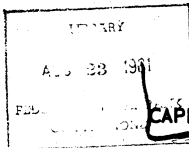


H.13
No. 21August 21, 1961CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. Germany: Money and Capital Markets During July

The tightening of German money and capital markets evident in the second half of June continued in July and early August. Offerings of securities by foreign holders, due partly to the Berlin situation but partly to reduced expectations of further increases in German bond prices, was an important cause of increased market tightness. German bondholders were also influenced by the revised expectations regarding future bond price trends.

Another factor contributing to the reduced liquidity of the money market was the continued increase in short-term investments abroad by German banks. On August 14, in a move to curtail this flow, the German Federal Bank ended the practice it had followed since last February of buying forward dollars from the commercial banks at the spot rate without charge.

On August 15, spot dollars in Frankfurt reached a new post revaluation high of 3.9950. The dollar has moved almost steadily if modestly upward since early June. Liquidation of forward contracts and selling by foreign holders of German bonds and shares remain important factors contributing to the improvement in the dollar rate; official intervention has also been mentioned as a reason for the strength of the dollar.

German bond markets remained generally quiet with further sales, principally by foreigners but also to some extent by domestic investors, depressing prices. The trend toward a 5 per cent long-term rate seems to be definitely halted for the time being. On July 19 the stock market suffered its sharpest setback since the DM revaluation, the decline being attributed almost exclusively to Berlin tensions. There was some improvement in late July after President Kennedy's speech of July 25 on Berlin, and as a result of short covering and of other technical factors. Further modest improvement occurred in early August.

Money Market. During most of July the money market, which had tightened during the second half of June, remained under pressure. Call money rates remained around 3 per cent for most of the month until a decline of 1/2 percentage point in the last week of July. One month rates

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were generally around 3 per cent and three-month rates above 3 per cent. During July the German commercial banks, taking advantage of the regulations permitting them to offset their short-term foreign assets against their short-term foreign liabilities in the computation of their minimum reserve requirements, moved money abroad in considerable amounts. Placed at term these short-term assets are not recallable until expiration of the period. Thus the tightness of the money market, although influenced by movement of foreign funds out of Germany because of the Berlin situation, was partly caused by technical factors.

On July 13, retroactive to July 1, the Federal Bank reduced minimum reserve requirements against resident deposits by 5 per cent of the October 1959 level. This brought little relief to the market until the latter part of the month when call money fell to around 2 1/2 per cent, one-month and three-month rates easing only slightly. Rates rose again in the first week of August, and on August 10 the Federal Bank again reduced reserve requirements by an additional 5 per cent of the October 1959 level, retroactive to August 1. This brought the total reduction so far this year to more than 26 per cent of the level of December 31 last. While this latest reserve requirement reduction will aid the money market it is not expected to offset fully the adverse effects of international tensions.

On August 14 the Federal Bank announced that effective immediately there would be a 0.25 per cent charge on dollar swap operations, with business limited to a one- to three-month range. Since mid-February there had been no charge for German commercial banks wishing to hedge forward dollar purchases for a period ranging from two weeks to six months; the Federal Bank stood ready to buy forward dollars from the banks at the spot rate. Banking circles in Frankfurt interpret the move as one to ease German money markets by discouraging the banks from placing short-term funds abroad. It is also believed that some banks may now move funds into fixed-interest securities and help to counter the recent rise in long-term yields.

Frankfurt Inter-bank Money Rates

| | Day-to-day money | | One-month | Three-month |
|---------------------|------------------|--------------|-------------|-------------|
| | Lowest rate | Highest rate | loans | loans |
| 1961 | | | | |
| May (monthly range) | 2.38 | 3.13 | 2.75 - 3.13 | 2.88 - 3.25 |
| June " | 1.75 | 3.13 | 2.75 - 3.13 | 3.00 - 3.25 |
| July (weekly range) | 1-7 2.63 | 3.13 | 3.00 | 3.13 |
| | 8-15 3.00 | 3.13 | 2.88 - 3.00 | 3.13 |
| | 16-23 2.88 | 3.13 | 2.88 - 3.00 | 3.00 - 3.13 |
| | 24-31 2.38 | 2.63 | 2.88 - 3.00 | 3.00 - 3.13 |
| Aug. (weekly range) | 1-6 3.00 | 3.13 | 3.00 | 3.13 |
| " | 7-13 2.13 | 2.88 | 2.88 - 3.00 | 3.00 - 3.13 |

There was no change during July or early August in the rates at which the Federal Bank is prepared to sell Treasury bills and short-term bonds in the open market and, as of August 18, they remained at the levels set on May 5.

