DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

H. 13
No. 131

December 11, 1963.

CAPITAL MARKET DEVELOPMENTS ABROAD

I. France
II. Nine Charts on Financial Markets Abroad

France: Money and Capital Markets, August-November, 1963

The French authorities moved decisively in the autumn of 1963 to arrest the increase in French prices with a series of anti-inflation measures announced on September 12 and November 14. A distinct slowing of price rises was achieved in October but was a consequence of direct price controls; Finance Minister Giscard d'Estaing stated that the actions taken to reduce demand pressures may require six months to achieve real stabilization. The rise in the Bank of France discount rate included in the November 14 measures, despite the reported opposition of the Governor of the Bank, led to a rise in some interest rates. (See Table 1.) Official reserve accruals slowed abruptly in October but resumed on a large scale in November. The French trade balance worsened again in September and October but there is no evidence as yet to support statements that the over-all balance of payments surplus has virtually disappeared.

Table 1. France: Selected Interest Rates, July-November, 1963
(at or nearest to end of month)

	July	Aug.	Sept.	Oct.	Nov.
Bank of France basic discount rate	3.50	3.50	3.50	3.50	4.00
Money market: day-to-day money secured by private paper	6.19	3.38	3.56	3.56	5.00
Treasury bills held by banks:					
Auction rates for free investments:					
3-month bills	2.13	2.19	2.13	2.00	2.00
2-year bills	3.13	3.06	3.13	3.10	3.13
Long-term bonds:					
Public sector	5.34	5.36	5.49	5.58	5.54
Corporate	6.01	6.00	5.95	6.16	6.13
Commercial banks:					
Prime lending rate	6.20	6.20	6.20	6.20	1/ 6.45
1-year deposits	2.50	2.50	2.50	2.50	2.50
Deposits with private savings banks	3.00	3.00	3.00	3.00	3.00

1/ Estimated.

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Comprehensive stabilization program is launched

Because monetary action earlier this year had failed to stem the rise in French prices, the French authorities introduced wide-ranging anti-inflation measures in September-November. The credit restrictions imposed last winter and spring slowed down the expansion in money supply from 12-1/2 per cent in March-September 1962 to 8 per cent in the same period of 1963 but they had no apparent effect on price trends. At the consumer level, where inflationary pressures have been strongest, prices in September were 7 per cent higher than a year earlier.

The anti-inflation program has consisted of three basic types of measures:

a. To curtail demand pressures, a number of monetary and fiscal steps were adopted. Under a directive of February 28, 1963, the banks were permitted to increase credit by 5 per cent from March to August and by 7 per cent from September to February (1964). On September 12, the September-February expansion was cut to 5 per cent, and consumer credit terms were tightened. Later, on November 14, increases were made in the Bank of France discount rate and in commercial bank loan rates. (See below.)

On the fiscal side, the estimated 1963 budget deficit was slashed from 7 to 6.22 billion francs by holding down the final supplementary expenditure authorizations. The 1964 deficit will fall to 4.75 billion francs. However, part of this reduction represents merely a shift of about 1.5 billion francs of Treasury loan expenditure to the Caisse des Dépots et Consignations, which will therefore be able to turn over correspondingly fewer resources to the Treasury. To soak up purchasing power, the Treasury floated a 2 billion franc bond issue on September 23.

b. To introduce competitive pressures on French prices, import duties were lowered temporarily on some products on September 12 and on additional items on November 14. To ease the labor market, a decision was made to speed up releases of men from the armed forces.

c. To provide immediate relief from price rises, several "emergency" price measures were adopted. On September 12 factory prices were frozen at August 31 levels, agreements were announced with many producers and distributors to sell at reduced prices until the end of the year in return for tax favors, and prices of government--produced goods and services were either reduced or stabilized. Ceilings on prices or price mark-ups were imposed on some foods and wine on October 9, and on a wide range of services on November 14. Because of these measures, the general index of consumer prices rose only 0.15 per cent in October, or by less than one-third the average monthly increase in the past year.

Discount rate is raised

In an unexpected step, the French authorities raised the Bank of France discount rate from 3-1/2 to 4 per cent on November 14. According to press reports (including the Economist), the rise was opposed by Governor Brunet of the Bank of France. The decision was taken by the 33-man National Credit Council which formulates French monetary policy (of which the Minister of Finance is President and the Governor of the Bank of France is Vice President). This is the first use of the discount rate weapon in the current anti-inflation drive that opened last February; the 3-1/2 per cent rate had been unchanged since October 1960. The rise in Bank rate is designed to achieve two specific effects. On the psychological side, the move is intended to dramatize the determination of the government to ensure the success of the stabilization plan. (Finance Minister Giscard d'Estaing has implied that he is staking his career on the outcome.) In addition, an immediate increase in the cost of commercial bank loans will be effected. The usual French practice is to have minimum rates charged customers on bank loans based on the Bank's discount rate. In this particular instance, the National Credit Council has raised minimum interest rates by 1/4 of 1 per cent (or by one-half of the amount of the discount rate increase). In the past, minimum customer loan rates have usually risen the full extent of the discount rate increase.

