DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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CAPITAL MARKET DEVELOPMENTS ABROAD

~~I. France~~
II. Nine Charts on Financial Markets Abroad

I. France: Money and Capital Markets, October 1963-January 1964

During the period under review, the effects of the French stabilization measures announced in September could be found in a marked slowdown in the rate of expansion in the money supply and a sharp increase in fourth-quarter imports; these heavier imports cut into the balance of payments surplus but they helped to slow down internal price rises. The extension in late January of the ceiling on bank credit which was due to expire on February 29 represented no further cut back in the projected rate of credit growth from the reduced levels set in September. In financial markets, there were new increases in yields on long-term bonds and on "free investment" Treasury bills.

With the reduced trade surplus, adjusted reserve accruals dropped from $79 million in November to $40 million in December and to $24 million in January. Third-quarter balance of payments results (just available) show an over-all surplus in 1963 somewhat below the comparable figures for 1962. (See Table 1, and, for details, Table 8.)

Table 1. France: Selected balance of payments statistics, quarterly
(in millions of U.S. dollars)

	1962				1963		
	I	II	III	IV	I	II	III
Trade balance (f.o.b.)	115	118	115	94	31	12	98
All other transactions 1/	193	272	128	115	186	388	111
Over-all balance 1/	308	390	286	209	217	400	209

1/ Before debt prepayments.

Thus far, the effects of the stabilization program can be found in four main areas:

a. The money supply increased by 5.3 per cent between September and December, a rate almost one-third below the expansion in the last four months of 1962. For the year 1964, the Finance Minister expects a rise no greater than 10 per cent compared with annual increases of 18 per cent in 1962 and 13-1/2 per cent in 1963.

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(Decontrolled after six months)

b. An upsurge in imports has followed the French tariff reductions announced last autumn; in the fourth quarter, seasonally-adjusted imports were nearly 10 per cent above third quarter levels. Imports advanced further in January. (See Table 7.)

c. On the fiscal side, the Finance Minister appears determined to carry out his commitment to reduce the budget deficit from 7 billion francs in 1963 to 4.75 billion francs in 1964 (as provided in the budget bill passed in December by the Assembly). In January he also announced the intention to hold the deficit at that level for 1965. Normally, the annual flow of private savings to the French Treasury (from savings banks, and sales of Treasury bills and long-term bonds to the general public) would cover deficits of this magnitude.

d. Finally, the rate of price advances was about half as rapid in the final three months of 1963 as in the same period of 1962, as may be seen in the following price changes (in per cent per annum:

	Sept.-Dec. 1962	Sept.-Dec. 1963
Wholesale food prices 1/	6.7	3.7
Retail prices	1.9	1.0

1/ Factory prices of manufactures have been controlled since September, and fuels and energy are produced by the government.

Monetary reforms are instituted

Four changes in French monetary practices were announced on January 22 as "completing the task undertaken within the framework of the stabilization plan." However, they are structural reforms rather than anti-inflation devices.

First, the commercial banks' compulsory portfolio of Treasury bills was reduced from 15 to 13 per cent of deposits. The change does not constitute any relaxation of credit: the banks' comprehensive liquidity ratio is still maintained at 36 per cent of deposits and, in addition, loans to customers are restricted by the renewal of the credit ceiling. On the contrary, it seems another step toward the eventual abolition of "required" bill holdings, first introduced in the early postwar period to freeze excess liquidity in the banking system, the fourth such reduction since January 1961, when the figure was 25 per cent. Henceforth, the compulsory holdings are to be known as Treasury certificates and will continue to yield 2-3/8, 2-7/8, and 3-1/8 per cent on 3-month, 1-year, and 2-year bills, respectively.

A second change applies to the Treasury bills held in excess of the required minimum (which have been sold at thrice-monthly auctions since April 1963). On January 22 the Finance Minister declared that in the future the rates at the auctions "will be freely determined as a function of supply and demand." Previously, the Treasury is reported to have refused to accept bids yielding a return higher than the fixed tap rates on the compulsory holdings (see above), according to La Vie Francaise of January 31. Under the new system, only 1-year bills will be offered by the Treasury.

A sharp rise in bill rates has been the initial result of this reform of the auctions. One-year bills were sold to yield 3.65 per cent at the January 29 auction and 3.61 per cent on February 5. (See Table 2.) Earlier, these rates had never been above 2-7/8 per cent and had often been lower.

Table 2. France: Treasury Bill Auction Rates: Sept. 1963-Feb. 1964
(per cent per annum)

		"FREE INVESTMENTS"	
	3-month	1-year	2-year
September 25	2.12	2.87	3.12
October 25	2.00	2.50	3.10
November 25	2.00	2.88	3.12
December 5	2.00	2.88	3.11
16	2.00	2.88	3.11
26	2.00	2.88	3.12
January 6	2.00	2.88	3.12
15	2.36	2.88	3.10
29	--	3.65	--
February 5	--	3.61	--

Source: Bank of France.

