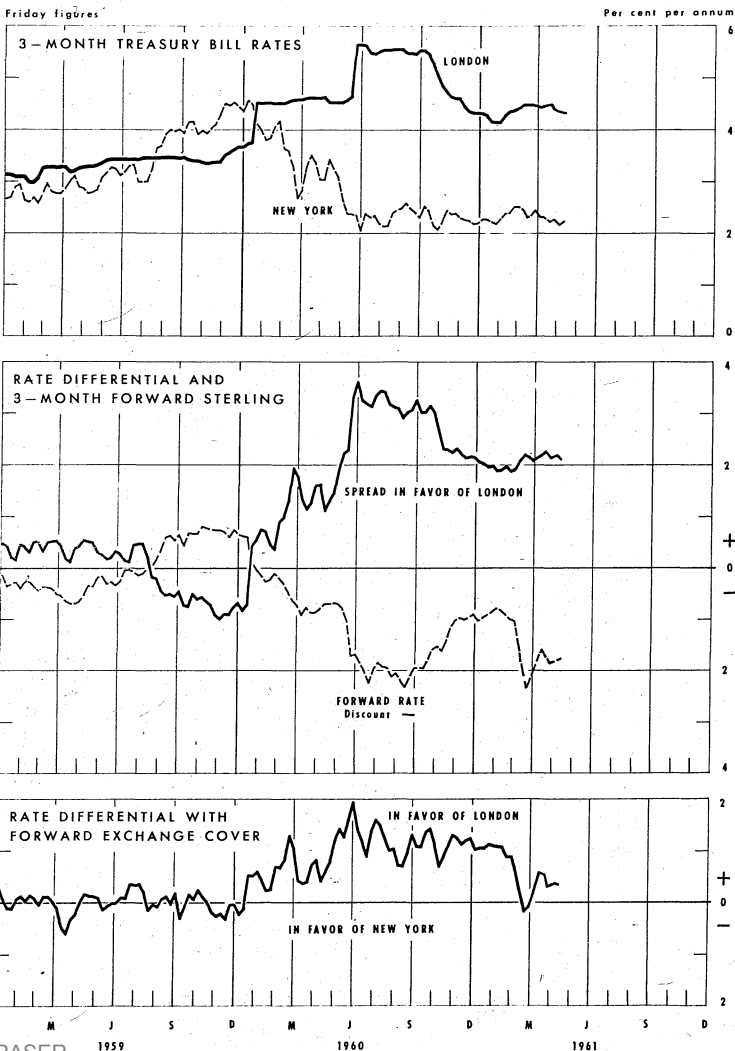


Chart 2

INTEREST ARBITRAGE, NEW YORK / LONDON

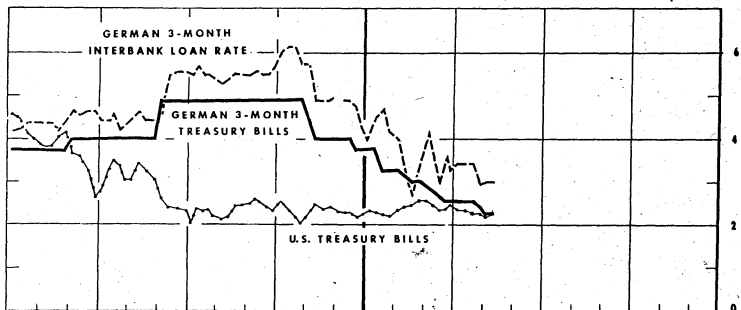


INTEREST ARBITRAGE, NEW YORK/FRANKFURT

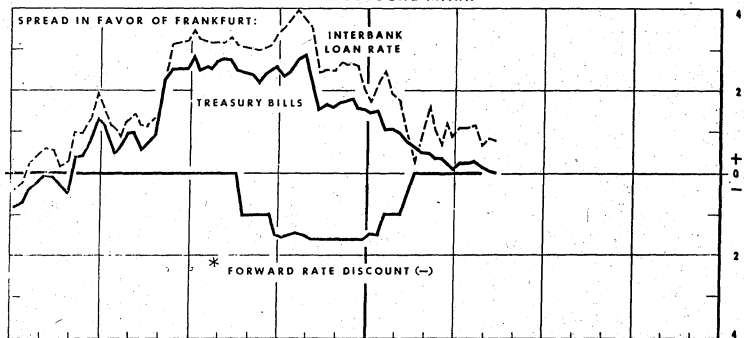
Friday figures

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

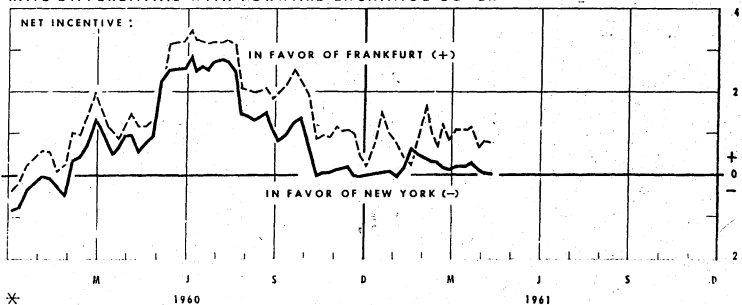
Per cent per annum



RATE DIFFERENTIAL AND FORWARD DEUTSCHE MARK



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER



* Note: 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

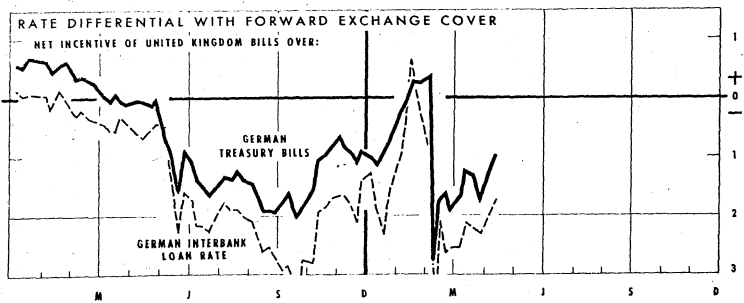
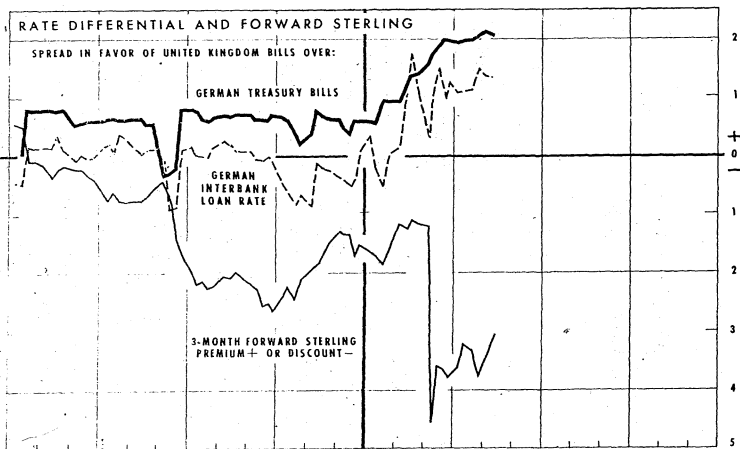
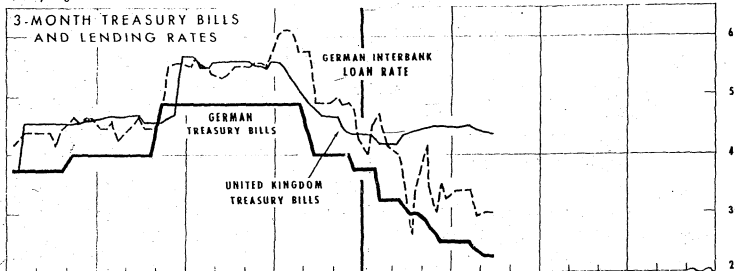
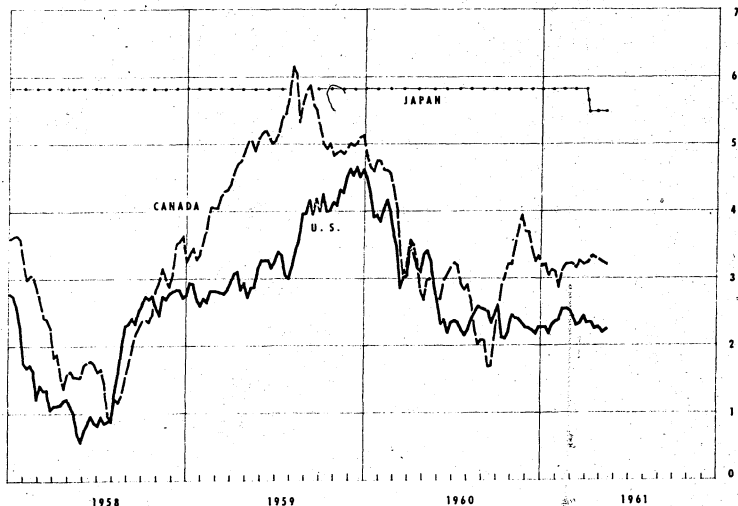
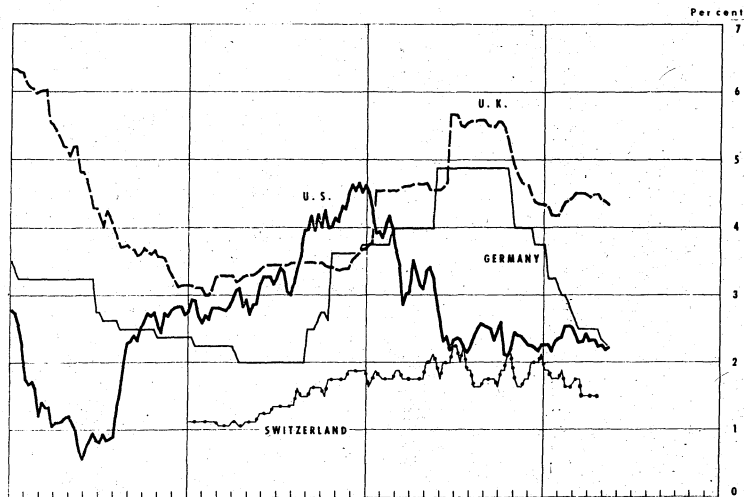


Chart 5
SHORT-TERM INTEREST RATES *



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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

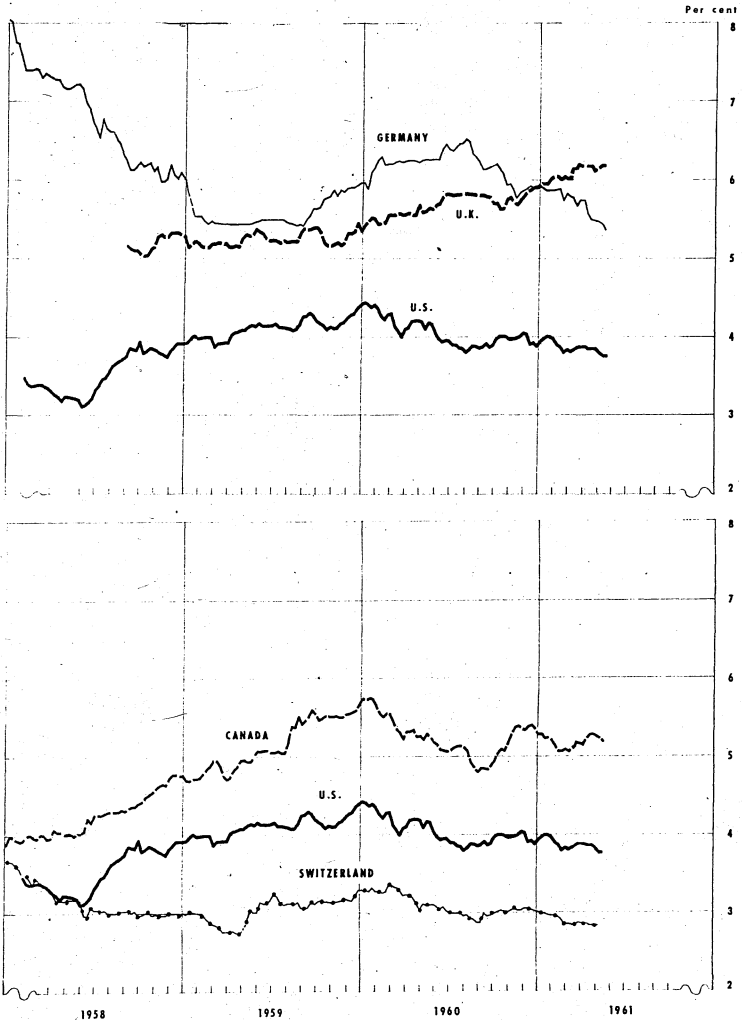
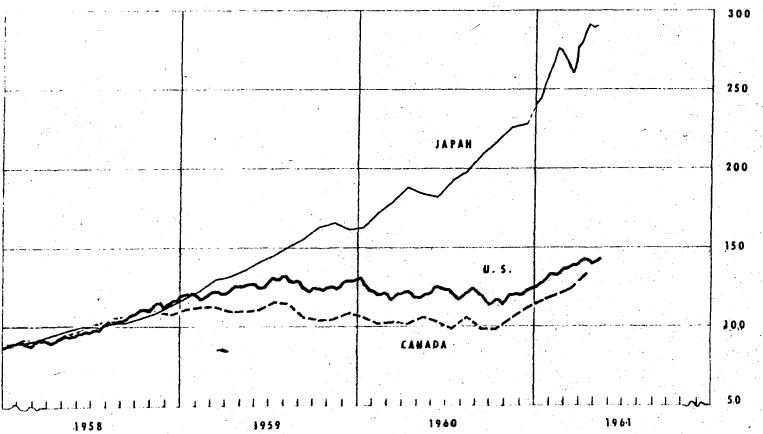
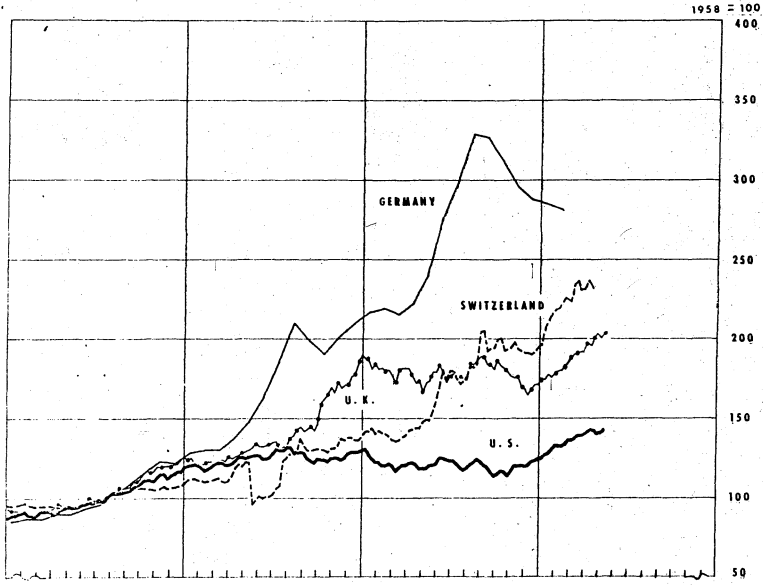


Chart 7

INDUSTRIAL STOCK INDICES *



* 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

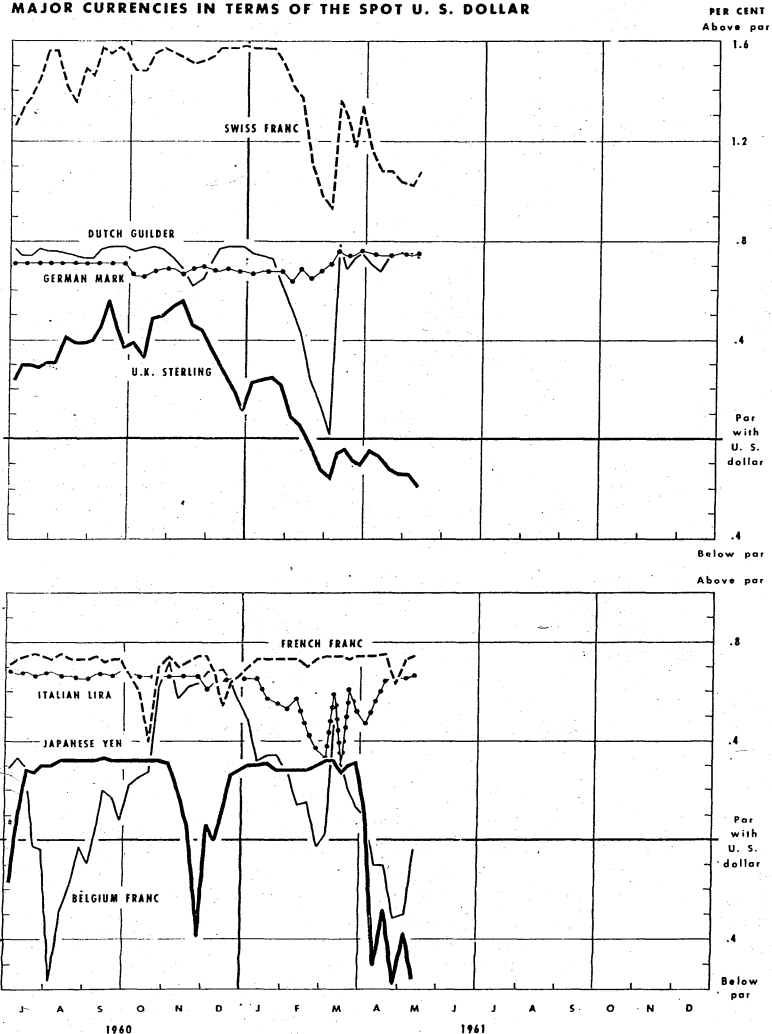


Chart 9

3-MONTH FORWARD RATES - LONDON QUOTATIONS