At the same time, an increase from 4-1/2 to 5 per cent was promulgated in the penalty rate paid by banks on rediscounts up to 10 per cent in excess of each commercial bank's rediscount ceiling established at the Bank of France. The 6 per cent penalty rate on rediscounts exceeding the ceilings by more than 10 per cent was unchanged as was the preferential 3 per cent rate on rediscounts of export bills, purchases of Treasury bills, and very short-term advances to banks against pledge of government securities.

The French authorities expect that the discount rate hike will not set in motion any significant flow of short-term funds into France from the outside. In the first place, the Paris money market is closed to all but French financial institutions. Second, the French authorities have virtually prohibited short-term foreign borrowings by French businesses by setting a ceiling of 4 per cent on the interest which can be paid. Third, foreigners can receive no interest on franc deposits in French banks.

The French authorities explained that they had delayed the discount rate action until there was a "return to a relative equilibrium on the exchange market." French reserve increases did halt for a time in September-October; however, they have resumed since and there is no evidence that the French external position has yet undergone a basic shift from surplus to equilibrium.

Interest rates moving up

The Paris money market went through three distinct phases during the period under review. There was a general rise in rates in response to the higher discount rate.

From August 1 to mid-September the market for day-to-day money eased: average opening rates for day-to-day money against private paper dropped from 5.26 per cent in July to 4.10 per cent in August and 3.13 per cent in September. (See Table 2.) In this period, banks adjusted their short-term loan portfolios in order to avoid repetition of the liquidity squeeze in which they had found themselves continuously from late May to August 1 when they frequently paid stiff penalty rates on over-the-ceiling rediscounts with the Bank of France because of earlier increases in the banks' minimum liquidity ratio. Even at month-end, after August 1, banks kept their rediscounts within the ceilings.

Table 2. France: Short-term Interest Rates, 1963

I. Day-to-day Money vs. Private Paper

Monthly average		Daily range		
March	3.43	August	1	6.13-6.25
April	3.92	September	4	3.00
May	3.91	October	3	3.00-3.13
June	4.76	November	7	4.25
July	5.26		14	3.50-4.00
August	4.10		21	3.88
September	3.13		28	4.50-5.50

II. Treasury Bills: Auction Rates for Free Investments

		3-mo.	1-yr.	2-yr.
July	25	2.25	2.75	3.13
August	26	2.19	2.81	3.06
September	25	2.13	2.87	3.13
October	25	2.00	2.50	3.10
November	5	2.00	2.88	3.13
	15	2.00	2.13	3.13
	25	2.00	2.88	3.13

Sources: Conseil National du Crédit and Bank of France

Rates tended slightly upward from mid-September to mid-November, in part because French foreign exchange accruals slowed down. The various [illegible] of the stabilization plan announced on September 12 had no direct [illegible] for [illegible] market, and the reduction in the banks' allowed [illegible] credit [illegible] portending [illegible] tighter money market conditions in the future.

[illegible] mid-November quotations for day-to-day money were at 3-3/8 to [illegible] came of the rise in the discount rate from 3-1/2 to [illegible] rate rose immediately to 4 per cent. Because banks [illegible] to rediscounting, the discount rate tends to act as [illegible] under market rates, and market rates fall below the discount rate only when (in periods of easing conditions) rediscounts cannot run off as [illegible] as market conditions would otherwise warrant. Day-to-day money rates [illegible] near 4 per cent for nearly two weeks, but moved up to between 4-1/2 and [illegible] on November 28 as the month-end approached.

At the Treasury bills auctions, changes in rates on bills for free investment were small and generally downward. The discount rate rise seemingly had no effect on these rates. Rates on 2-year bills held almost continously at 3-1/8 per cent, while those on 3-month bills eased and settled at 2 per cent in November. (See Table 2.)

Yields on long-term bonds rose during the period under review, thus reversing the downward trend of the first seven months of the year. In November, yields on public sector bonds (excluding Treasury bonds) averaged 17 basis points higher than in July, and the comparable increase in corporate yields was 13 basis points.

Prices of public sector bonds changed little in August and early September, but the big Treasury bond flotation on September 23 had a depressing effect. Yields rose from 5.37 per cent in the week ending September 13 to 5.49 per cent in the week ending September 27. (See Table 3.) Further price declines pushed yields to 5.58 per cent in early November, after which yields fell back slightly to 5.54 per cent.

Table 3. France: Long-term Bond Yields, 1962-63 1/

		Public Sector 2/	Corporate
Last full week of month			
1962 - March		5.74	6.42
June		5.56	6.23
September		5.50	6.10
December		5.46	6.05
1963 - March		5.43	6.02
June		5.38	6.05
September		5.49	5.95
October		5.53	6.08
Week ending (1963):			
September	13	5.37	5.95
	20	5.45	5.97
	27	5.49	5.95
October	25	5.53	6.08
November	1	5.58	6.16
	8	5.58	6.11
	15	5.54	6.11
	25	5.54	6.13

1/ Redeemable bonds; excluding indexed and participating issues.
2/ Excludes Treasury bonds (which have income tax advantages).

Corporate yields did not change immediately following the Treasury issue, but moved up in October. In November these yields fluctuated between 6.11 and 6.16 per cent, compared with a range of 5.96 to 6.09 per cent in July.

Prices on the Paris stock market declined during most of the period under review as investors interpreted bearishly several of the anti-inflation measures taken by the government. Prices rose in August, but declined 8 per cent over the weeks between September 12 and November 29 to a new low for the year. (See Table 4.) Losses came to 1-1/2 per cent and 2-1/2 per cent, respectively, in the immediate wake of the two anti-inflation packages announced September 12 and November 14. There was no heavy selling at any time, but a persistent absence of demand. The shock of President Kennedy's death was not reflected in any sell-off in Paris.

Table 4. France: Index of French Stock Prices, 1962-63
(weekly index; December 29, 1961 = 100)

1962 - High (April 27)		114.8	1963 - Week ending:		
Low (Nov. 9)		96.3	September	13	97.0
1963 - High (Jan. 4)		104.6		20	95.2
Low (Nov. 29)		89.3	November	8	92.5
1963 - Week ending:				15	91.1
July	26	94.7		22	90.3
August	30	99.4		29	89.3

Source: INSEE

Financial circles supported the stabilization measures as being in the long run interests of the nation. But apprehension was voiced over the possible effects on near-term profits. The plan has put ceilings on prices (for an indefinite "temporary" time) while no action was taken to moderate the rapid uptrend in wage rates. The reductions in tariffs will increase foreign competion in French markets. And there is some feeling that economic growth will be slowed by the monetary and fiscal restraints.

Increased activity in French security markets

Three developments have high-lighted new issue activity in recent months:

a. The volume of new issues in the second quarter was well above a year earlier even excluding the Treasury loan in May;

b. The Treasury in September issued its second long-term loan of 1963; and

c. The French capital market was opened up to limited foreign borrowing in November.

Total net new issues in the April-June quarter of 3.96 billion francs were 67 per cent greater than in the second quarter of 1962. After allowing for the Treasury's 1 billion franc issue of May 20, the remaining net issues of 2.96 billion francs were still 25 per cent greater than a year earlier. (See Table 5.) Yields to the lender on the principal second-quarter bond issues are also shown in Table 5. 1/

Table 5. France: Net New Security Issues, 1962-63
(In millions of francs)

I. Issues by Sector

	1962		1963	
	I	II	I	II
Treasury	--	--	--	1,000
Public authorities	--	10	--	250
Public credit institutions	900	550	1,050	700
National enterprises	1,010	1,530	1,340	330
Competitive sector	1,210	1,530	1,190	1,680
Stocks	(880)	(1,030)	(860)	(1,260)
Bonds	(240)	(440)	(260)	(340)
Participations	(90)	(60)	(70)	(80)
Total	3,120	2,370	3,580	3,960

II. Yields to Lender on Major Loans, Second Quarter of 1963

Groupement des industries agricoles, alimentaires, et de grande consommation "G.I.A.C."	5.70
Crédit National	5.60
Compagnie Générale d'Electricité	5.69
Treasury (coupon rate 4-1/4 per cent) 1/	4.49
Groupement des industries mécaniques "G.I.M.E.C.A."	5.70
P.T.T. (gov't postal and telecommunications agency)	5.60

1/ Interest exempt from personal income tax.
Source: Conseil National du Crédit

The second Treasury loan of 1963 floated on September 23 (the second since 1958) was designed, as was the May loan, to absorb purchasing power. The September loan was for 2 billion francs (twice the size of the May loan) for 20 years, and was sold at par for cash only. The coupon rate rises from 4-1/4 per cent in the first 10 years to 4-3/4 per cent in the last ten. Redemption will be by lot over the second 10 years, and the redemption price rises from 105 in the eleventh through fifteenth year to 107-1/2 in the final five years. Again, there is a large tax advantage to the investor, as interest is exempt from personal income tax in the first 10 years. The loan was fully subscribed.

On November 14, the Finance Minister announced that France was abandoning its long-standing total prohibition of foreign flotations in Paris. International institutions have already begun to borrow, and later foreign

1/ The coupon rate on the Treasury May loan is 4-1/4 per cent, and not 4-1/2 per cent as reported in the paper in this series dated August 7, 1963.

governments will be permitted to raise long-term funds in France. It is not known how liberal the authorities will be in terms of the amount of loans they will sanction, or whether private borrowers will ultimately be given access also.

The first loan is being placed by the European Investment Bank for 60 million francs ($12.1 million) for 20 years beginning December 20, 1963. The coupon rate is 5 per cent, but the bonds were offered at 94.5 for payments received by December 20 and at 94.9 for payments received by January 20, 1964. Subscriptions, which opened on November 25, are restricted to French insurance companies and other institutional investors, but the bonds will later be traded on the Paris Bourse. One-fourth of the bonds will be retired at par at the end of 5, 10, 15 and 20 years; at the end of the tenth year, bondholders may obtain advance repayment of the remaining obstanding bonds at a price of 98.33 and surrender of the tenth year's 5 per cent annual coupon. If bondholders do not exercise this privilege and if they pay for the bonds by December 20, the average yield to maturity at time of issue works out at 5.73 per cent. This is very close to yields on recent new issues of public sector bonds in France (excluding Treasury bonds, which have income tax advantages).

Earlier, on September 22, the authorities gave permission for the creation of open-end investment trusts in accordance with the recommendations by the Lorain Committee last June to increase the flow of French savings into long-term securities. The legal provisions for these trusts are more liberal than was expected. At least 30 per cent of total assets must be in some combination of corporate bonds, government bonds, Treasury bills, and bank deposits (all denominated in French francs). At least 90 per cent of all assets must consist of these items plus other negotiable securities quoted on a stock exchange, either in France or abroad, and not necessarily denominated in French francs. These provisions allow ample scope for purchases of foreign issues. (Individual investors are free to purchase foreign securities.)

Reserve accruals pick up again in November

French official reserve accruals slowed down abruptly in September and October, but increased again in November. Although the balance of payments surplus may have been reduced, there is no evidence that it has moved into equilibrium, as some French reports have implied.

Adjusted official reserve gains dropped from $183 million in July to $81 million in August. (See Table 6.) These results reflected the changes in the foreign borrowing and lending operations of the French commercial banks: their net foreign borrowing rose by $110 million in July and then fell by $7[illegible] million in August. These changes in turn reflected the banks' internal liquidity needs, which were severe in June-July and then eased.

Reserve gains dropped off sharply in late September, and from September 26 to October 24 Bank of France holdings showed no net change. The adjusted increase in total official reserves (i.e., including the Exchange Stabilization Fund) was $54 million in September, and $17 million in October. Two events of a transitory character contributed to this slowing down:

Table 6. France: Reserves and Balance of Payments, 1962-63
(In millions of dollars)

	Change in: Adjusted official reserves 1/	Change in: Commercial banks' net foreign position	Balance of payments surplus
1962			
Qtr. I	+264	- 1	400
II	+413	- 89	389
III	+403	- 43	286
IV	+198	+ 40	210
1963			
Qtr. I	+388	-157	217
II	+325	+ 20	400
III	+318	- 40	n.a.
July	+183	-109	n.a.
August	+ 81	+ 76	n.a.
September	+ 54	- 7	n.a.
October	+ 17	n.a.	n.a.
November	+ 79	n.a.	n.a.

1/ Adjusted for changes in IMF position, advance debt redemption, subscriptions to international organizations by franc area countries of $22 million in September 1963, and transfer of $8 million of IBRD certificates out of reserves in April 1963.
Sources: Ministry of Finance, IMF and OECD.

a. On August 7 the French authorities adopted more stringent criteria on foreign borrowings by French business firms. Under the tighter regulations, fewer new loans were allowed and maturing loans could not be renewed. Earlier such borrowing had greatly increased when domestic credit ceilings were placed on French banks.

b. In addition, leads and lags in trade payments (which earlier had been very favorable to France) shifted against her.

The resumption of reserve accruals that began in late October continued in November, when the increase for the month was $79 million. No special transactions occurred in November, and it is not thought that the discount rate pulled in any short-term funds.

The over-all French <u>balance of payments</u> surplus of $617 million in the first half of 1963 was nearly as large as the $697 million surplus in the same period of 1962. The current surplus dropped very sharply from $483 million to $239 million. As was to be expected from the customs statistics, payments for imports rose much more (17 per cent) than did receipts from exports (11 per cent), and the surplus on services was also reduced. But private long-term capital inflow increased from $174 million to $268 million, because of heavy repatriation of French capital abroad in the form of securities and loans, and the surplus on errors and omissions jumped from $70 million to $137.

The surplus in the third quarter of 1963 may be estimated at $278 million on the basis of a $318 million adjusted increase in official reserves and a $40 million increase in the net foreign liabilities of the commercial banks. This estimated figure is nearly identical with the $286 million actual surplus realized in the third quarter of 1962.

After seasonal adjustment, France's foreign trade balance worsened severely in September and again in October. The deficit (imports valued c.i.f.) rose from an average of $20 million in July-August to $83 million in September and $122 million in October. Imports in October were up 17 per cent from July-August, a jump which came on the heels of the tariff reductions in mid-September. October exports were up 3-1/2 per cent over July-August.

Because the unadjusted trade balance showed little variation in these months, trade movements apparently played little role in the September-October slowing of reserve gains.

The exchange rate for the franc slipped below its upper limit against the dollar on September 24 and continued to trade just below the ceiling through October 24. It returned to the upper limit on October 25 and remained there through November.

The price of the Napoleon gold coin rose from 41.60 francs on July 24 to 42.80 francs on November 27, an increase of 2.9 per cent. In early September the approach of the IMF annual meeting engendered uneasiness over the gold content of the dollar which caused a rise in Paris gold prices. Most of this rise was erased upon the announcement of French stabilization measures on September 12. A new outburst of strikes in the public services in France was believed to be behind a firming of prices in late October and early November.

European and British Commonwealth Section

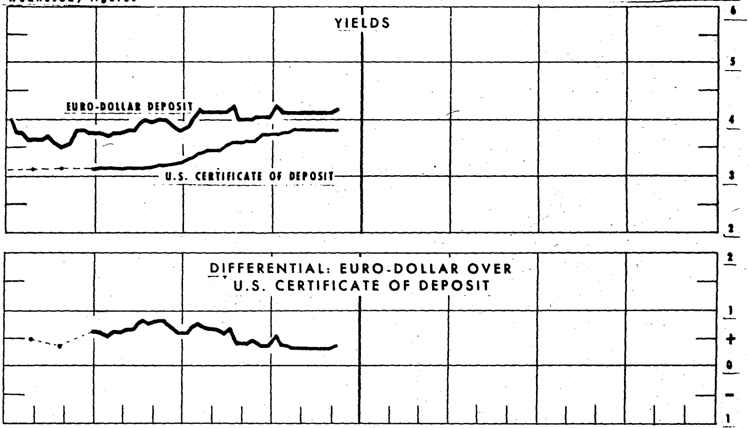
Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

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

Wednesday figures

Per cent per annum



NEW YORK OFFER RATES ON SELECTED 3-MONTH INVESTMENTS

Friday figures

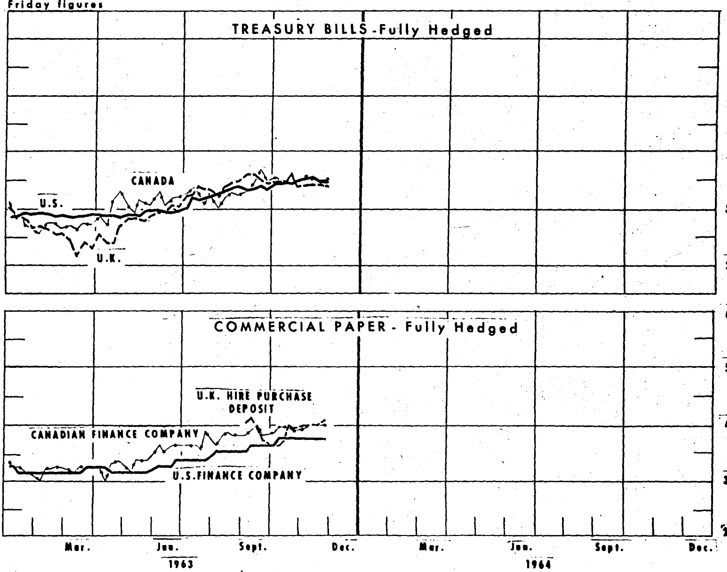


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Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