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

In mid-July, rates on Euro-dollar deposits in London declined somewhat. During late July and early August the margin of advantage between the Frankfurt money market and London Euro-dollar call rate shifted back and forth, the spread on either side remaining small. Since mid-June the spread has been well below 1/2 a percentage point. The large German commercial banks continue to hold most of their foreign assets in three-month Euro-dollar accounts, which yield about 3 1/8 per cent. Although the spread between the Frankfurt three-month loan rate and the London three-month rate on Euro-dollars has been almost negligible since mid-June, the German commercial banks have had an additional incentive in the fact that the privilege they have had since April of offsetting their foreign assets against their foreign liabilities for purposes of determining required reserves has reduced the amount of reserves that must be held at the maximum rates.

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

| | Rate for U.S. dollar deposits money in Frankfurt | Rate for U.S. dollar deposits on basis in London | Incentive in favor of London Euro-dollar call rate | 3 months money in Frankfurt | Rate for U.S. dollar deposits on basis in London | Incentive in favor of London Euro-dollar 3-month rate |
|--------|---|---|--|-----------------------------------|--|---|
| 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 |
| 9 | 2.50 | 2.88 | 0.38 | 3.07 | 3.50 | 0.43 |
| 16 | 2.13 | 2.88 | 0.75 | 3.07 | 3.50 | 0.43 |
| 23 | 2.50 | 2.88 | 0.38 | 3.07 | 3.38 | 0.31 |
| 30 | 2.50 | 2.75 | 0.25 | 3.13 | 3.38 | 0.25 |
| July 7 | 2.63 | 2.75 | 0.12 | 3.13 | 3.31 | 0.18 |
| 14 | 3.07 | 2.63 | -0.44 | 3.13 | 3.25 | 0.12 |
| 21 | 2.94 | 2.63 | -0.31 | 3.07 | 3.25 | 0.18 |
| 28 | 2.44 | 2.75 | 0.31 | 3.07 | 3.31 | 0.24 |
| Aug. 4 | 3.07 | 2.75 | -0.32 | 3.13 | 3.25 | 0.12 |
| 11 | 2.38 | 2.75 | 0.37 | 3.07 | 3.25 | 0.18 |

In mid-July the spread between Treasury bill yields in the United States and Germany shifted to favor the German bill over the U.S. bill on a net incentive basis, but only negligibly. In early August the spread again favored the U.S. bill (but also negligibly) as the U.S. bill rate rose above July levels, increasing 19 basis points between August 4 and 11. Until August 11 there was little or no change in the spread between the U.S. bill rate and the German inter-bank loan rate, with the German rate still favored on a net incentive basis (see charts 3 and 4). As of August 11, however, the rise in the U.S. bill rate had narrowed the incentive in favor of the Frankfurt inter-bank loan rate from about 0.84 per cent per annum on August 4 to about 0.63 per cent per annum on August 11.

The German banking community has been concerned by the persistent tightness of the money market in recent weeks. Larger reductions in the reserve requirements had been hoped for, while some observers also suggested that both the federal and state governments should utilize some of their rapidly growing surpluses, resulting from high tax receipts, to ease the market. While there has also been some pressure to lower the Federal Bank's selling rate for Treasury bills and short-term bonds there have been no indications that the Bank contemplates such a move at this time.

| | German Inter-bank loan rate vs. U.S. bill rate | | | | | Bundesbank's Treasury bill selling rate vs. U.S. bill rate | | | |
|------|---|----------------------|--------------------------------|---------------------------------|----------|---|--------------------------------|---------------------------------|----------|
| | German 3 mos. inter-bank loan rate | U.S. bill rate | Spread over U.S. bill | Net covered incentive | | 3 mos. bill rate | Spread over U.S. bill | Net covered incentive | |
| | | | | of German rate ^{1/} | in favor | | | of German rate ^{1/} | in favor |
| 1961 | | | | | | | | | |
| June | | | | | | | | | |
| 2 | 3.13 | 2.47 | 0.66 | 0.66 | 2.25 | -0.22 | -0.22 | -0.22 | -0.22 |
| 9 | 3.07 | 2.35 | 0.72 | 0.72 | 2.25 | -0.10 | -0.10 | -0.10 | -0.10 |
| 16 | 3.07 | 2.33 | 0.74 | 0.74 | 2.25 | -0.08 | -0.08 | -0.08 | -0.08 |
| 23 | 3.07 | 2.28 | 0.79 | 0.79 | 2.25 | -0.03 | -0.03 | -0.03 | -0.03 |
| 30 | 3.13 | 2.27 | 0.86 | 0.86 | 2.25 | -0.02 | -0.02 | -0.02 | -0.02 |
| July | | | | | | | | | |
| 7 | 3.13 | 2.30 | 0.83 | 0.83 | 2.25 | -0.05 | -0.05 | -0.05 | -0.05 |
| 14 | 3.13 | 2.20 | 0.93 | 0.93 | 2.25 | 0.05 | 0.05 | 0.05 | 0.05 |
| 21 | 3.07 | 2.16 | 0.91 | 0.91 | 2.25 | 0.09 | 0.09 | 0.09 | 0.09 |
| 28 | 3.07 | 2.24 | 0.83 | 0.83 | 2.25 | 0.01 | 0.01 | 0.01 | 0.01 |
| Aug. | | | | | | | | | |
| 4 | 3.13 | 2.29 | 0.84 | 0.84 | 2.25 | -0.04 | -0.04 | -0.04 | -0.04 |
| 11 | 3.07 | 2.44 | 0.63 | 0.63 | 2.25 | -0.19 | -0.19 | -0.19 | -0.19 |

^{1/} To encourage capital outflow the Bundesbank provided forward dollars flat to German banks until August 11. As of that date a charge of 0.25 per cent was imposed on such dollar swap operations.

Foreign Trade. Seasonally adjusted West German trade figures for the periods indicated are as shown below.

| | Exports | Imports | Trade balance |
|----------|-------------------------------|---------|------------------|
| | (in millions of U.S. dollars) | | |
| 1960 | 11,374 | 10,129 | 1,245 |
| 1961 - I | 3,141 | 2,556 | 585 |
| - II | 3,231 | 2,807 | 424 |
| April | 1,181 | 971 | 210 |
| May | 1,003 | 932 | 71 |
| June | 1,047 | 904 | 143 |

Foreign Exchange. On the foreign exchange markets the spot rate for the dollar rose during July and early August. After the British measures of July 25 the spot rate for the pound sterling reached its highest level in more than three months in Frankfurt. However, the discount on forward sterling again rose to more than 5 per cent per annum, making a movement of Frankfurt bank funds into Treasury bills on a covered basis unprofitable, despite the substantial interest rate differential between the two centers in favor of the London bill.

The improvement in the dollar rate is attributed in part to the selling of German bonds and shares by foreigners, principally American and Swiss, with the Berlin situation the principal motive for such selling. Newspaper accounts also credit the strength of the spot dollar to official support operations. British banking authorities also are reported to have supported the pound. Further liquidation of maturing forward contracts through the purchase of spot dollars was also reported. The spot dollar, which had reached a post-revaluation high of 3.9796 on June 28, reached its July high of 3.9832 on the last day of the month and advanced further in August to 3.9950 on the 15th.

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

| | | |
|------|----|--------|
| July | 7 | 3.9772 |
| " | 20 | 3.9793 |
| " | 26 | 3.9810 |
| " | 31 | 3.9832 |
| Aug. | 3 | 3.9844 |
| " | 9 | 3.9938 |
| " | 14 | 3.9930 |
| " | 15 | 3.9950 |

Bond Market. The bond market, which lost its buoyancy in June, continued under pressure in July and the first half of August. Prices fell, and the trend toward a 5 per cent bond rate, the "magic five per cent" as it is being called by German financial reporters, has definitely been halted, at least for the time being. Twice before, in 1957 and 1959, the five per cent rate was in sight, but failed to be

reached because restrictive measures were adopted for anti-inflationary purposes. The current reversal, like the recent tightness in the money market, is attributable primarily to international tensions which in recent weeks have led to selling of German bonds and stocks, especially among foreigners. The firmer position of the dollar has contributed to the liquidation of foreign holdings. Moreover, some German investors, expecting further increases in interest rates, see less chance for capital gains from rising bond prices, and have also reduced their holdings of domestic bonds.

Following the July 13 reduction in reserve requirements there was some slight improvement in the market; industrial bonds were up somewhat while issues of the public authorities managed to sustain their levels. But the reversal of the assumption that interest rates would continue to fall caused buyers to demand higher rates on bonds, especially those of the public authorities. The Federal Bank's latest monthly report confirms the report that the 12-year 5 per cent German Federal Railways issue offered between July 4 and 12 at a price of 98 was not fully placed, the underwriting banking consortium being forced to hold a portion of the issue in its own portfolio. As of August 4 the offer price on the market was down to 96.

There has been almost no mortgage bond activity now for several weeks. A heavy demand for mortgage funds is expected in the fall, and borrowers are currently unable to place low-yield bonds except at marked discounts. In June, 48 per cent of issue permits were for mortgage and municipal bonds to be issued at 5 per cent. In July the proportion fell to around 25 per cent, other permits covering obligations to be issued at higher rates.

Well-informed banking circles have reported that the German Federal Bank intervened on the bond market to keep yields from rising above $5\frac{1}{2}$ per cent. On July 11 the Bank bought bonds of the public authorities to support prices. Intervention at later dates has also been reported. It had been hoped that once it was known that the Bank was determined to stabilize prices, confidence would return to the fixed-interest-bearing security market. In July, however, the average yield on issues of public authorities is expected to show a slight rise to 5.7 per cent. Through August 11, bond prices showed no improvement; but it is hoped that the further reduction in reserve requirements on August 10, and the imposition of a charge on commercial bank dollar swap operations, will aid the market to some extent.

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 | 5.8 | 5.6 | 5.6 |
| | June | 5.8 | 5.6 | 5.6 |
| | July (est.) | 5.9 | 5.7 | 5.7 |

Stock Market. The German stock market experienced a sharp setback in July as a result of increasing tensions over Berlin. On July 19 the German shares markets suffered their severest declines since the revaluation of the DM. Between July 17 and July 21 prices fell sharply, in some cases by as much as 100 points in a day, and German financial circles expressed the opinion that the German stock markets were in their most serious situation since World War II.

The vulnerability of the German stock exchanges to the reactions of foreign holders of German shares became quite evident. There was heavy selling on Swiss and American account sending stock prices downward. It was also reported that some small German investors sold out at any price because of foreign selling and mounting tensions, although the majority of small and medium domestic investors retained their holdings. Chemical and electric shares, recent favorites, were especially hard hit as were department store and automobile shares, the last two being heavily involved in recent speculative activity. Daimler Benz fell over 200 points (from DM 2560 to DM 2300) in two days, July 19-20, while chemical shares fell an average of more than 20 points in the same period. On July 21, stock values were 11 per cent below the level at the end of 1960, and 23 per cent below their all-time high early last September.

The fall was attributable almost exclusively to international tensions of a political nature, although some investors were reported as believing that after the rapid rise in share prices during the past year stock prices were too high and out of line with earnings, dividends, and prospective dividends. Excellent company reports were not sufficient to counteract investor unwillingness to take risks in the face of Berlin.

In late July, stock prices strengthened, aided by support operations of the German banks and covering by speculators who had sold short. There was further improvement in early August following President Kennedy's speech of July 25 on Berlin. The strength in Frankfurt was

interpreted as reflecting that of the New York market, and orders from the United States for German shares were reported. There were good gains in most stock prices, especially industrials, and the good showing of stocks which have been favorites of Swiss and American investors (Badische Anilin, Siemens, Hoechst Farbenwerke, Dresdner Bank, etc.) may indicate some return of Swiss and American funds into the German stock exchanges. In the second week of August some stock prices drifted below the first week levels, but first week gains in general were maintained.

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

| | | |
|-------------|---------|--------|
| <u>1961</u> | Apr. 28 | 426.88 |
| | May 5 | 434.01 |
| | 26 | 465.69 |
| | June 3 | 467.15 |
| | 16 | 477.88 |
| | 30 | 462.67 |
| | July 13 | 440.85 |
| | 18 | 431.10 |
| | 21 | 398.85 |
| | 28 | 422.05 |
| | Aug. 4 | 425.39 |
| | 11 | 429.65 |

European Section.

II. 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

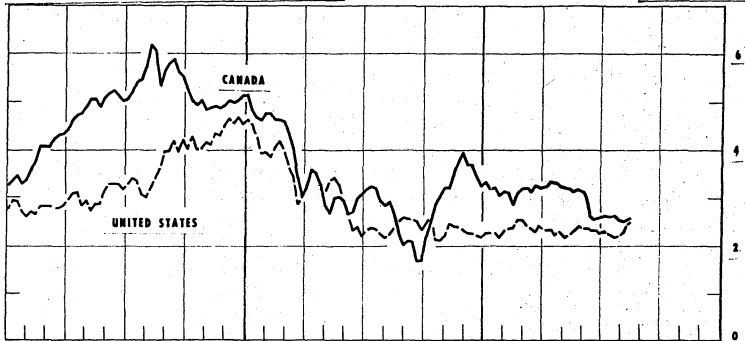
Chart 1

INTEREST ARBITRAGE, UNITED STATES / CANADA

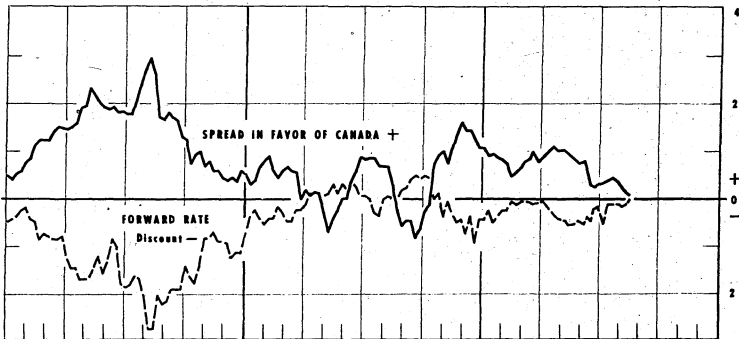
Thursday figures

THREE-MONTH TREASURY BILL RATES

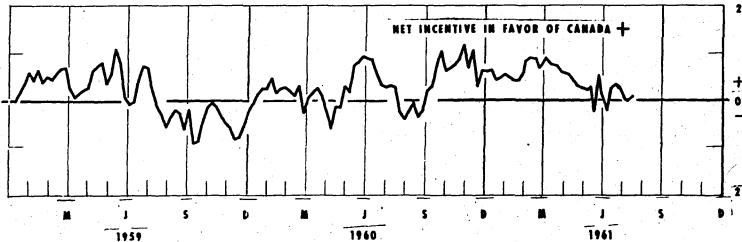
Per cent per annum



RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR



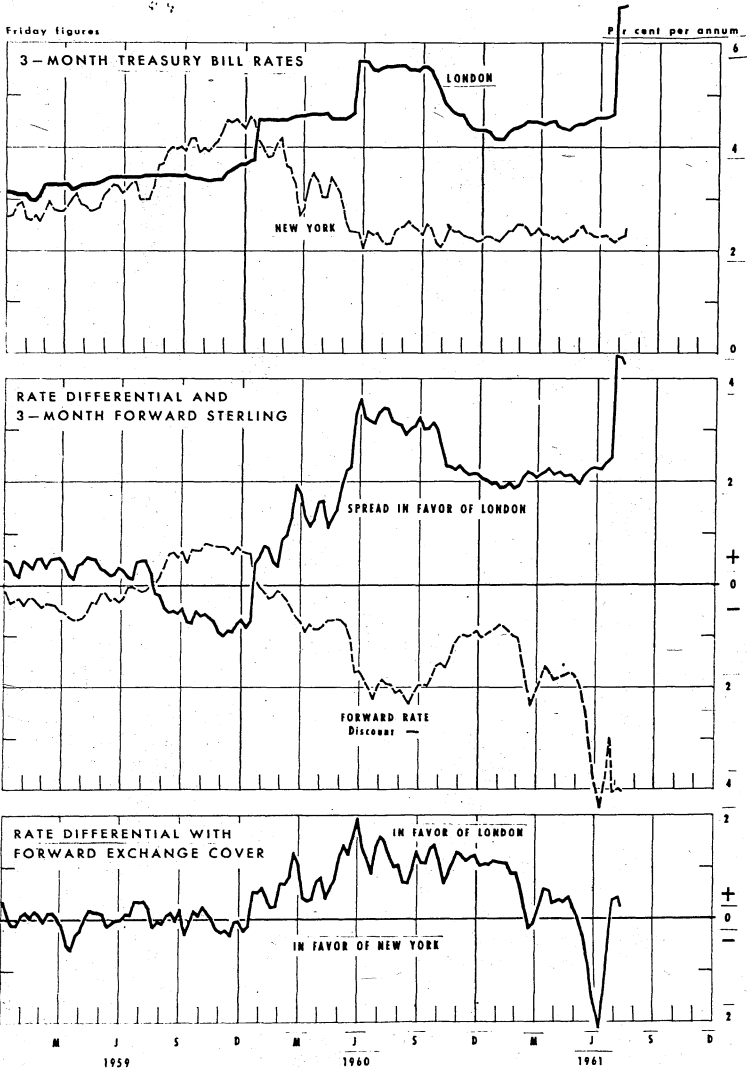
RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER



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Chart 2

INTEREST ARBITRAGE, NEW YORK / LONDON

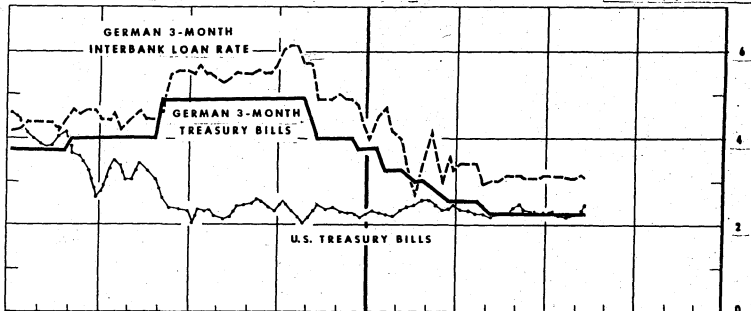


INTEREST ARBITRAGE, NEW YORK / FRANKFURT

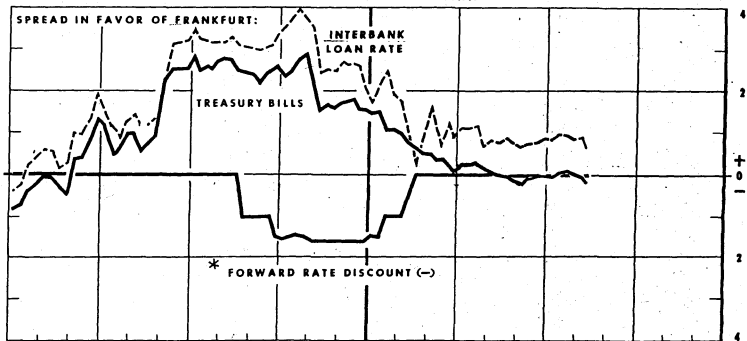
Friday figures

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

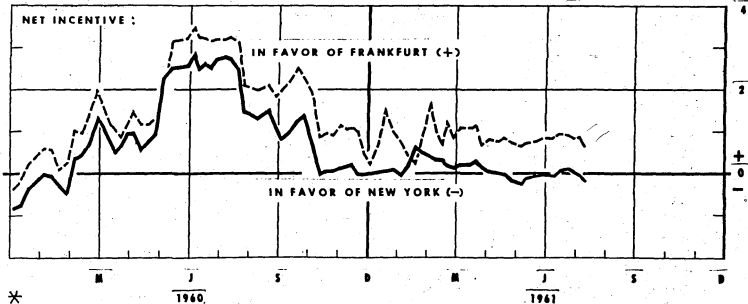
Per cent per annum



RATE DIFFERENTIAL AND FORWARD DEUTSCHE MARK



RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER



*

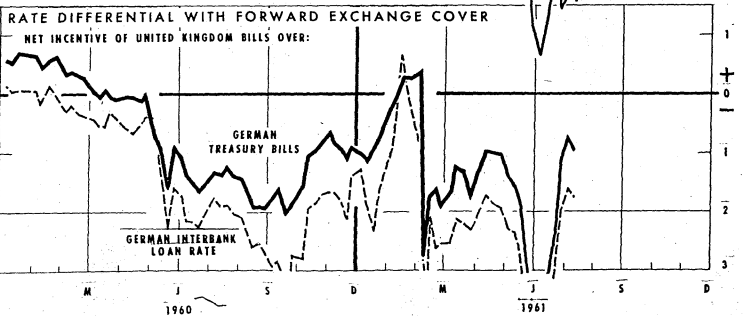
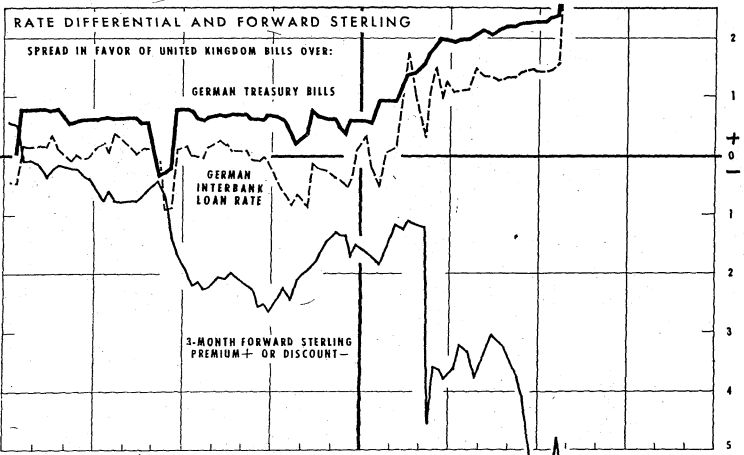
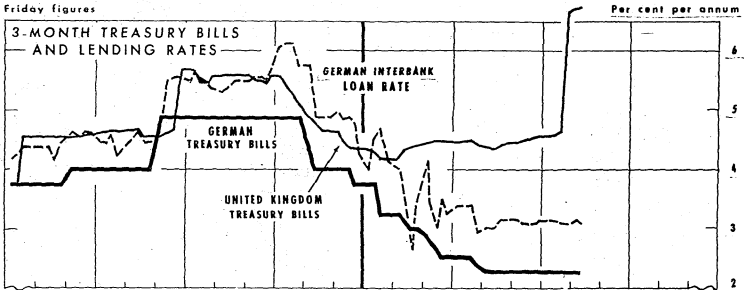
Note: Special forward dollar rate (either flat or premium on spot) available to German commercial banks.

12

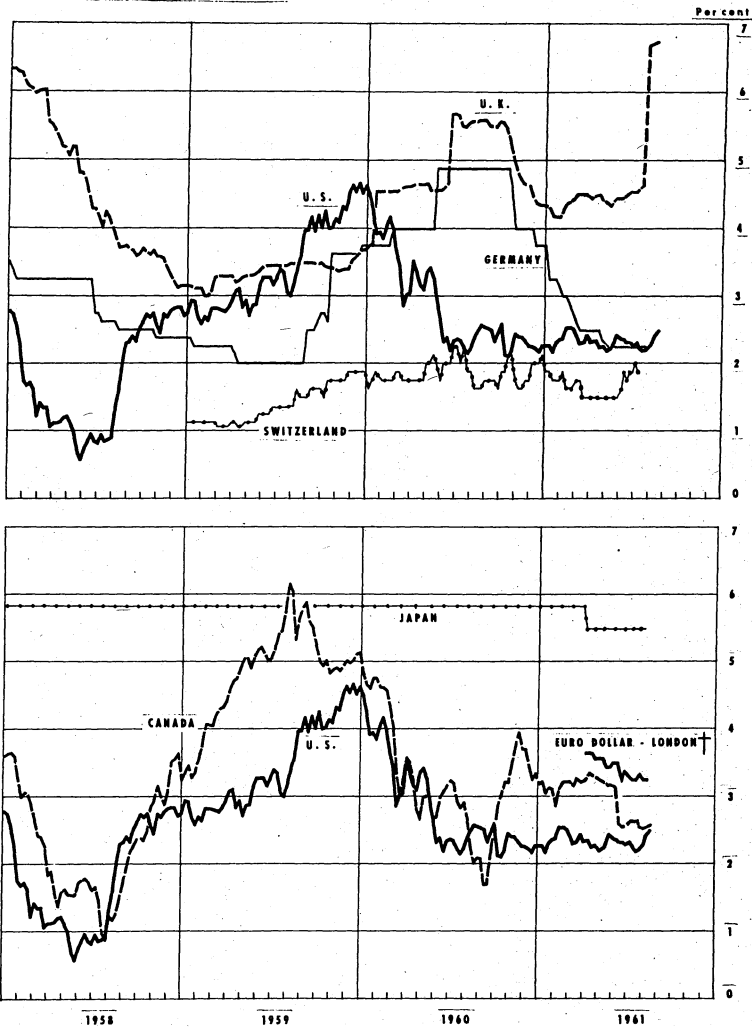
Chart 4

INTEREST ARBITRAGE, FRANKFURT/LONDON

Friday figures



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

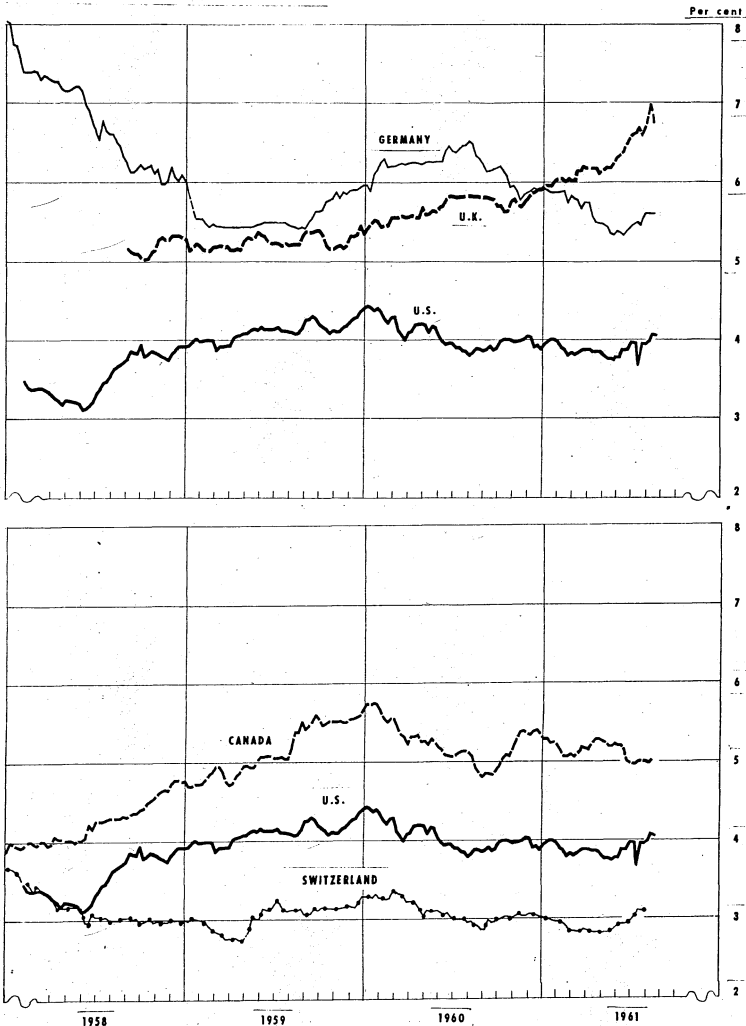
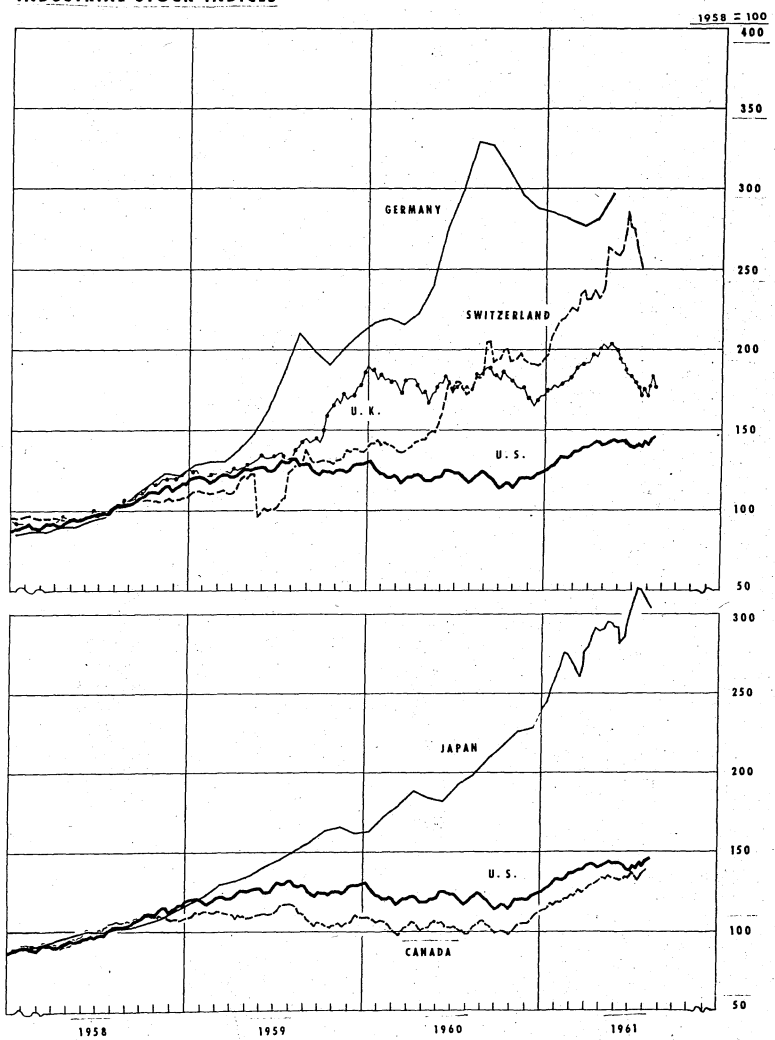


Chart 7

INDUSTRIAL STOCK INDICES *



*

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

Chart 8

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

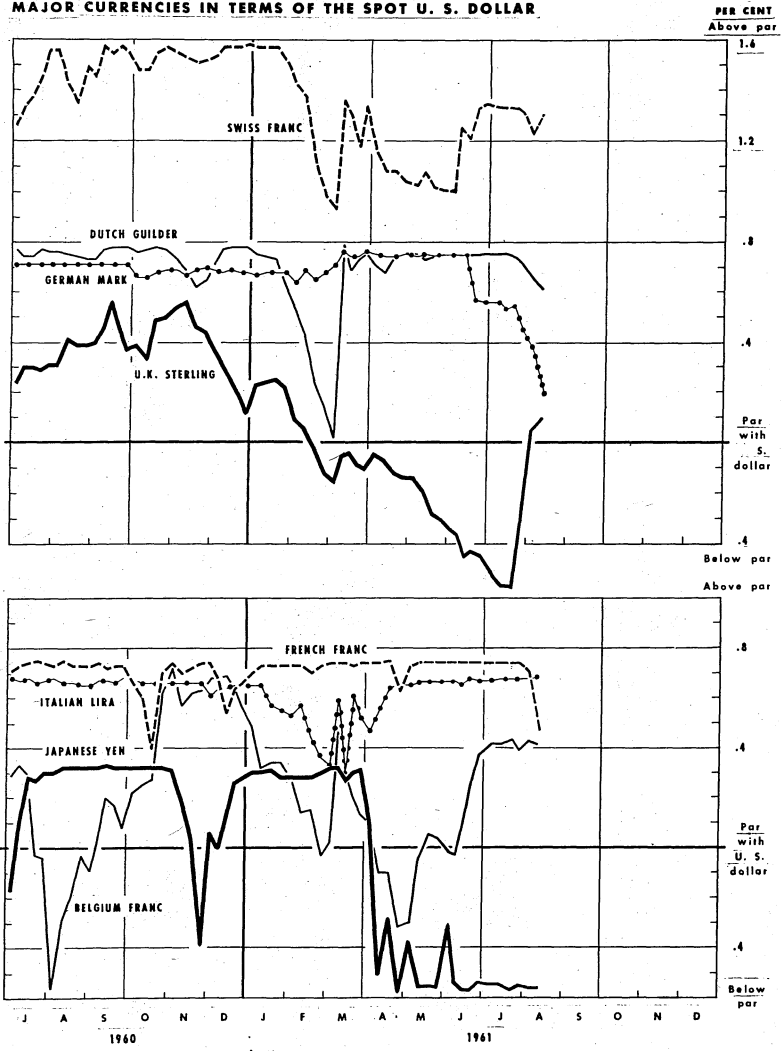


Chart 9

3-MONTH FORWARD RATES - LONDON QUOTATIONS