The Financial Times of January 31 said that these higher rates "resulted in precisely the opposite outcome to what had been intended." This appears likely to have been the case; the officially-stated purpose of the auctions given last April (when they were first instituted) was to reduce short-term rates to encourage investment in longer-term paper. The Financial Times ascribes the higher rates to a "temporary shortage of funds," but they may have arisen from a temporary glut of bills in the banks' portfolio. The lowering of the required holding was equal to about 1.5 billion francs, or much more than the 400 million francs of bills offered at each of the last two auctions.

A third measure was directed at encouraging the flow of individual savings into long-term securities. Rates on one type of the (non-marketable) Treasury bills sold to the general public were cut 10 to 20 basis points. This follows earlier reductions in yields on this general category of Treasury paper over the last three years. As these instruments are tax-exempt, the latest reduction reduces yields by 20 to 40 basis points for individuals in the 50 per cent income tax bracket.

Finally, in a minor move, the Bank of France rate on 30-day advances to banks against government securities was raised from 3 to 4 per cent on January 23 in order to align it with the basic discount rate. These advances are of very small importance.

Seasonal factors dominate money market

The Paris money market went through three phases between November 1963 and early February. In December, the banks became less liquid as the note issue increased. Day-to-day money rates against private paper rose to a peak of 7-8 per cent on December 27-31 and the banks were forced to discount some paper at the 5 per cent ("hell") and 6 per cent ("super-hell") penalty rates at the Bank of France.

By mid-January, with the note reflow, the market eased into a quite liquid state. The banks reduced their discounts at the central bank. On February 5 the market absorbed Fr 400 million of 1-year Treasury bills; with some excess liquidity absorbed, day-to-day money rates returned to about the early December levels of 4.1 per cent (normal for a discount rate of 4 per cent). (See Table 3.)

Over the past 12 months, however, the effect of the credit-tightening measures has been to increase the level of day-to-day money rates. (See Table 3.) Much of the increase in day-to-day rates is explained by the 1/2 per cent increase to 4 per cent in the discount rate in November 1963. However, the average level of rates in December-January was up over the year by more than 1/2 of 1 per cent, because, with tighter conditions, more discounting has been at the 5 per cent and 6 per cent penalty rates over the month-end.

Security markets active; bond yields rise

For a second successive quarter, new security issues were in much greater volume than a year ago. In the July-September quarter net new issues at 3.31 billion francs were over 2-1/2 times more than a year previous. (See Table 4.) The Treasury loan in September1/ accounted for 2 billion francs of this total. In addition, private borrowers placed another 1.33 billion francs (net) in new issues or nearly 12 per cent above the year-ago level.

Over the first nine months of 1963, net new issues including the Treasury ran 63 per cent ahead of 1962 and excluding the Treasury were up 18 per cent. However, the gain in issues by the competitive (largely private) sector was only 4 per cent.

1/ See France: Money and Capital Markets, August-November, 1963, dated December 11, 1963.

Table 3. France: Day-to-Day Money Rates Against Private Paper: September 1963-February 1964
(per cent per annum)

	1963-64	1962-63
Monthly Averages		
September	3.13	3.48
October	3.64	3.51
November	4.14	3.50
Daily Rates 1/		
December 6	4.06	3.50
13	4.06	3.44
20	4.31	3.50
26	6.06	3.63
January 2	6.25	3.44
9	4.94	3.38
16	3.69	2.88
23	3.50	3.44
30	4.06	3.50
February 6	4.12	3.38

1/ Average of daily range. Days shown are for Fridays in 1963-64; 1962-63 data are for Thursdays in same week.
Source: Bank of France.

Yields to maturity on third-quarter new issues (see Table 4) were very close to those on new issues in the second quarter, and do not reflect the substantial rise in long-term market yields which began in mid-September.

Parliament has authorized the Treasury to issue, prior to May 10, 1964, another loan with tax-exemption features, up to an amount of 2 billion francs. The Finance Minister has indicated the likelihood of a new loan in March, although the amount may be less than 2 billion francs.

Long-term bond yields moved up again in December-January. Yields on public sector bonds rose almost continuously from 5.51 per cent at the close of November to 5.65 per cent in the last week of January. (See Table 5.) Yields on corporates were irregularly higher, averaging 6.24 per cent in January compared with 6.14 in November and 6.21 in December. The recent rise in yields, which dates from the start of the stabilization program in mid-September, has carried long-term yields up almost 30 basis points on both public sector and corporate bonds.

Table 4. France: Net New Security Issues, 1962-63
(in billions of francs)

I. Issues by Sector

	1962 I	1962 II	1962 III	1963 I	1963 II	1963 III
Treasury	--	--	--	--	1.00	2.00
Public authorities	--	.10	.16	--	.25	--
Public credit institutions	.90	.55	--	1.05	.70	--
Other public sector	1.01	1.53	.01	1.34	.33	.29
Competitive sector	1.21	1.53	1.02	1.19	1.68	1.04
Stocks	.88	1.03	.73	.86	1.26	.59
Bonds	.24	.44	.23	.26	.34	.38
Partnership participations	.09	.06	.06	.07	.08	.07
Total	3.12	2.37	1.19	3.58	3.96	3.33

II. Yields to Lender on Major Loans, Third Quarter, 1963

Caisse Nationale des Autoroutes	5.58
Compagnie de Saint - Gobain	5.72
Treasury (20 years) 1/	4.60
Groupement de l'industrie chimique de synthèse	5.72

1/ Interest exempt from personal income tax in first 10 years.
Source: Conseil National du Crédit.

Table 5. France: Long-Term Bond Yields, 1962-64 1/

	Public Sector 2/	Corporate
Last full week of month:		
1962 - December	5.46	6.05
1963 - January	5.44	6.05
August	5.36	6.00
November	5.51	6.20
December	5.58	6.22
1964 - January	5.65	6.23
Week ending:		
1963 - December 13	5.57	6.20
27	5.58	6.22
1964 - January 10	5.59	6.22
24	5.63	6.25
31	5.65	6.23

1/ Redeemable bonds, excluding indexed and participating issues.
2/ Excluding Treasury bonds (which have income tax advantages).
Source: Bank of France.

Sharp fluctuations in stock prices in recent weeks were related by observers to changes in traders' psychology rather than to any change in the business situation.

Prices continued to fall in early December, and the new low for the year on December 13 was 18 per cent below the market's level at the start of 1963. A cut in margin requirements on futures transactions on December 13 was interpreted as indicating a more favorable attitude by government toward investors, and a brief rally ensued. In early January, Prime Minister Pompidou expressed the view that the 1963 decline in stock prices had been overdone. This remark led to the market's first strong advance since last summer, with prices rising nearly 6 per cent between January 3 and 17. (See Table 6.) (One year earlier, prices had plunged after Mr. Pompidou said French stock prices were too high.) However, another drop in the market -- for which analysts had no ready explanation -- set in at the close of January, and by February 5 most of the January price gain was erased.

Table 6. France: Index of French Stock Prices, 1963-64
(for week ending on date shown; Dec. 29, 1961 = 100)

1963 -	high (Jan. 4)	104.6	1964 -	January 3	87.3
	low (Dec. 13)	86.1		10	90.9
	November 29	89.3		17	92.2
	December 13	86.1		24	92.8
	20	86.8		31	91.4
	27	88.4			

Source: I.N.S.E.E.

Reserve gains continue but at reduced rate

Increases in official holdings of gold and foreign exchange dropped from $79 million in November to $40 million in December and then to $24 million in January.1/ No special transactions took place in either month.

The available data suggest that the French surplus in the fourth quarter was reduced from the year-ago level. In the first place, the official reserve gains (adjusted for special official transactions) of $141 million in October-December of 1963 were below the $198 million gain in the comparable months of 1962.

1/ The French Exchange Stabilization Fund reportedly acquired no dollars from the market in the period January 10-31. However, the Bank of France balance sheet shows an increase in reserves of $15 million in this period.

Second, France's seasonally-adjusted trade deficit (imports c.i.f.) was $333 million in the last quarter of 1963 in comparison with $81 million a year earlier. (See Table 7.) Placing imports on an estimated f.o.b. basis and eliminating trade with the overseas franc area, the balance (unadjusted for seasonal variations) shifted from an estimated surplus of $100 million to an estimated deficit of $27 million between these two quarters.

Table 7. France: Seasonally-Adjusted Foreign Trade, 1962-63
(in millions of dollars)

	Imports c.i.f.	Exports	Balance
Quarter			
1962 - I	1,740	1,854	+114
II	1,767	1,791	+ 24
III	1,917	1,833	- 84
IV	1,965	1,884	- 81
1963 - I	2,004	1,857	-147
II	2,142	2,085	- 57
III	2,181	2,058	-123
IV	2,415	2,082	-333
Month			
1963 - September	752	670	- 82
October	836	711	-125
November	769	660	-109
December	809	712	- 97
1964 January	880	[illegible]	-136

Source: OECD.

Finally, the third quarter saw a resumption of the tendency toward a reduced over-all surplus. Third-quarter transactions yielded an over-all surplus of $209 million, down from $286 million in July-September 1962.