Per cent per annum

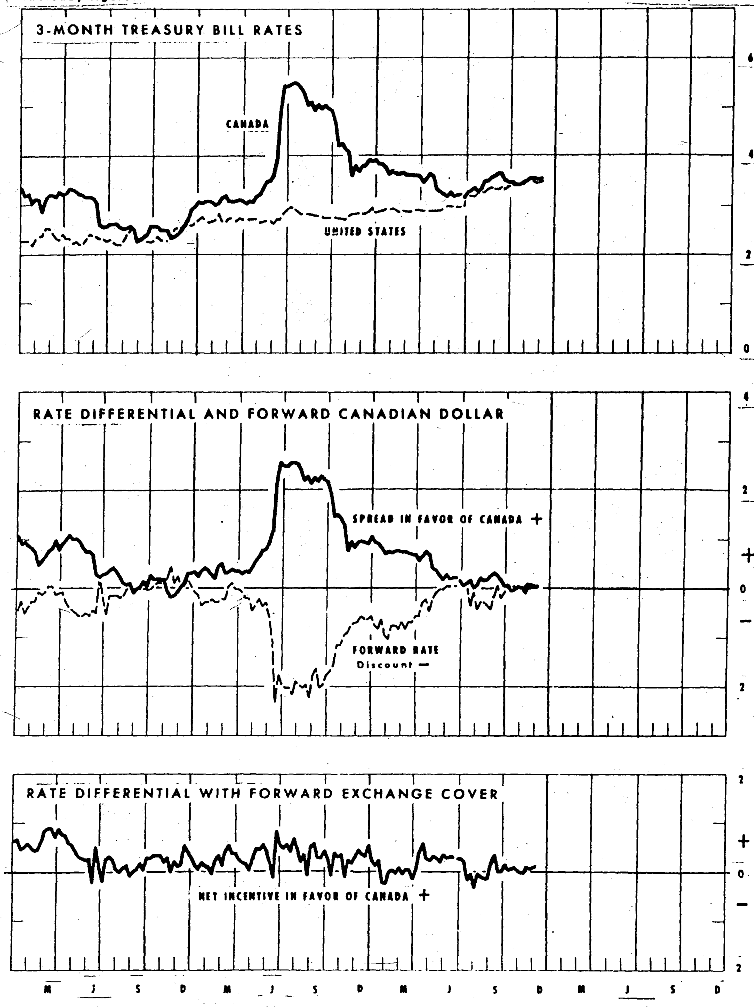

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

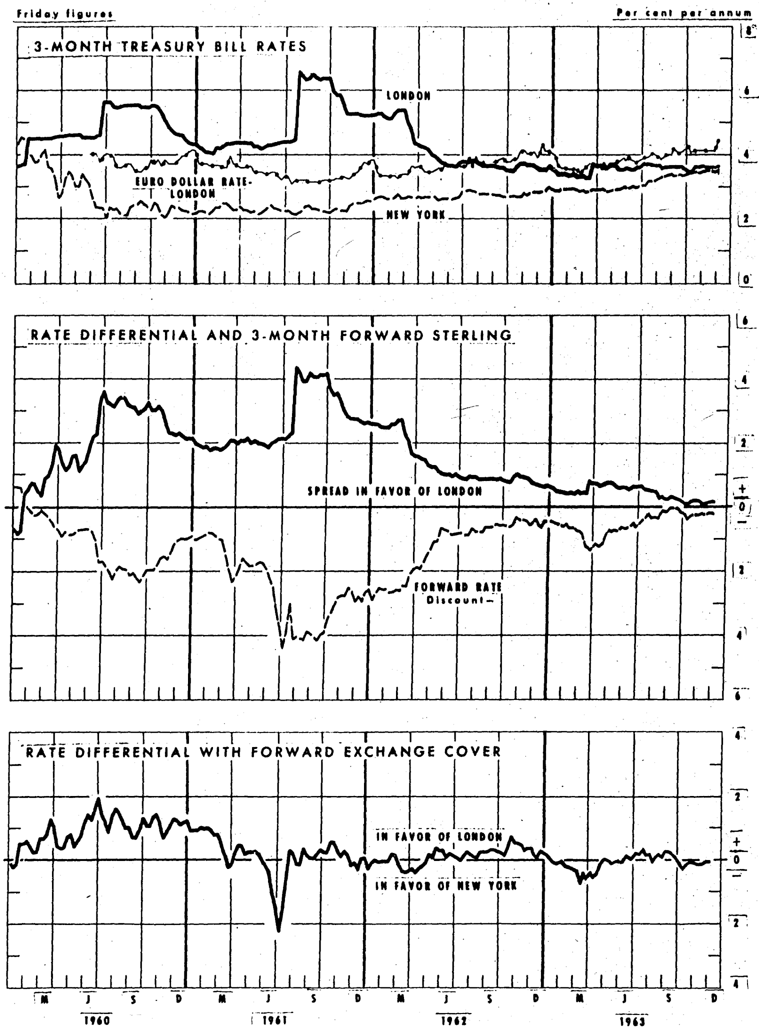

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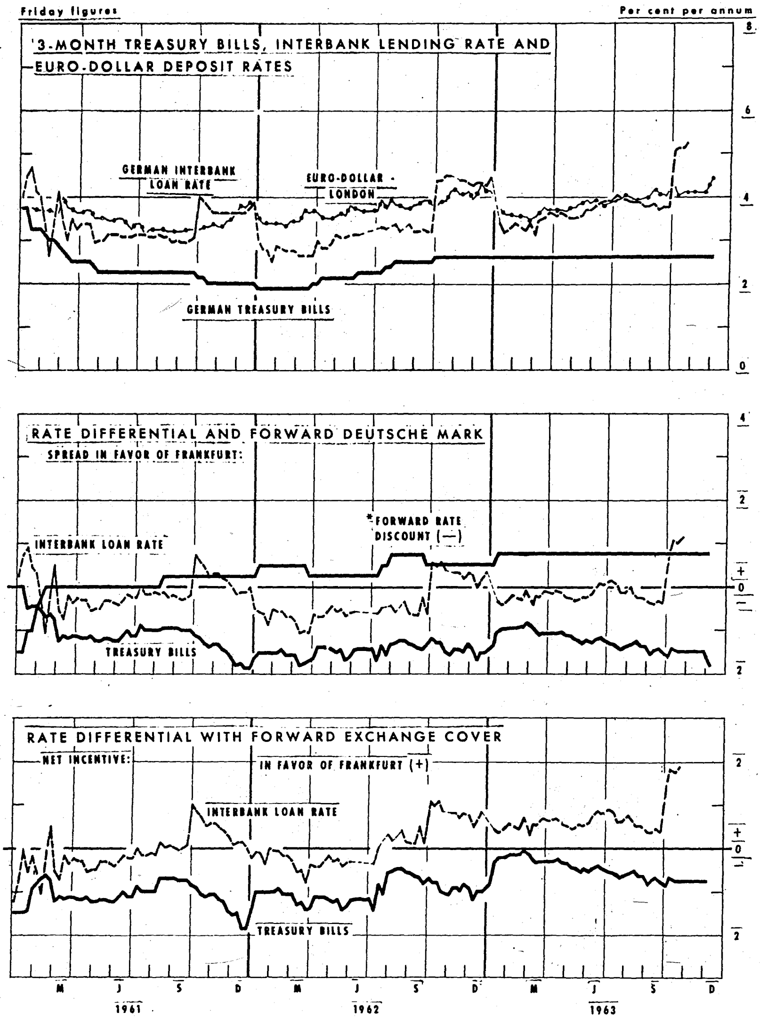
Chart 4

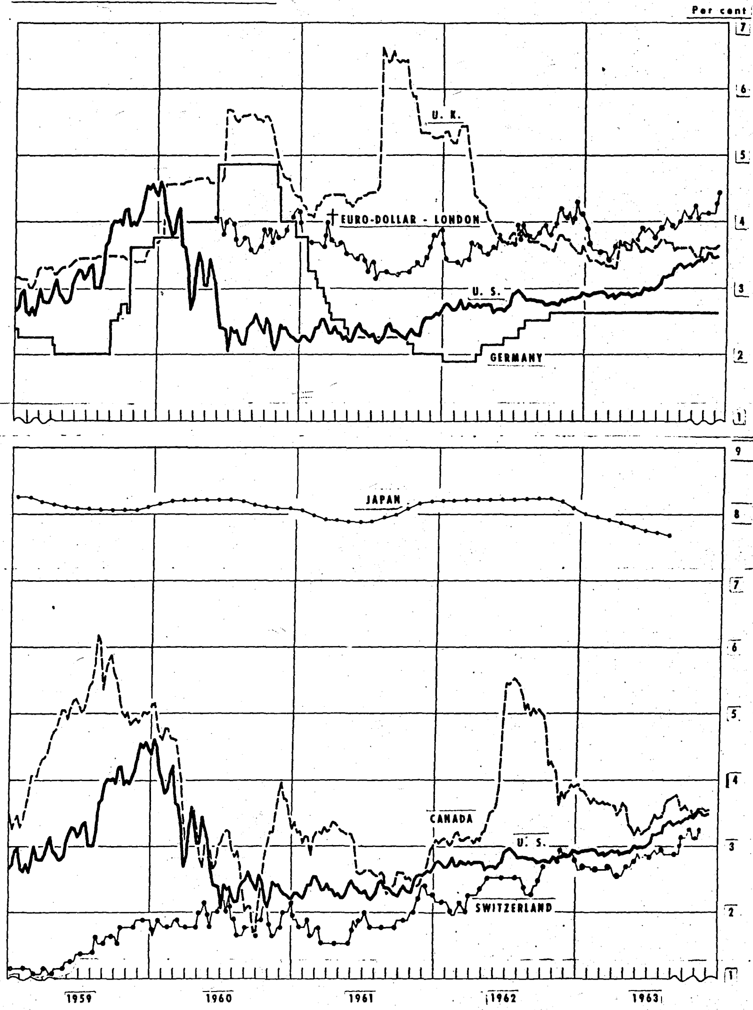
INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS



*Note: Special forward rate available to German commercial banks.

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

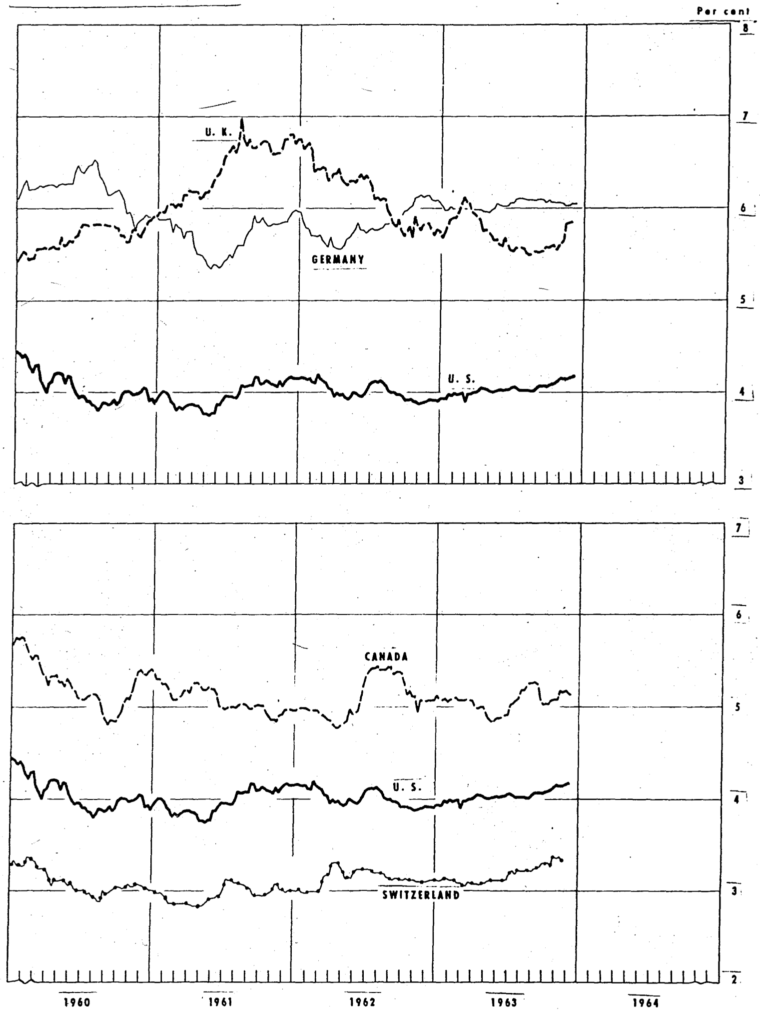
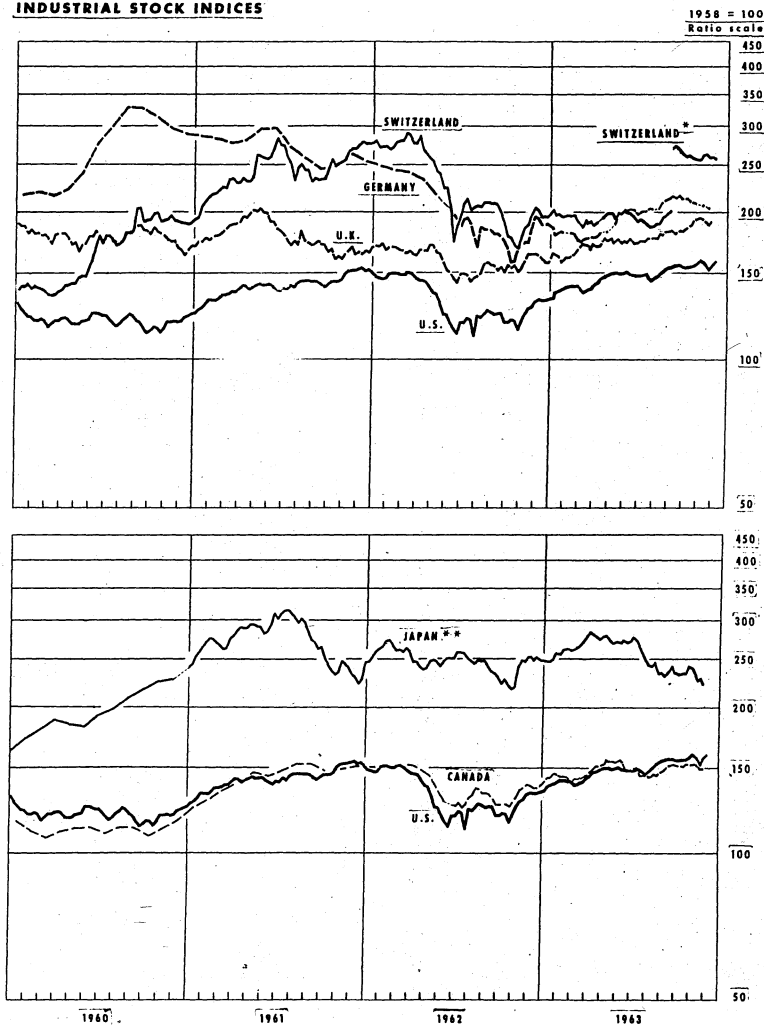


Chart 7

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

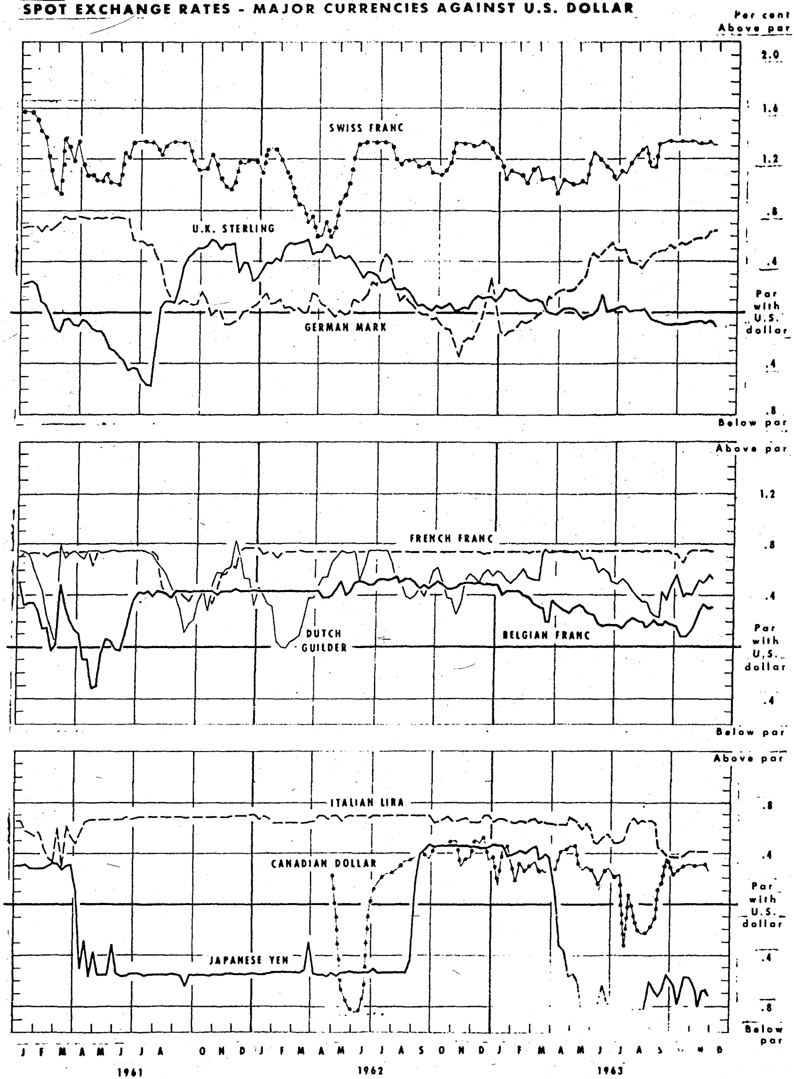

Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures