DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
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CAPITAL MARKET DEVELOPMENTS ABROAD

FEB 11 1964

I. Germany
II. Nine Charts on Financial Markets Abroad

Germany: Money and Capital Markets, November 1963-January 1964

Continued heavy purchases by foreign investors of new offerings of Federal agency bonds was the dominant factor affecting German financial markets from November through January. The capital inflow had the effect of pushing down yields in the German bond market and contributed to the heavy volume in the stock market. The yield on the 5-1/2 per cent Federal Railways bond (1958-83), for example, declined by 19 basis points in the month of January, as may be seen in the following table (yields in per cent per annum):

December 1963		January 1964	
6	6.05	3	6.04
13	6.02	10	6.01
20	6.03	17	5.89
27	6.03	24	5.85
		31	5.84

By late January, a decline in the coupon on new bond offerings from 6 to 5-1/2 per cent had been realized. In addition, stock prices rose 5 per cent during the first three weeks of January.

These security purchases contributed substantially to the re-emergence of a very considerable balance of payments surplus which exceeded $1.0 billion for the first eleven months of 1963 (compared with a year-ago deficit of $16 million). Foreign demand for German currency from the capital inflow and from a renewed large trade surplus pushed the D-mark close to the official upper limit and produced heavy official accumulations of foreign exchange. In 1963, for example, the Bundesbank's official reserves rose by $655 million.

Because of the renewed reserve accruals, the German authorities took action in three major fields during the period under review. First, to bring to an end rumors in the exchange markets of a second revaluation of the D-mark, the Bundesbank's Council issued a public statement on January 24 that the current situation warranted neither the taking of monetary policy measures nor a change in foreign exchange policy.

Secondly, to curtail the long-term capital inflow, the government bond consortium reduced the coupon on a new Federal agency offering in early February from 6 to 5-1/2 per cent and put into effect a new policy of delayed foreign participation. This issue (a 5-1/2 per cent, DM 270 million of the Federal Railways priced to yield about 5.8 per cent) will be opened

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to domestic subscribers on February 5 but to foreign subscribers only on February 11. Prior to this decision, the German press had speculated that an outright prohibition of purchases by foreign investors might be established.1/ It will be interesting to see how successful this six-day delay will be in preventing foreign bidding for the new bonds, especially at a time when the general trend in German bond yields is downward. It will offer a possibility to test domestic demand at the lower coupon. In any case, if foreign demand continues, it will help to push market prices of new bonds upward (perhaps above the issue prices) and, in this way, accelerate the decline in German bond yields. Because of his fears that restrictive actions were in the making, the Chairman of the Capital Issues Committee recently spoke in favor of measures to encourage an outflow of German capital rather than action to block the inflow of foreign funds.

Thirdly, the authorities took steps to reduce official reserve accruals as they had in 1962: in late November, in particular, they sought to discourage German commercial banks from repatriating funds from foreign financial centers. The Bundesbank raised the repurchase prices for Treasury obligations to encourage sale prior to maturity as an alternative to the repatriation of funds from abroad. They also made available to the banks short-term Treasury notes (30 to 59 day) which could be timed to meet the banks' year-end liquidity needs. These steps and the unusually early commercial bank preparations in November help to explain why money-market conditions in Germany were unexpectedly easy during the period under review.

Money market unexpectedly easy at year-end. An ample supply of funds, together with early and extensive preparations by the commercial banks for their year-end liquidity needs, kept conditions in the German money market unexpectedly easy during the final two months of 1963. The Bundesbank raised its repurchase prices for Treausry obligations at the end of November to encourage the banks to cash in domestic securities instead of repatriating foreign balances. For the same reason, it also made available to the banks short-term (30 to 59 day) Treasury notes to enable the banks to meet window-dressing needs. The range in the rates for call money at Frankfurt banks during December was slightly lower than the range for the year as a whole and somewhat below previous Decembers. (See Table 1.)

In January the money market became seasonally easier: according to the Frankfurter Allgemeine Zeitung, call money was as low as 1-7/8 to 2-1/8 per cent at mid-January, largely due to seasonal factors. At the end of the third week of the month call money rates turned up sharply, again in line with the usual seasonal movements.

Sharp drop in bond yields in January. During January government bond yields declined sharply and interest rates began to move to a lower level. From November to mid-January, Federal government security issues with a 6 per cent coupon continued to meet an active demand. (See Table 2.)

1/ Frankfurter Allgemeine Zeitung, January 25, 1964 and prior issues.

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Table 1. Germany: Money Market Rates in Frankfurt, October, 1963-January, 1964 a/

(in per cent per annum)

		Day-to-day money	Three-month loans
October	1- 7	3-1/4 - 3-3/4	5 - 5-1/8
	8-15	2-1/2 - 3-1/4	5 - 5-1/4
	16-23	2-5/8 - 2-7/8	5 - 5-1/4
	24-31	2 - 2-7/8	5-1/4
November	1- 7	2-1/2 - 3-1/8	5-1/8
	8-15	2-3/8 - 2-5/8	4-7/8 - 5-1/8
	16-23	2-5/8 - 3-1/8	4-7/8 - 5
	24-30	2-1/2 - 3-1/8	4-7/8 - 5
December	1- 7	2-7/8 - 3-1/8	4-7/8 - 5
	8-15	2-5/8 - 2-7/8	5 - 5-1/4
	16-23	2-3/4 - 3	5
	24-30	2 - 2-7/8	4-7/8
	31	5 - 5-1/2	

a/ Highest and lowest rates quoted each week by Frankfurt banks.
Source: Deutsche Bundesbank

Table 2. Germany: Gross Placements in Security Markets 1/ (millions of DM, month or monthly average)

	1962		1963					
	III	IV	I	II	III	Sept.	Oct.	Nov.
"Occasional" borrowers bonds:								
Industrial	113	60	143	88	166	157	2	25
Public authorities	358	187	489	451	328	101	546	677
Foreign issuers	--	--	32	--	--	--	--	--
Other bonds 2/	154	57	259	153	180	149	259	66
Total	625	304	923	692	674	407	807	768
Mortgage and communal bonds	532	480	652	578	575	516	647	639
Total gross bond placements 3/	1,157	784	1,575	1,270	1,249	923	1,454	1,407
Gross share placements	172	170	155	51	117	69	194	43
Total security placements at issue value	1,329	954	1,730	1,321	1,366	992	1,648	1,450

1/ Market value.
2/ Mostly bonds of specialized credit institutions.
3/ Includes medium-term notes (Kassenobligationen).
Source: Deutsche Bundesbank Monthly Report, Table V, 6.

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In mid-November a Federal Railways 12-year, DM 265 million issue at 6 per cent was quickly taken up with considerable foreign participation.

Lower rates were foreshadowed in mid-December by Shell's DM 125 million, 15-year conversion loan with a 5-1/2 per cent coupon offered to yield 5.8 per cent to maturity. However, the European Investment Bank's first venture into the German market with a 5-1/2 per cent, DM 60 million issue offered to yield 5.68 per cent did not seem to attract private investors even with its tax exemption and short maturity features, and it was very probably placed with the banks and institutional investors.

Bond yields moved lower in January as prices rose. (See Table on page 1.) An early January Federal government 6 per cent loan was quoted as high as 101-5/8 soon after issue and the DM 100 million, 10-1/2-year Osaka loan, which was issued to yield 6.54 per cent, quickly rose to 102.

The Federal Railways have announced a DM 270 million issue for February 5. The 11-year bonds carry a coupon of 5-1/2 per cent and yield approximately 5.8 per cent. Foreigners will be able only to subscribe from February 11 on the part of the issue not taken up domestically. Earlier German mortgage banks had discontinued their offerings of 6 per cent bonds as they reportedly prepare 5-1/2 per cent bonds for issue. The Equalization of Burdens Bank will test the market reaction to a 5-1/2 per cent coupon on January 28th with a shorter maturity issue, the outcome of which will very likely influence the rate on subsequent government issues. The Bundesbank, which would like to see the rate fall for balance of payments reasons, recently arranged the sale of DM 300 million of 3 and 4-year government notes (Kassonobligationen) with effective yields of 4.9 and 5.2 per cent respectively, a small decline from year-end rates. It is significant that the market took them up immediately upon offer despite this small decline.

Federal budget for 1964 remains restrictive. In order to help reduce inflationary pressures from the government sector, the 1964 Federal budget holds expenditures down to a level commensurate with the expected growth in GNP. The main increases in outlays are for military spending and social benefits. The Treasury's borrowing needs for 1964 are now estimated at the DM 2.2 billion raised in 1963. However, the final settlement of the share the Federal Government is to get from the income taxes collected jointly with the State governments, (at 39 per cent or one percentage point below that budgeted) may add a further DM 0.4 billion to this figure, although the Finance Minister has stated that there should not be any recourse to the capital market for this additional amount.

Throughout 1963 fiscal policy remained restrictive, as it has been for the past few years. Although public transactions drew upon the liquidity of the private sector more heavily during the first half of the year than in the second half, the domestic government cash surplus for the first nine months of the year was about the same as the DM 3.8 billion for the same period in 1962. The large first-half government surplus, in part, reflected delays in outlays on government investment projects because of the bad winter weather. Public spending increased for the third quarter, and the Federal deficit was DM 1.8 billion or, adjusted for foreign transactions, DM 0.6 billion compared with a DM 0.1 billion deficit for the same 1962 period.

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Stock market moves up in January. In the German stock market prices continued to move lower in November with foreign selling contributing to the downward pressure. Sales by U.S. investors were believed to be prominent, some sales being motivated by tax considerations, however. Spreading optimism regarding business prospects shored up the market during December as the F.A.Z. general stock index remained relatively stable.

A bullish New Year market pushed the F.A.Z. index up 5 per cent during the first three weeks of the year, and on January 13 it passed the 1963 high recorded on September 9. (See Table 3.) Increased market activity has been attributed to wider investment buying from both domestic and foreign sources, especially Swiss sources. A very successful $15 million capital stock issue by the large German firm, Kaufhof, could encourage new stock issues by other firms in the near future; during the July-November 1963 period new capital stock issues were only approximately one-half the volume of the last six months of 1962.

Table 3. Germany: Stock Index, June 1963-January 1964 a/
(December 31, 1958 = 100)

All time high:	Aug. 31, 1960	264.60	1964 high:	Jan. 15	197.71
1963 high:	Sept. 9	194.81	1964 low:	Jan. 2	189.08
1963 low:	Feb. 26	151.54			

1963	June	28	178.96		Nov.	22	181.43
	July	26	181.90			29	180.80
	Aug.	30	191.10		Dec.	6	183.79
	Sept.	27	191.89			13	182.72
	Oct.	31	186.05			20	183.66
	Nov.	1	186.52			31	187.71
		8	183.77	1964	Jan.	3	190.98
		15	184.96			10	193.73
						17	197.14

a/ General stock index.
Source: Frankfurter Allgemeine Zeitung.

Foreign trade surplus very high

Recently released figures show Germany's 1963 merchandise trade surplus just below the 1961 all-time high at DM 6 billion ($1.5 billion) as compared with DM 3.5 billion in 1962.

The foreign trade balance increased sharply in the fourth quarter as exports continued to rise over previous monthly levels and imports declined slightly from the September level. The seasonally adjusted monthly average for fourth-quarter exports rose by more than 5 per cent over the

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third quarter average while imports actually decreased by 2.5 per cent (because of a decline in government imports of military equipment). (See Table 4.) As a result, the fourth quarter trade balance was about 50 per cent larger than the already high third quarter trade surplus.

Table 4. Germany: Merchandise Trade, 1962-1963
(seasonally adjusted, monthly averages, in billions of DM)

	1962			1963					
	II	III	IV	I	II	III	IV	Nov.	Dec.
Exports	4.46	4.45	4.39	4.37	4.83	4.98	a/5.25	5.12	a/5.36
Imports	b/ 4.09	4.19	4.20	4.15	4.35	4.52	a/4.41	4.41	a/4.28
Trade balance	b/ .37	.26	.19	.22	.48	.46	a/ .84	.71	a/1.08
Industrial goods Imports	b/ 2.80	3.02	3.09	3.07	3.26	3.32	c/	c/	c/

a/ Estimate.
b/ Change in import accounting procedure raised imports for the first quarter, 1962 by DM 0.124 billion (monthly rate) and those for April by a negligible amount.
c/ Not available.
Source: Bundesbank, Monthly Report.

Two recent developments will very probably enhance a continuation of the German foreign trade surplus. In December the Bundesrat (Upper House of the German parliament) passed a bill raising the turnover tax rebate on export sales of some 200 selected industrial items from the existing range of 1 to 3 per cent to a range of 4 to 5 per cent retroactive to July 31 of last year. This will make it slightly easier for the German exporter to compete abroad and especially benefits the steel, textile and leather industries. These measures merely add to Germany's trade surplus and have the same effects on Germany's international competitive position as an equivalent devaluation of the D-mark.

Balance of payments in continued substantial surplus. Early in 1963, heavy private capital inflows pushed the German balance of payments into surplus; after mid-year, however, the growing trade surplus became the more important factor in the balance of payments surplus. The third quarter merchandise trade balance was DM 1,558 million compared with net capital inflows of DM 1,268 million. (See Table 5.) The third quarter balance of payments surplus was DM 1,156 million, slightly below the second quarter. Although the merchandise trade balance and the long-term capital inflows were not much changed between October and November, November's balance of payments surplus was off sharply from the previous month's total primarily because of a large transfer of funds to Germany's frozen military purchases account

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in the United Kingdom. The German eleven-month balance of payments surplus for 1963 was an unexpectedly large DM 4,071 million ($1 billion) compared to a DM 65 million ($16 million) deficit during the first eleven months of 1962.

Table 5. Germany: Balance of Payments 1962-November 1963
(in millions of DM)

	Jan. - Nov.		1 9 6 3				
	1962	1963	I	II	III	Oct. a/	Nov. a/
1. GOODS & SERVICES							
Trade balance	3,018	b/ 5,055	572	1,265	1,558	820	840
Services	- 960	-1,088	53	- 471	- 878	29	179
Total	2,058	3,967	625	794	680	849	1,019
2. OFFICIAL PAYMENTS							
Donations	-3,165	-3,124	-931	- 911	- 845	-215	-222
Long-term capital	- 754	- 789	- 96	- 256	- 88	-120	-229
Short-term capital	- 103	- 88	219	100	141	- 23	-525
Total	-4,022	-4,001	-808	-1,067	- 792	-358	-976
3. PRIVATE CAPITAL							
Securities transactions							
Foreign purchases 1/			700	731	703		
German purchases	996	3,037				315	273
(increase-) 2/			-161	- 48	- 100		
Other long-term			205	268	151		
Short-term 3/	- 124	1,043	78	278	205	495	- 13
Errors and omissions	1,027	25	183	286	309	-533	-220
Total	1,899	4,105	1,005	1,515	1,268	277	40
SURPLUS OR DEFICIT (-)	- 65	4,071	822	1,242	1,156	768	83

a/ Preliminary.
b/ A change in import accounting procedure has resulted in approximately DM 400 million of goods in bonded warehouses being included in the first 4 months imports. This is offset in errors and omissions.
1/ Foreign purchases of German securities.
2/ German purchases of foreign securities.
3/ Includes commercial bank capital other than foreign exchange assets.

Source: Basic data from Bundesbank and International Financial Statistics rearranged by author.

German foreign reserves increase

The large 1963 balance of payments surplus increased Germany's over-all international reserves by $887 million for the year compared with a decrease in 1962 of $183 million. But November and December reserve increases were much less favorable than the year as a whole due to large official payments abroad. In November an unusually large payment to the

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United Kingdom was made (see above page 6), and in December the usual year-end prepayments for military equipment were made both to the United States and United Kingdom (estimated at around $250 million). The Bundesbank's holdings of gold and foreign exchange increased by $655 million during the year.

The reverse flow of funds from Germany expected in the early weeks of 1964 was not as great as the decline in commercial bank foreign exchange during the November-December period. The Bundesbank lost about $185 million in foreign exchange between January 1 and 15, about $100 million less than the decrease in commercial bank foreign exchange holdings during the last two months of 1963. From January 16 to 23, the Bundesbank's holdings increased by $65 million as a result of the underlying payments surplus.

Deutche Mark in heavy demand.

The D-mark was heavily demanded on the foreign exchange markets during the final two months of the year, and its rate against the dollar rose to the year's high of 25.171 cents to the mark on December 6. (See Table 6.) The strong demand for the mark in early November and December, reflected the commercial bank's usual year-end operations, Germany's trade surplus and foreign investor interest, especially in bonds. The Bundesbank stayed in the market continuously during December, taking in considerable dollar amounts to take the pressure off the D-mark rate.

Table 6. Germany: Exchange Rate in U.S. Cents per DM and forward in % per annum
(noon buying rates)

Par value	25.000
Upper limit	25.188
Lower limit	24.875

		Spot	Forward			Spot	Forward
October	4	25.138	-0.09	December	6	25.171	-0.20
	11	25.132	+0.22		13	25.170	-0.18
	18	25.138	+0.09		20	25.163	-0.17
	25	25.143	+0.04		27	25.159	+0.04
November	1	25.145	-0.20	1964			
	8	25.149	-0.05	January	3	25.136	+0.85
	15	25.156	-0.11		10	25.130	+0.80
	22	25.158	-0.20		17	25.157	+0.60
	29	25.161	-0.25		24	25.168	+0.85

Source: Federal Reserve Board.

In 1964, the dollar quotation for the D-mark fell rather sharply from its mid-December high as the reversal of commercial bank funds got under way, and the Bundesbank entered the market, this time as a buyer of D-marks. At the same time, the premium on the 3-month forward mark rose considerably to 0.85 per cent, indicating the desire for cover for the short-term capital outflows.

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Persistent rumors that the Deutsche mark might be revalued heightened at mid-January with the meeting of the Deutsche Bundesbank council. At the conclusion of its meeting, the council issued a firm statement that there was no need for any new monetary or foreign-exchange policy measures. Separately, Economics Minister Schmuecker labeled such rumors "absolutely absurd".

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

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Table 8. Germany: Selected Money Market Yields and Exchange Rates
(per cent per annum)

		3-mo. Euro-dollar deposits London	3-mo. inter-bank loans Frankfurt	Spread in favor London	3-mo. U.S. $ into Marks		3-mo. Treas. bills		
					Comm. bank a/	Market	U.K.	Ger.	U.S.
1963-Jan.	25	3.59	3.25	+0.34	+0.75	+0.3	3.41	2.63	2.93
Feb.	22	3.44	3.38	+0.06	+0.75	0.0	3.34	2.63	2.87
Mar.	29	3.69	3.63	+0.06	+0.75	+0.1	3.66	2.63	2.92
Apr.	26	3.72	3.50	+0.22	+0.75	0.0	3.76	2.63	2.89
May	31	3.84	3.69	0.25	+0.75	-0.3	3.61	2.63	3.00
June	28	3.84	3.88	-0.04	+0.75	-0.3	3.63	2.63	2.99
July	26	4.00	3.88	+0.12	+0.75	+0.1	3.69	2.63	3.20
Aug.	30	4.00	3.75	+0.25	+0.75	+0.2	3.62	2.63	3.38
Sept.	27	4.09	3.75	+0.34	+0.75	-0.2	3.54	2.63	3.34
Oct.	25	4.12	5.25	-1.13	+0.75	-0.2	3.61	2.63	3.43
Nov.	8	4.12	5.12	+1.00	+0.75	0.0	3.61	2.63	3.53
	15	4.12	5.00	+0.88	+0.75	-0.1	3.61	2.63	3.52
	22	4.12	4.94	+0.82	+0.75	-0.2	3.61	2.63	3.48
	29	4.12	4.94	+0.78	+0.75	-0.2	3.61	2.63	3.47
Dec.	6	4.44	4.94	+0.50	+0.75	-0.2	3.64	2.63	3.49
	13	4.62	5.12	+0.50	+0.75	-0.2	3.61	2.63	3.49
	20	4.62	5.00	+0.38	+0.75	-0.2	3.61	2.63	3.51
	27	4.25	4.88	+0.63	+0.75	0.0	3.61	2.63	3.50
1964-Jan.	3	4.12	n.a.	n.a.	+0.75	+0.8	3.61	2.63	3.51
	10	4.00	n.a.	n.a.	n.a.	+0.8	3.61	2.63	3.52
	17	4.00	n.a.	n.a.	n.a.	+0.6	3.61	2.63	3.52

a/ Special swap rate provided by Bundesbank to domestic commercial banks for 2-6 month period.

Table 9. Germany: Selected Loan, Deposit and Security Rates
(per cent per annum)

	Comm. bank loans a/	6-12 mo. deposits		Bond yields		Share Yields	Yield gap
		Savings	Time	5-1/2% Railway 1958-83	Public authorities		
1962-August	7.50	3.50	2.75	5.83	6.0	3.58	2.2
September	7.50	3.50	2.75	5.92	6.0	3.79	2.1
October	7.50	3.50	2.75	6.04	6.2	3.89	2.1
November	7.50	3.50	2.75	6.14	6.2	3.34	2.8
December	7.50	3.50	2.75	6.08	6.1	3.44	2.7
1963-January	7.50	3.50	2.75	5.99	6.0	3.58	2.4
February	7.50	3.50	2.75	5.99	6.0	3.75	2.2
March	7.50	3.50	2.75	5.99	6.0	3.63	2.4
April	7.50	3.50	2.75	5.97	6.0	3.56	2.4
May	7.50	3.50	2.75	6.00	6.1	3.19	2.9
June	7.50	3.50	2.75	6.03	6.1	3.26	2.8
July	7.50	3.50	2.75	6.10	6.1	3.20	2.9
August	7.50	3.50	2.75	6.09	6.1	3.09	3.0
September	7.50	3.50	2.75	6.09	6.1	3.08	3.0
October	7.50	3.50	2.75	6.07	6.1	3.17	2.9
November	7.50	3.50	2.75	6.04	6.0	3.26	2.8
December	7.50	3.50	2.75	6.03	n.a.	n.a.	n.a.

a/ Approved credits on current account.

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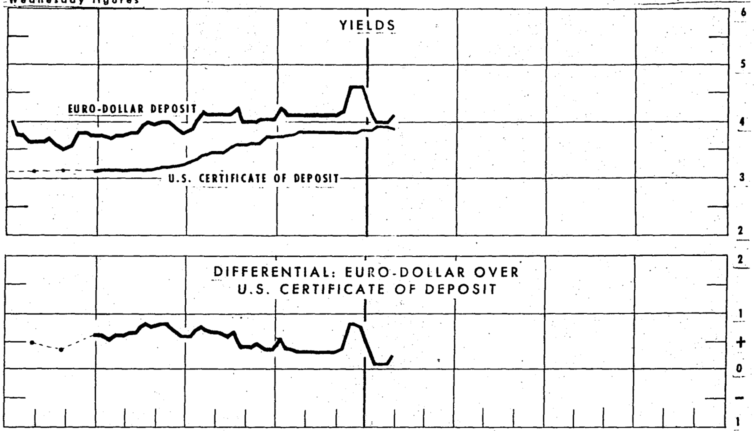
Chart 1

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

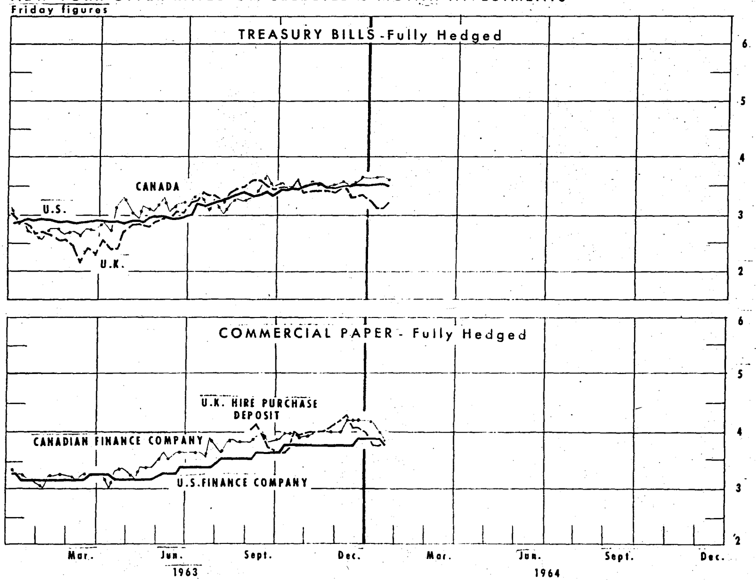


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Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

Per cent per annum

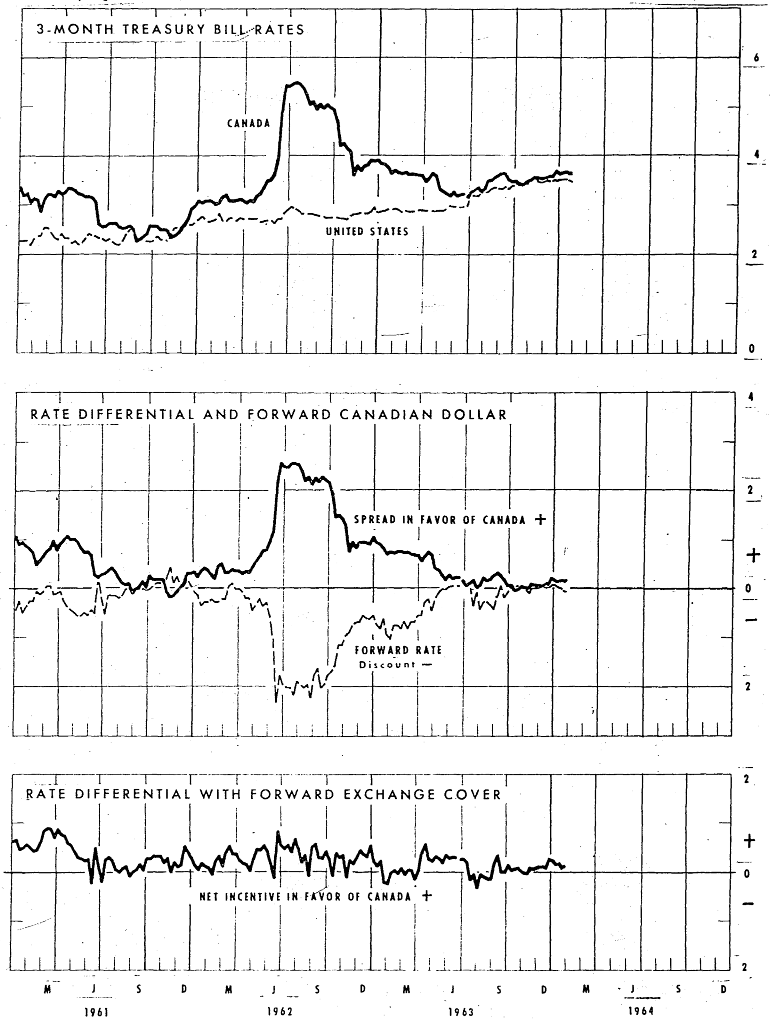

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Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

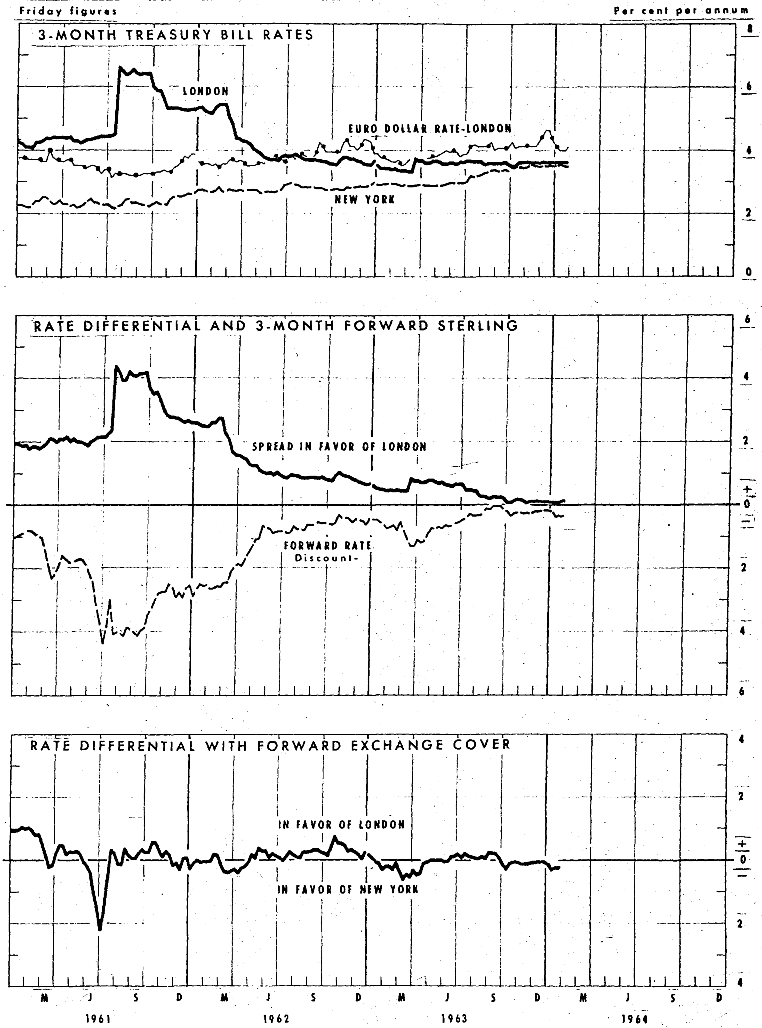

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Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

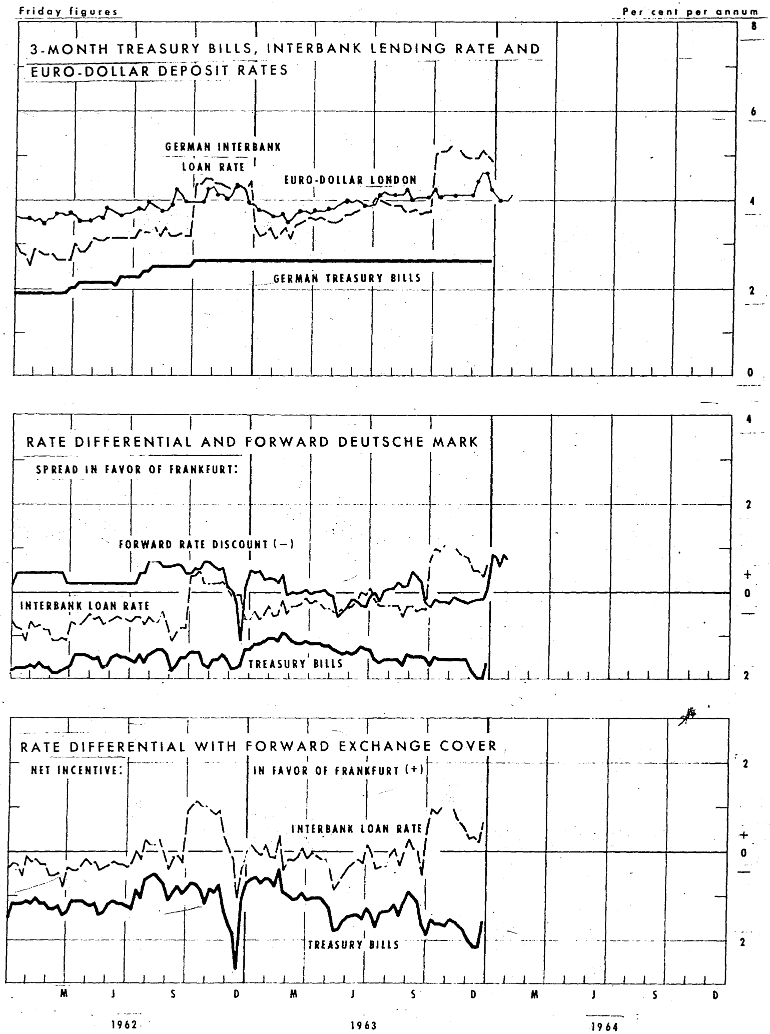

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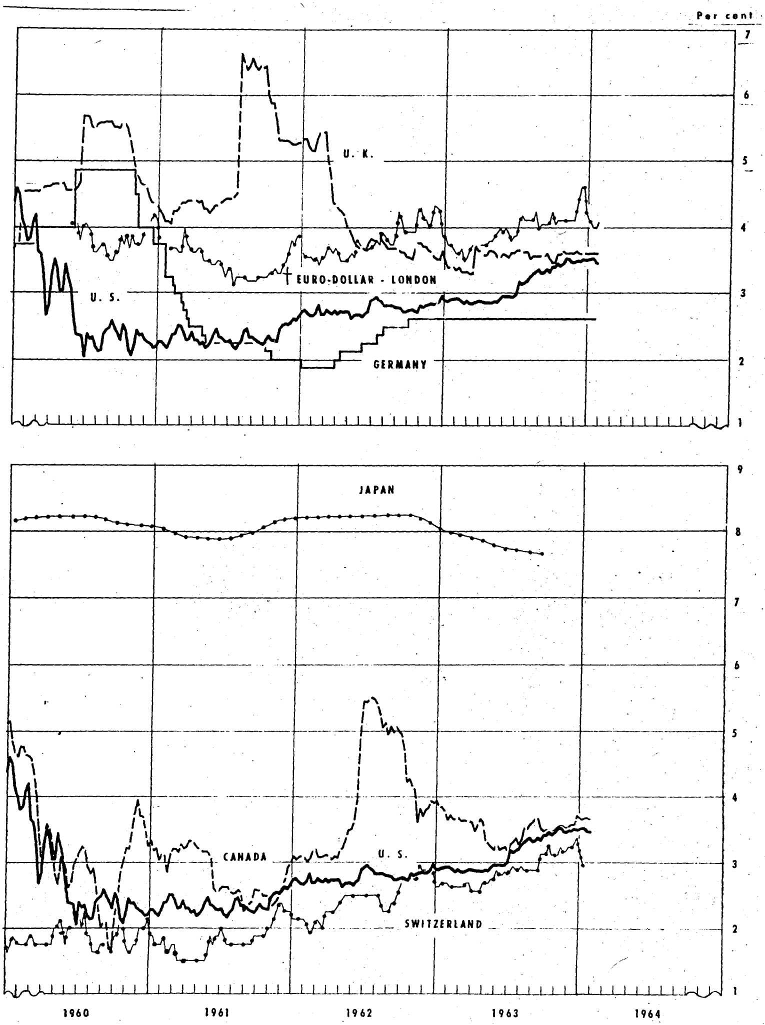
Chart 5

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

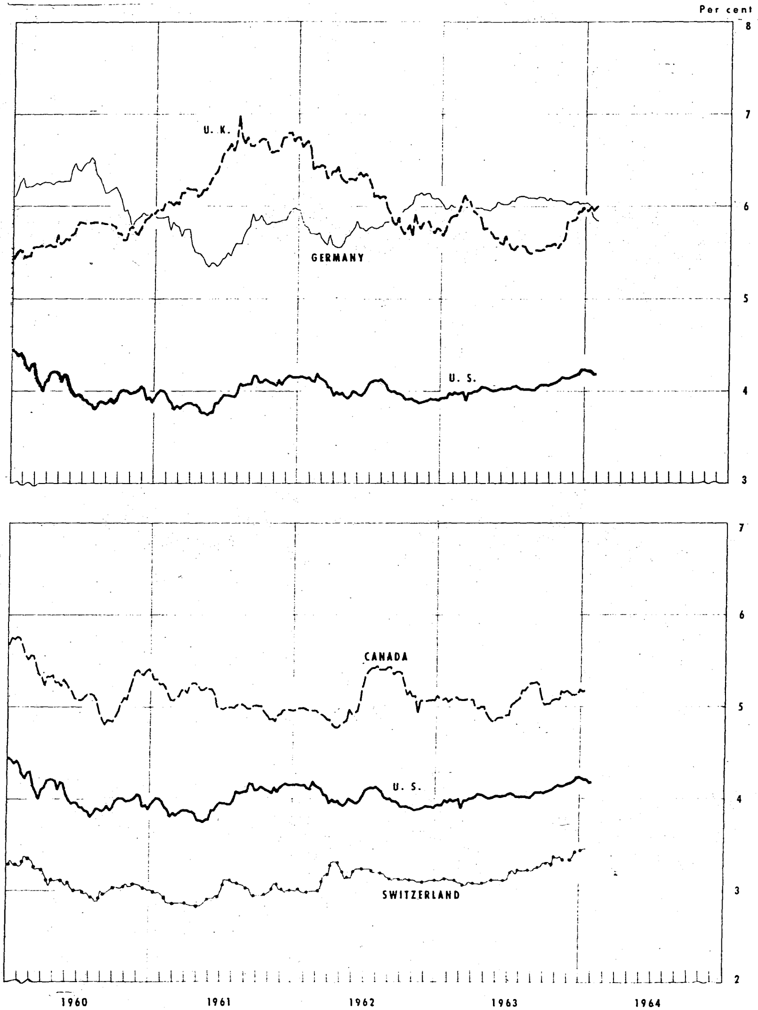

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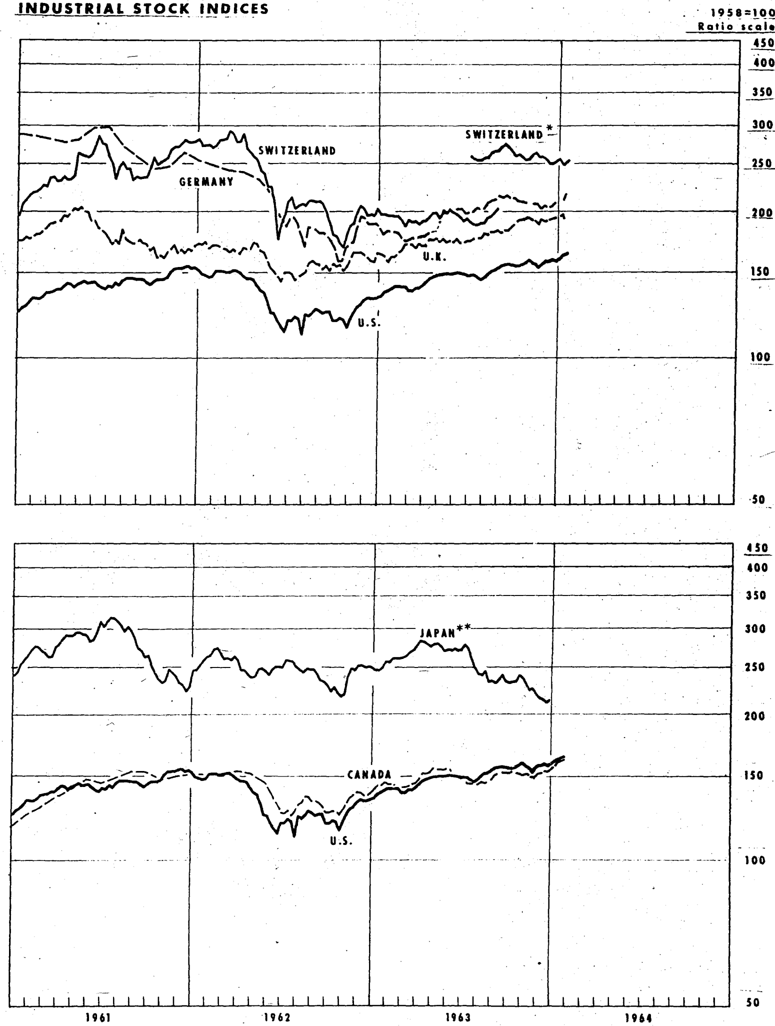
Chart 7

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

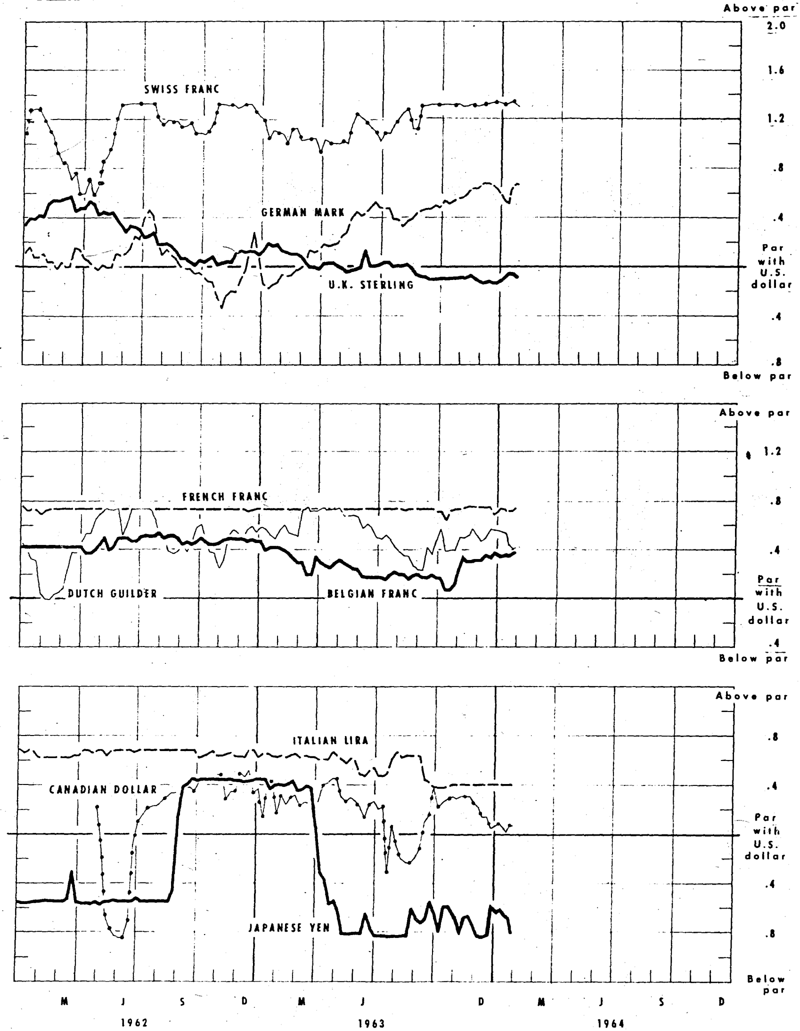

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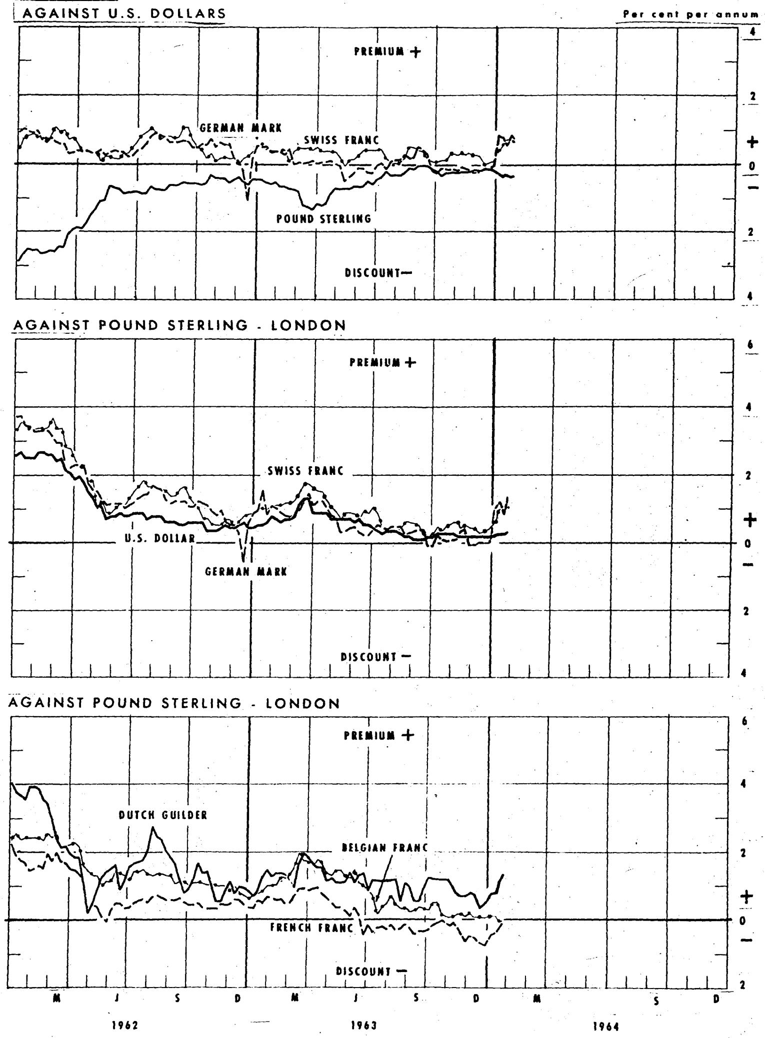
Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures



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