The trade balance (payments basis, imports f.o.b.) was consistently less favorable in 1963 because of the much heavier increase in imports than in exports. (See Table 8.) The surplus on current invisibles was also lower in all of the first three quarters of 1963, largely because of a big rise in French expenditures for foreign travel.

By contrast with the weakened position on current transactions, the surplus on capital movements and other items has been maintained. The net inflow of private long-term capital approached the 1962 rate in both the first and third quarters; in the second quarter it far exceeded the 1962 rate because of heavy liquidation of foreign securities by French residents. Even though short-term private capital, the net balance of the overseas franc area, and errors and omissions have fluctuated, there has been no clear-cut deterioration in these accounts.

Table 8. France: Balance of Payments, 1962-63
(in millions of dollars)

	Quarter I	Quarter II	Quarter III	Quarter IV	Year
I. Trade Balance					
1962	115	118	158	94	476
1963	31	12	98		
A. Imports f.o.b.					
1962	1,288	1,333	1,244	1,481	5,364
1963	1,525	1,616	1,508		
B. Exports					
1962	1,402	1,451	1,402	1,575	5,840
1963	1,555	1,628	1,606		
II. Balance on Non-Trade Items 1/					
1962	193	272	128	115	717
1963	186	388	111		
A. Current invisibles					
1962	95	163	34	52	344
1963	71	125	30		
B. Private long-term capital					
1962	115	57	119	110	403
1963	113	155	108		
C. Private short-term capital 2/					
1962	-58	23	-77	33	- 81
1963	-62	20	-12		
D. Public long-term capital 1/					
1962	-34	-17	-55	-22	-127
1963	-32	-27	-57		
E. Overseas franc area					
1962	26	31	63	26	145
1963	50	23	9		
III. Errors and Omissions					
1962	50	15	58	-97	31
1963	45	92	42		
IV. Over-all Balance 1/					
1962	308	390	286	209	1,193
1963	217	400	209		

1/ Before debt prepayments.
2/ Including operations pending settlement.
Source: Ministry of Finance.

In the foreign exchange market, because of France's less strong balance of payments position the franc dipped slightly below its upper limit against the dollar of 20.41 U.S. cents on several occasions during December-January. The franc held at the ceiling in most of December but dropped to 20.399-20.405 between December 27 and January 2. It was again quoted at just below its upper limit in the period January 13-28 and no dollars were purchased from the foreign exchange market. The rate returned to the ceiling on January 29, and some dollar purchases were then reported.

The price of the Napoleon gold coin tended to decline slightly in the period under review, falling from 42.80 francs at the end of November to 42.60 francs on February 5.

European 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

Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

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

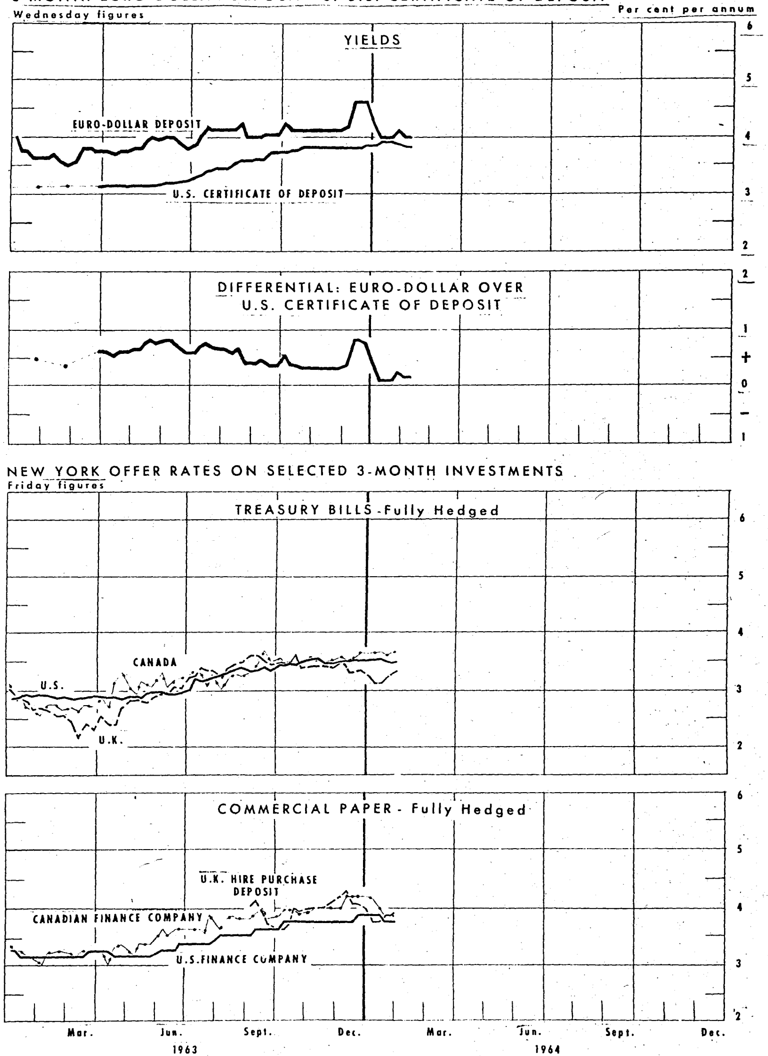

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Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

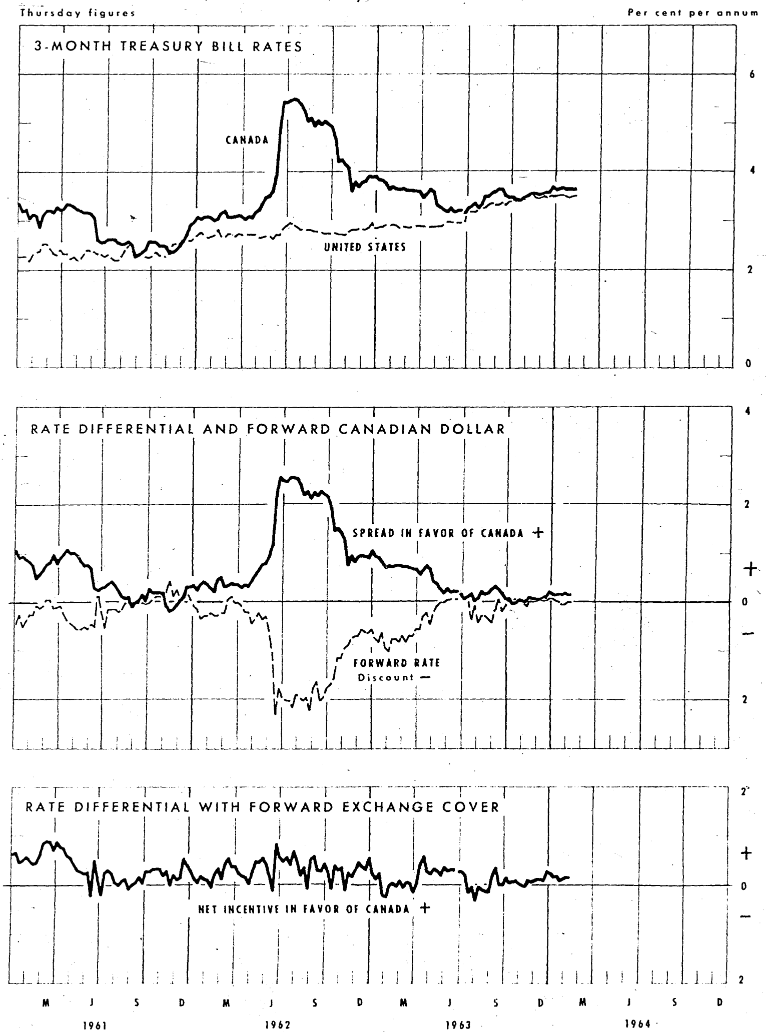

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures — Per cent per annum

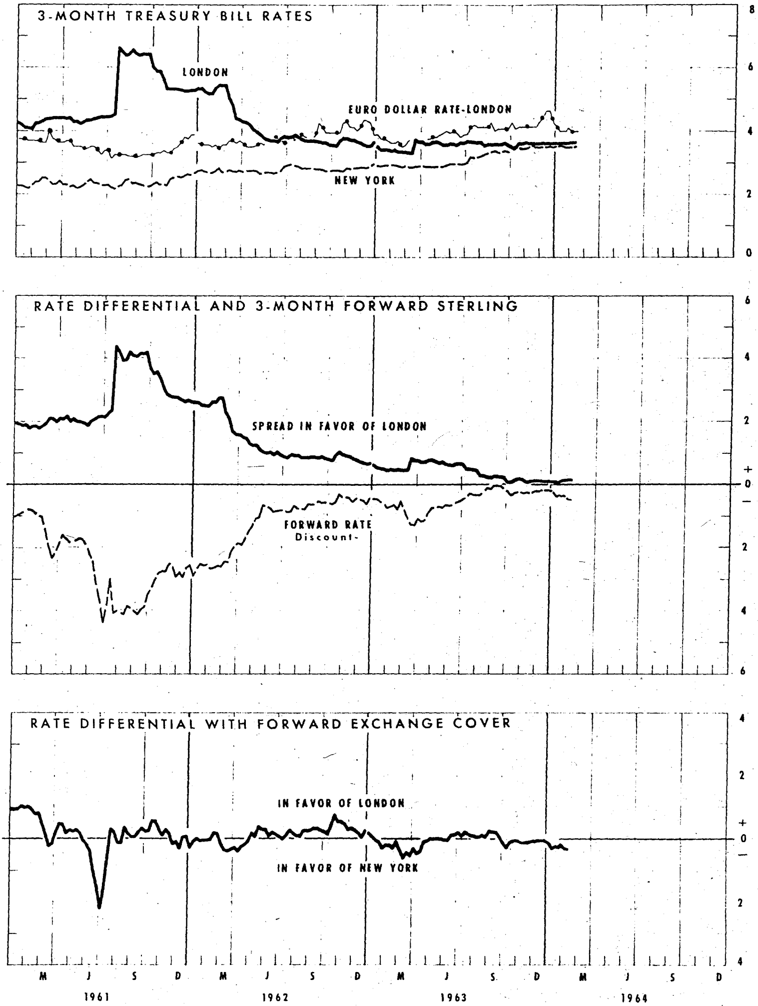

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Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

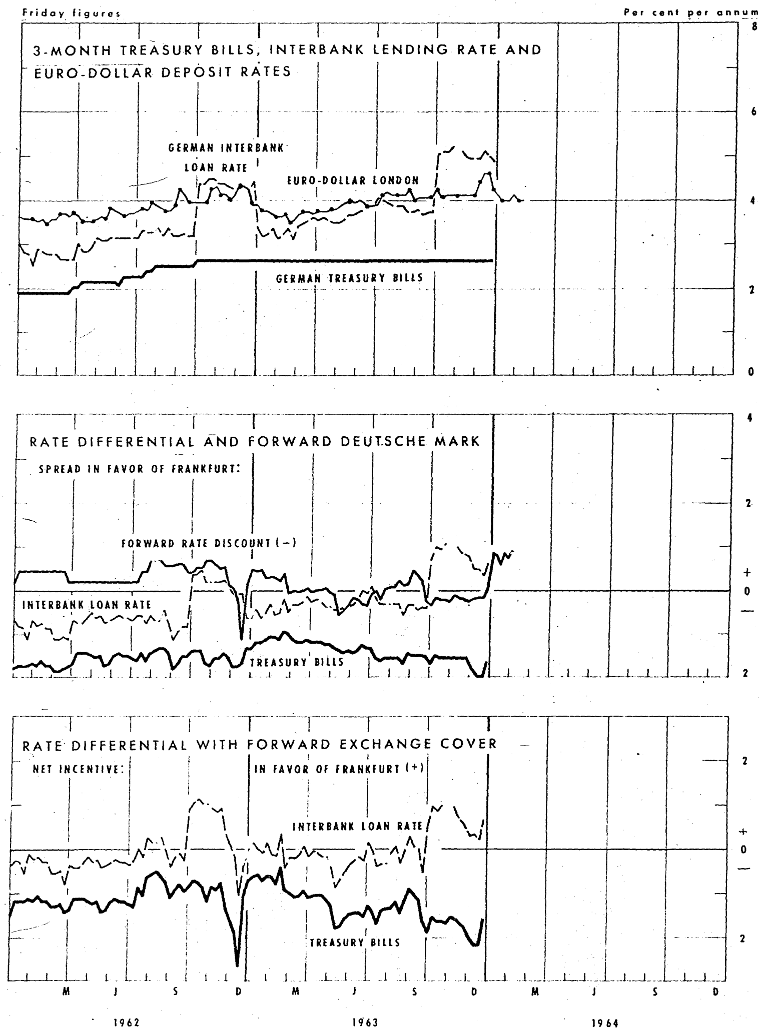
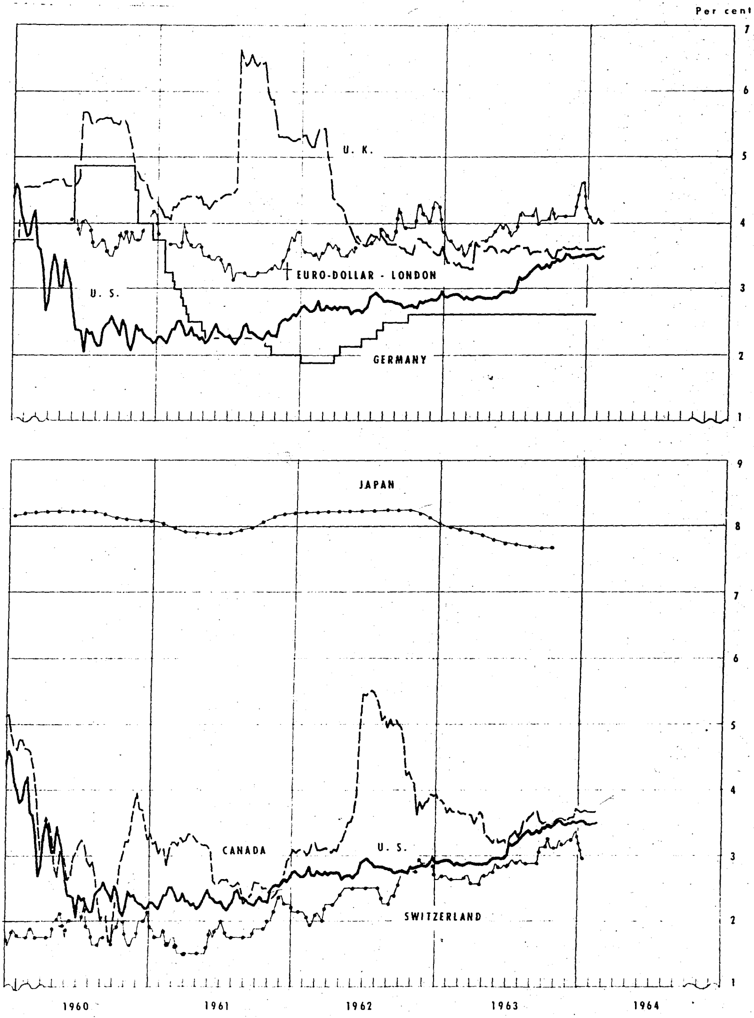


Chart 5

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

Chart 6
LONG-TERM BOND YIELDS

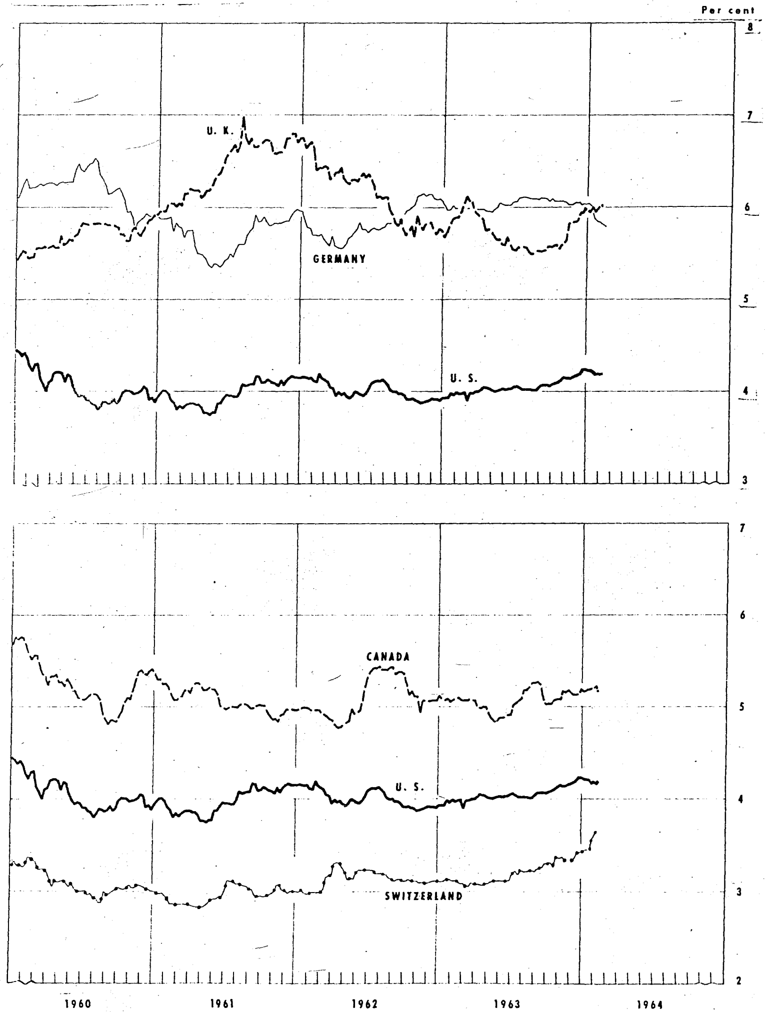
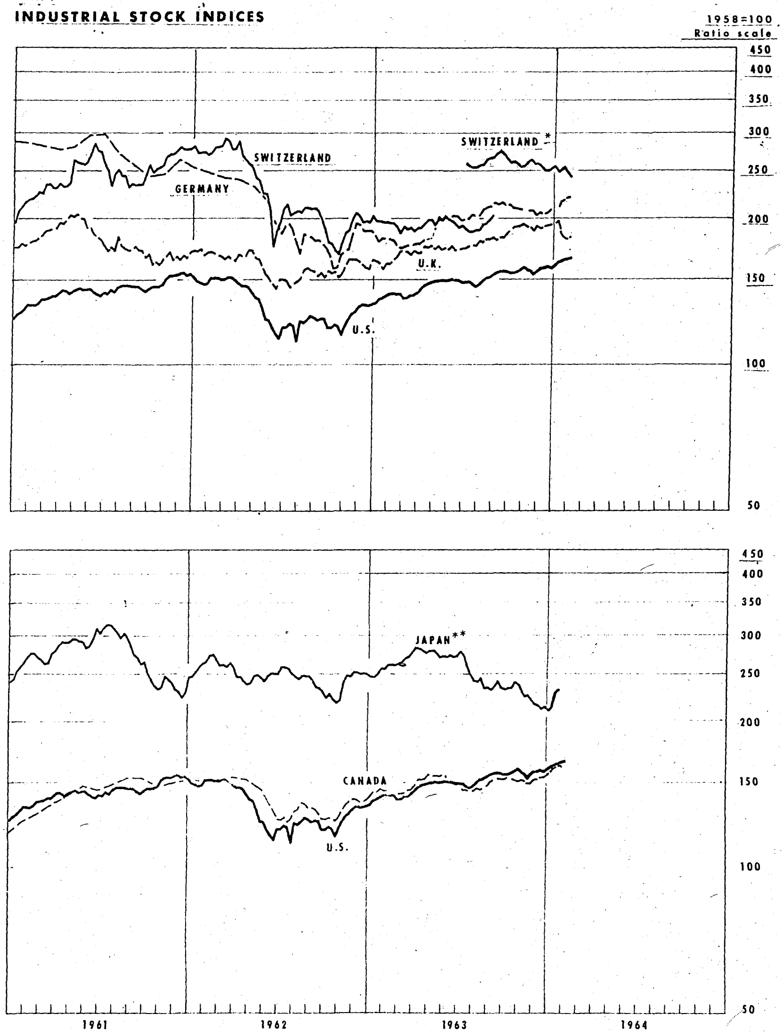


Chart 7

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

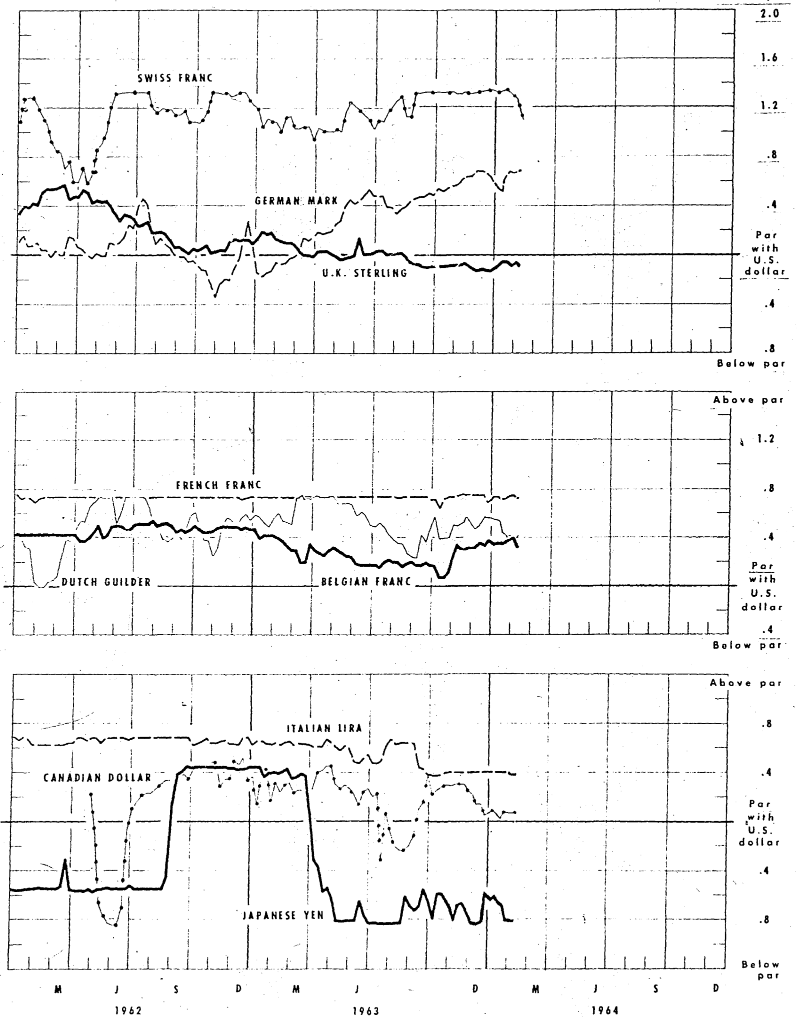

Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures