

H. 13
No. 140

March 4, 1964.

CAPITAL MARKET DEVELOPMENTS ABROAD

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

Germany: Money and Capital Markets, January-February 1964

Continuing heavy inflows of funds from abroad remained the dominant factor not only in German financial markets but also in the general economic situation in Germany during the period under review. Foreign purchases helped to push up prices on both German bonds and industrial stocks during January but these rises slowed down during February. (See Table 1.) Capital inflow and the continuing foreign trade surplus produced heavy additions to the foreign exchange reserves of the Bundesbank and caused the spot and forward D-mark to strengthen in foreign exchange markets in late January and in February.

Table 1. Germany: Selected Financial Indicators, January-February 1964
(in per cent per annum unless otherwise noted)

	January			February		
	<u>3</u>	<u>17</u>	<u>31</u>	<u>7</u>	<u>14</u>	<u>21</u>
<u>Bond yields:</u>						
Railroad bond (1958-83)	6.04	5.89	5.84	5.81	5.79	5.79
<u>Stock price index:</u>						
Industrials (index)	191.0	197.1	198.5	198.5	198.7	200.9
<u>Exchange rates:</u>						
Spot DM (U.S. cents)	25.136	25.157	25.166	25.169	25.171	25.176
Forward (% p.a.)	+0.8	+0.6	+0.8	+0.9	+0.9	+0.9
<u>Foreign exchange reserves:</u>						
Bundesbank (changes in period) U.S. \$ (millions)	a/- 71	-112	+ 94	+ 18	+ 63	+ 67
a/ January 1-7.						

The size of reserve accruals from the payments surplus led financial markets to expect the German authorities to take steps to counter the inflows of funds. However, the authorities have apparently decided to adopt a "wait and see" attitude and to move only cautiously to deal with the payments surpluses.

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Formal statements against a second revaluation of the D-mark were made both by the Bundesbank's Council in January and in February by the Minister of Economics. Both the banking and the German export communities support this stand.

The action taken in January to exclude foreign buyers from subscribing to new Federal Government securities for the first five days after the books are opened appears initially to have been successful since an early February offering was fully subscribed within the five-day period reserved to domestic investors. No information is yet available on whether foreign investors made secondary purchases of these securities.

In any case, the inflow of private capital into German financial markets continues unabated. Foreign investors have been purchasing industrial stocks, in response to the continued improvement in the German business- and particular the profit-situation. These purchases helped to account for the substantial rises in stock prices during the first two months of this year after they had been declining in the final quarter of 1963. (See Table 1.) The Swiss stabilization measures are also thought to have helped to divert foreign funds to German financial markets.

The strengthening of the spot D-mark close to the upper limit against the dollar and the widening of the forward premium close to 1.0 per cent per annum for the 3 month D-mark reflect both the capital inflows and the substantial German trade surplus. In 1963, the trade surplus was \$1,452 million or nearly as large as the record \$1,600 million surplus in 1961 when the D-mark was revalued. The outlook for the foreign trade surplus for 1964 is also favorable.

The payments surpluses and the reserve accruals by the Bundesbank reported after mid-January, together with rising foreign demands for German products in the form of an enlarged backlog of foreign orders, are raising once again the problem of the inflationary impact of these developments on the German economy. The German authorities are faced with the question of how to reduce the inflows, especially on capital account, and how to prevent the development of excess demand pressures within the domestic economy without altering the "neutral" monetary policy in effect over the past two years.

Bond market continues active. By mid-February, the downward move of bond yields stabilized at an effective yield for new issues of around 5.86 per cent per annum. The experimental 5-1/2 per cent coupon rate and the lower effective yield on recent offerings apparently did not inhibit purchases (see Table 2). Placements in January were close to DM 3.0 billion, compared with a fourth-quarter monthly rate of DM 1.4 billion and the previous January high of DM 2.2 billion in 1963. For February a substantial number of further issues have been announced in addition to the DM 270 million Federal Railways issue floated successfully early in the month. The Federal Postal System will float a DM 200 million loan at the 5.5 per cent coupon priced to yield 5.86 per cent and other bond issues totalling more than DM 1 billion are expected in the next two months.

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

	1962		1963						
	III	IV	I	II	III	IV	Nov.	Dec.	
"Occasional" borrowers bonds:									
Industrial	113	60	143	88	166	117	25	326	
Public authorities	358	187	489	451	328	424	677	49	
Foreign issuers	---	---	32	---	---	20	---	59	
Other bonds ^{2/}	154	57	259	153	180	172	66	190	
Total	625	304	923	692	674	733	768	624	
Mortgage and communal bonds	532	480	652	578	575	672	639	731	
Total gross bond placements ^{3/}	1,157	784	1,575	1,270	1,249	1,405	1,407	1,355	
Gross share placements	172	170	155	51	117	116	43	111	
Total security placements at issue value	1,329	954	1,730	1,321	1,366	1,521	1,450	1,465	

^{1/} Market value.

^{2/} Mostly bonds of specialized credit institutions.

^{3/} Includes medium-term notes (Kassenobligationen).

Source: Deutsche Bundesbank Monthly Report, Table V, 6.

There appears to be considerable doubt as to whether the 5.5 per cent coupon will prevail in the market. A recent DM 60 million bank issue was floated with a 6 per cent coupon and the Capital Market Committee is reported to feel that the decision as to whether the coupon rate should be 6 per cent or 5.5 per cent should be left to the issuers. While a reduction in the German long-term rate was considered to be desirable, the Committee stated that no action should be taken inconsistent with prevailing market conditions. This report ties in with other statements by official and private spokesmen that the current inflow of capital should be viewed soberly and not be "over-dramatized". However, the OECD annual report on Germany takes a much more serious view of the problem:

"should such capital imports continue to increase at anything like the recent rate, they could well become an international disequilibrating factor of some importance, particularly if accompanied by a steadily improving current account balance."

A variety of measures is being discussed to reverse the inflow. They range from proposals to make government bonds tax-free (and thus reduce yields to foreigners) to measures to promote capital exports (such as

eliminating the securities issue tax and giving tax advantages to direct investment in underdeveloped countries). In addition, Dr. Abs of the Deutsche Bank has proposed a multilateral financing scheme. In this scheme, a borrower could arrange with a consortium of banks in different European countries to float bond issues simultaneously in each country. The bonds would be denominated in the currency of the country of issue and the coupon rate and maturity would be the same in all countries. But the issue price (and consequently the yield) would vary according to market conditions in each country. The main advantage of this parallel financing scheme, according to Dr. Abs, is that it allows for much larger loans than can be placed in any single European financial center.

The emphasis on capital-export promoting measures is in part because financial markets do not appear to believe that the authorities could move to free public bonds from taxation.

Stock market rises. Revival of foreign interest in German stocks indicates that the foreign funds are not flowing only into new bond issues. The strength of the German economy as well as the attractive bond yields are serving as a magnet for investment funds. Funds were reported to be coming primarily from France and Switzerland and were moving mainly into steel and bank stocks. The active foreign demand, which was joined also by domestic demand, has pushed stock prices, as measured by the F.A.Z. index, up 7 per cent since year-end. (See Table 3 and Chart 7.)

Money market tightens slightly. Mainly seasonal factors dominated money market conditions in January. Large tax payments and proceeds from the Federal loan floated in that month increased Federal deposits with the central bank and withdrew liquidity from the banking system. But a seasonal decline in money circulation offset these contractive movements; in addition year-end window-dressing operation generally leave the banking system with large amounts of liquid funds in January.

At mid-month, after the unwinding of window-dressing operations was completed, call money rates in Frankfurt moved slightly higher. (See Table 4.) Early in the month they had averaged about 2-1/2 per cent; during the second half they ranged from 2-1/8-3-1/4 per cent. Payments on the Federal Railways loan floated in early February and minor tax payments pushed up call money to 3 - 3-1/8 per cent after mid-February.

Trade balance continues large. Total trade expanded substantially in January after declining in December. Seasonally-adjusted exports rose 12 per cent and imports 19 per cent over the month. The trade balance in January was a substantial DM 0.75 billion, unchanged from November (see Table 5).

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Table 3. Germany: Stock Index, September 1963-February 1964
(December 31, 1958=100)

All time high:	Aug. 31, 1960	264.60	1964 high:	Feb. 20	200.93
1963 high:	Sept. 9	194.81	low:	Jan. 2	189.08
1963 low:	Feb. 26	151.54			

1963	Sept. 27	191.89	1964	Jan. 3	190.98
	Oct. 31	186.05		10	193.73
	Nov. 29	180.80		17	197.14
	Dec. 6	183.79		24	197.32
	13	182.72		31	198.47
	20	183.66	Feb. 7		198.48
	31	187.71		14	198.67
				21	200.91

Source: Frankfurter Allgemeine Zeitung.

Table 4. Germany: Money Market Rates in Frankfurt,
November, 1963-January, 1964 a/
(in per cent per annum)

		<u>Day-to-day money</u>	<u>Three-month loans</u>
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	
January	1- 7	2-1/2 - 2-7/8	3-1/4 - 3-1/2
	8-15	2-1/8 - 2-1/2	3-1/4 - 3-3/8
	16-23	2-1/4 - 3-1/4	3-1/4 - 3-3/8
	24-31	2-1/8 - 3	3-1/4 - 3-3/8

a/ Highest and lowest rates quoted each week by Frankfurt banks.

Source: Deutsche Bundesbank

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The trade surplus is expected to be large in the near future. Export order backlogs are growing: during the last half of 1963 export deliveries were at an annual rate of \$15.4 billion and orders at a \$16.1 billion rate. This heavy inflow of orders appears to be continuing into 1964.

Large balance of payments surplus in 1963. The German balance of payments recorded a substantial surplus of DM 3,169 million (\$792 million) in 1963 as compared with a DM 1,130 (\$282 million) deficit in 1962. The improvement was the result of a DM 2.9 billion increase in the trade balance and a DM 1.5 billion rise in private capital inflows. Official payments abroad were DM 0.1 billion higher than in 1962. (See Table 6.)

Table 5. Germany: Merchandise Trade 1962-January 1964
(seasonally adjusted monthly averages, in billions of DM)

		Exports, f.o.b.	Imports, c.i.f.	Industrial goods Imports	Trade Balance
1962	Year	4.38	4.15	2.95	.23
1963	Year	4.81	4.38	a/ 3.24	.43
	I	4.40	4.15	3.07	.25
	II	4.84	4.43	3.26	.41
	III	4.99	4.66	3.32	.33
	IV	5.01	4.27	b/	.74
	Nov.	5.08	4.33	b/	.75
	Dec.	4.80	3.90	b/	.90
1964	Jan.	5.40	4.65	b/	.75

a/ January-October.

b/ Not available.

Source: Bundesbank: Monthly Report.

The fourth quarter balance registered a small deficit because October and November surpluses were more than offset by a deficit in December. This was the result of very large government prepayments on military purchases to the United Kingdom and the United States which brought the fourth quarter official short-term capital outflow to DM 1.3 billion; in addition, there was a very large outflow on unrecorded transactions. These probably occurred in connection with the commercial banks' window-dressing operations as it was reported in December that banks had again been putting some of their repatriated funds in the Euro-dollar market. Indications are that there was a substantial balance of payments surplus in January.

Economics Minister Schmuecker, in a recent interview, said that the persistent balance of payments surpluses are being watched closely, but that currently "there is no reason to dramatize the situation". He felt that freedom of capital movements is a basic feature of German economic policy and that the major concern should be to "avoid anything which might encourage

Table 6. Germany: Balance of Payments 1962-1963
(in millions of DM)

	Year		1963			
	1962	1963	I	II	III	IV
1. GOODS & SERVICES						
Trade balance	2,990	5,808	693	1,138	1,201	2,776
Services	-1,202	-1,131	62	- 435	- 841	83
Total	<u>1,788</u>	<u>4,677</u>	<u>755</u>	<u>703</u>	<u>360</u>	<u>2,859</u>
2. OFFICIAL PAYMENTS						
Donations	-4,005	-3,630	-1,011	- 975	- 915	- 729
Long-term capital	-4,830	-4,497	-1,107	-1,226	-1,001	-1,163
Short-term capital	114	- 319	116	270	592	-1,297
Total	<u>-4,716</u>	<u>-4,816</u>	<u>- 991</u>	<u>- 956</u>	<u>- 409</u>	<u>-2,460</u>
3. PRIVATE CAPITAL						
Securities transactions						
Foreign purchases 1/	1,522	2,859	700	731	773	655
German purchases (increase-) 2/	- 726	- 471	- 160	- 44	- 100	- 167
Other long-term	348	782	203	285	150	144
Short-term 3/	20	1,015	78	278	205	454
Errors and omissions	634	- 877	237	245	177	-1,536
Total	<u>1,798</u>	<u>3,308</u>	<u>1,058</u>	<u>1,495</u>	<u>1,205</u>	<u>- 450</u>
SURPLUS OR DEFICIT (-)	<u>-1,130</u>	<u>3,169</u>	<u>822</u>	<u>1,242</u>	<u>1,156</u>	<u>- 51</u>

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 rearrange by author.

speculation". However, the current situation does not appear to be one of an inflow of speculative short-term funds, but rather one of inflow of long-term investment capital coupled with a widening trade surplus. The German authorities have also gone on record that neither a reduction of import equalization taxes or export turnover tax rebates is contemplated at this time.

Reserve rise resumed. Official reserves were being drawn down during the first half of January as commercial banks unwound their window-dressing operations and put large amounts abroad. For January as a whole, Bundesbank gold and foreign exchange holdings declined by \$89 million while commercial banks short-term assets abroad increased by \$223 million (see Table 7).

For the first three weeks in February official reserves are estimated to have increased by \$148 million.

Table 7. Germany: Changes in Reserve Position 1962-December 1963
(in millions of U.S. dollars)

	Jan. - Dec.		1963				1964	
	<u>1962</u>	<u>1963</u>	<u>I</u>	<u>II</u>	<u>III</u>	<u>IV</u>	<u>Dec.</u>	<u>Jan.</u>
A. Bundesbank gold and foreign exchange								
Gold	15	164	69	5	8	82	20	1
Foreign exchange	<u>-109</u>	<u>491</u>	<u>-70</u>	<u>248</u>	<u>163</u>	<u>150</u>	<u>36</u>	<u>- 90</u>
Total	- 94	655	- 1	253	171	232	56	- 89
B. Drawing rights on IMF	-120	35	2	--	25	8	3	--
C. Commercial banks foreign exchange	- 63	73	223	56	62	-268	-301	223
Total A through C	<u>-183</u>	<u>763</u>	<u>224</u>	<u>309</u>	<u>258</u>	<u>- 28</u>	<u>-242</u>	<u>134</u>

Source: IMF, International Financial Statistics; Bundesbank, Monthly Report.

The continuing inflow of funds has again given rise to revaluation rumors, which in turn have stimulated further capital inflows. In addition, the optimistic business outlook is again making stock market investments attractive, particularly with the weakening of other continental exchanges, such as the French. The announcement of the Swiss stabilization measures was also reported to have been followed by capital flows from Switzerland to Germany.

D-mark strong. After moving down temporarily in the beginning of January, the spot D-mark does move up (See Table 8 and Charts 8 and 9). The spot mark reached a low point on January 13 at 25.129 U.S. cents and has since moved up steadily. On February 21 the DM was traded at 25.176 U.S. cents. Part of the weakness of the U.S. dollar is ascribed to the high cost of forward cover, which currently is 0.9 per cent per annum. This rate is well above the posted swap rate of 0.75 per cent at which the Bundesbank will give forward cover, but apparently no business is being done with the Bundesbank.

Table 8. Germany: Exchange Rate in U.S. Cents per DM and
Three Months Forward Rates in per cent per annum
(noon buying rates)

		Par value	25.000				
		Upper limit	25.188				
		Lower limit	24.875				
		<u>Spot</u>	<u>Forward</u>				
1963	Sept. 27	25.125	-0.2	1964	Jan. 3	25.136	0.8
	Oct. 31	25.146	-0.2		10	25.130	0.8
	Nov. 29	25.161	-0.2		17	25.157	0.6
	Dec. 6	25.171	-0.2		24	25.168	0.8
	13	25.170	-0.2		31	25.166	0.8
	20	25.163	-0.2		Feb. 7	25.169	0.9
	27	25.156	0.0		14	25.171	0.9
					21	25.176	0.9

Source: Federal Reserve Board

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

Table 9. 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.	29	4.12	4.94	-0.78	+0.75	-0.2	3.61	2.63	3.47
Dec.	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	3.38	+0.74	+0.75	+0.8	3.61	2.63	3.51
	10	4.00	3.31	+0.69	+0.75	+0.8	3.61	2.63	3.52
	17	4.00	3.31	+0.69	+0.75	+0.6	3.61	2.63	3.52
	24	4.00	3.31	+0.69	+0.75	+0.8	3.61	2.63	3.49
	31	4.12	3.31	+0.81	+0.75	+0.8	3.61	2.63	3.48
Feb.	7	4.00	n.a.	n.a.	+0.75	+0.9	3.64	2.63	3.49
	14	4.00	n.a.	n.a.	+0.75	+0.9	3.64	2.63	3.50
	21	4.06	n.a.	n.a.	+0.75		3.64	2.63	3.51

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

Table 10. 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 author- ities		
1962-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	2.7
December	7.50	3.50	2.75	6.03	6.0	3.16	2.8
1964-January	7.50	3.50	2.75	5.93	n.a.	n.a.	n.a.

a/ Approved credits on current account.

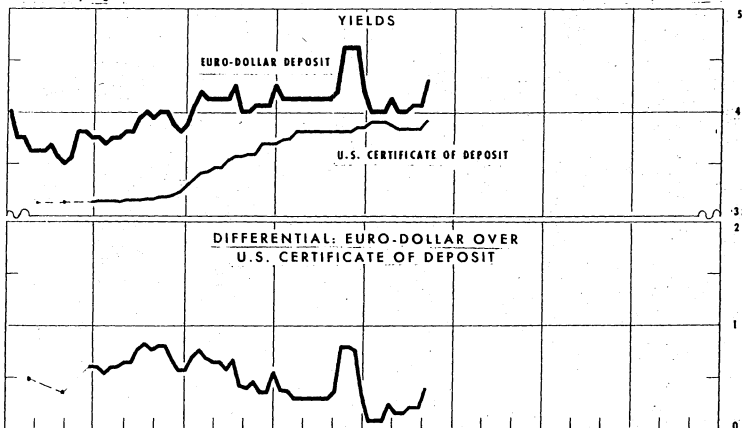
Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

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

Wednesday figures

Per cent per annum



DIFFERENTIAL: EURO-DOLLAR OVER U.S. CERTIFICATE OF DEPOSIT

NEW YORK OFFER RATES ON SELECTED 3-MONTH INVESTMENTS

Friday figures

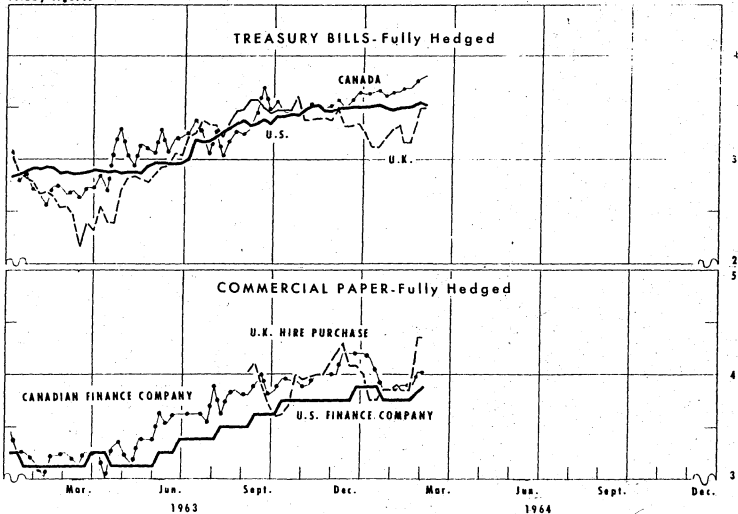


Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

Per cent per annum

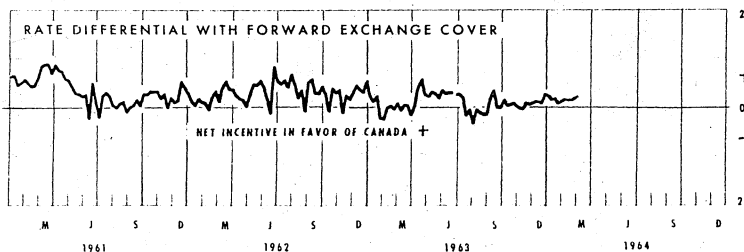
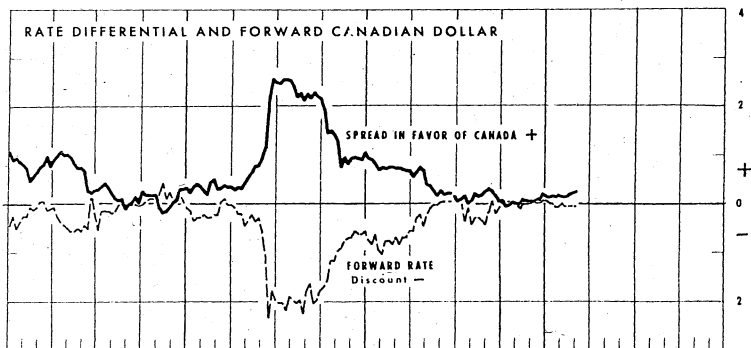
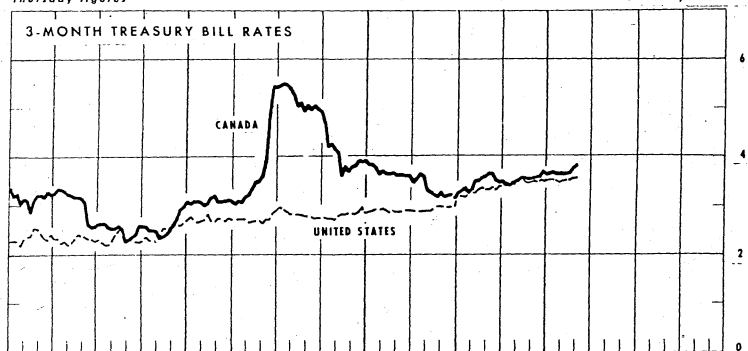


Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

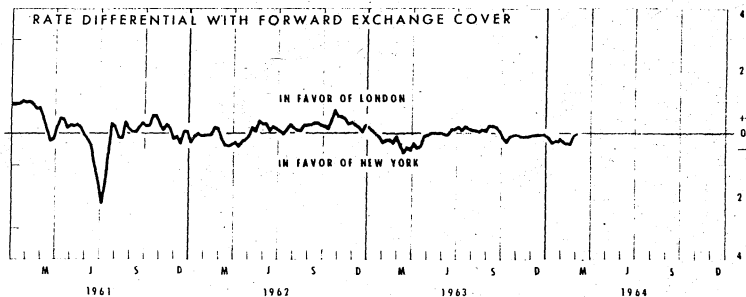
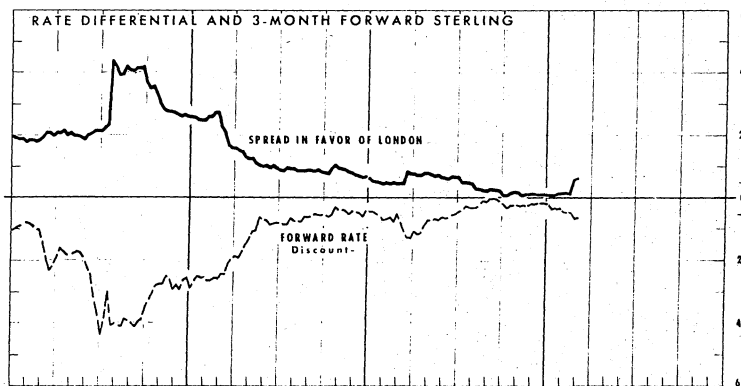
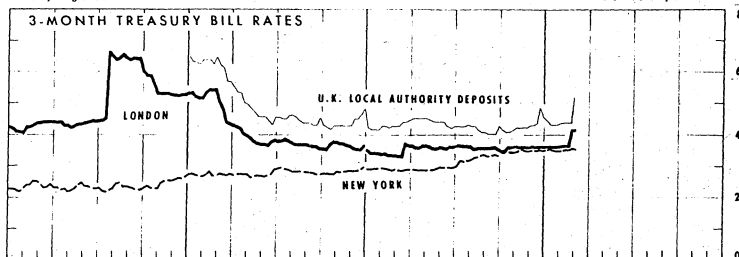


Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

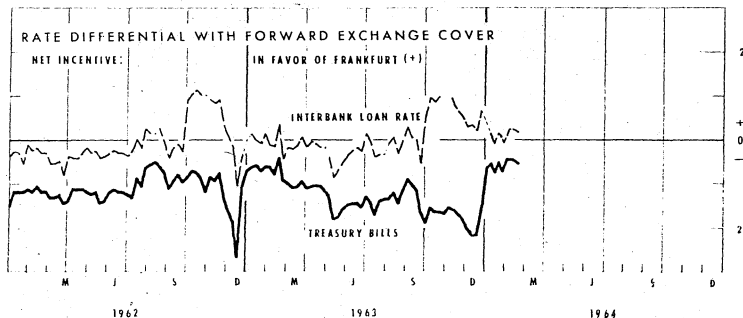
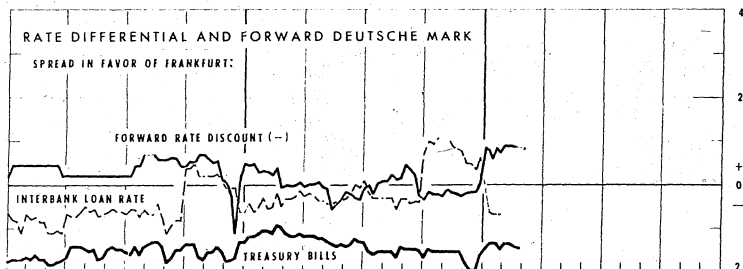
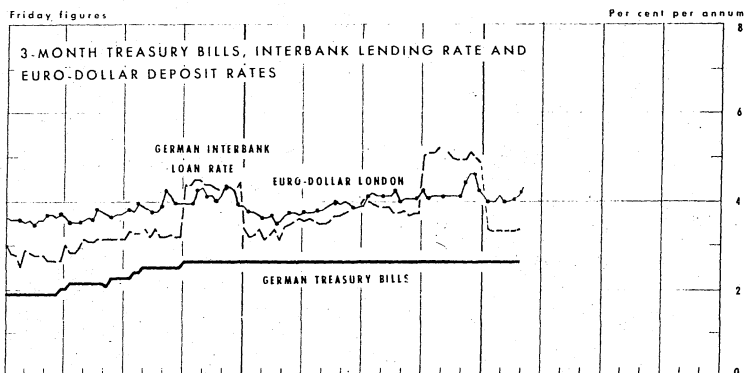
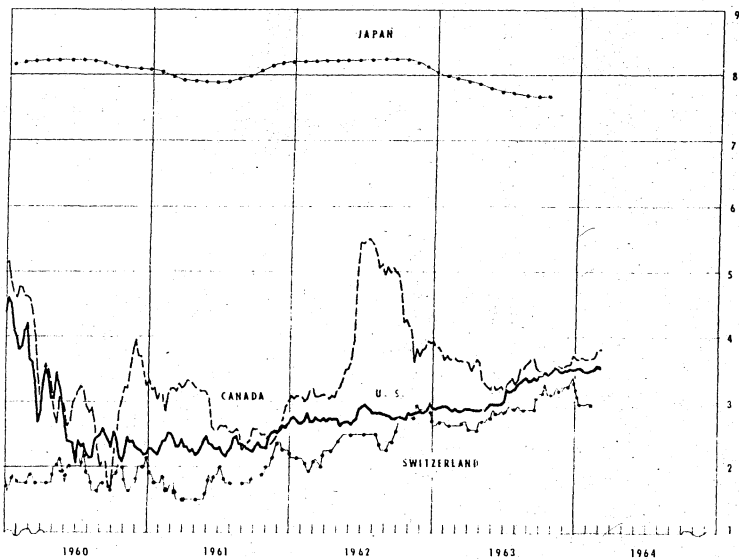
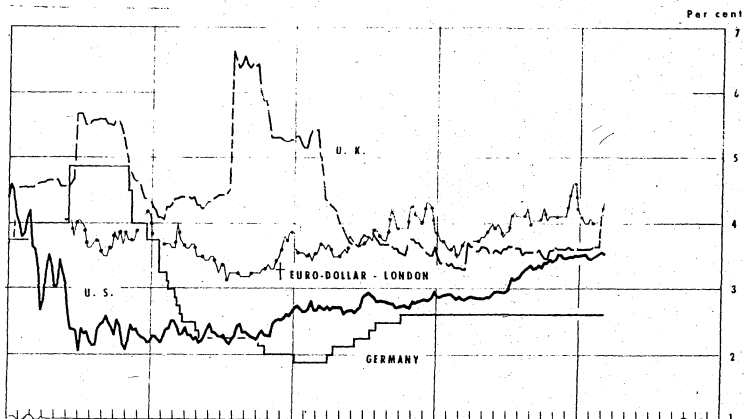


Chart 5
SHORT-TERM INTEREST RATES *



* 3-month Treasury bill rates for all countries except Japan. American rate on bank deposit and discount and Switzerland 3-month deposit rate.

† 3-month rate for U.S. dollar deposits in London.

Chart 6

LONG-TERM BOND YIELDS

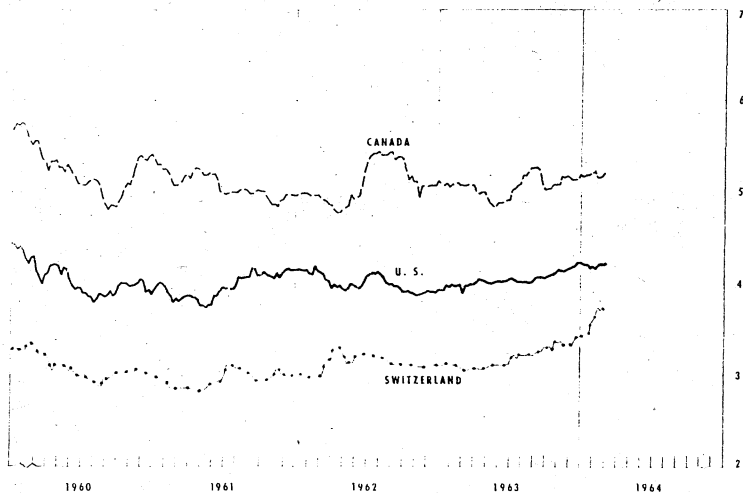
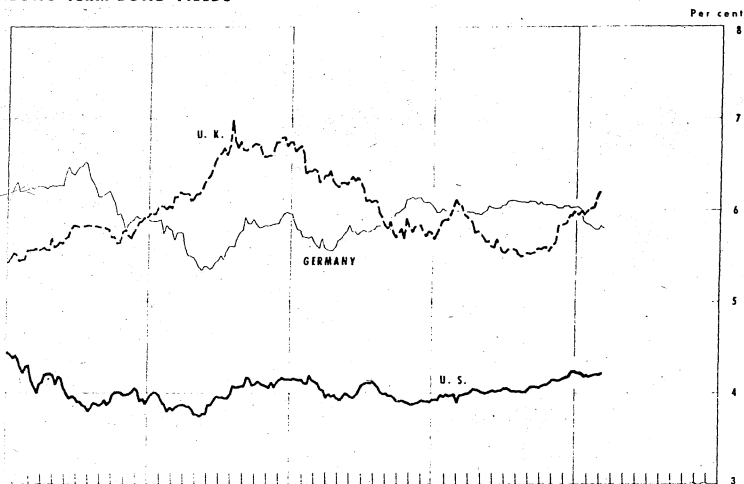
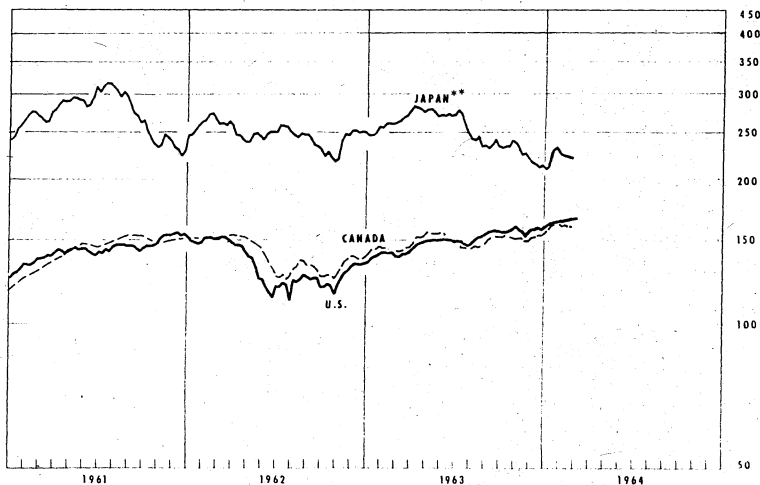
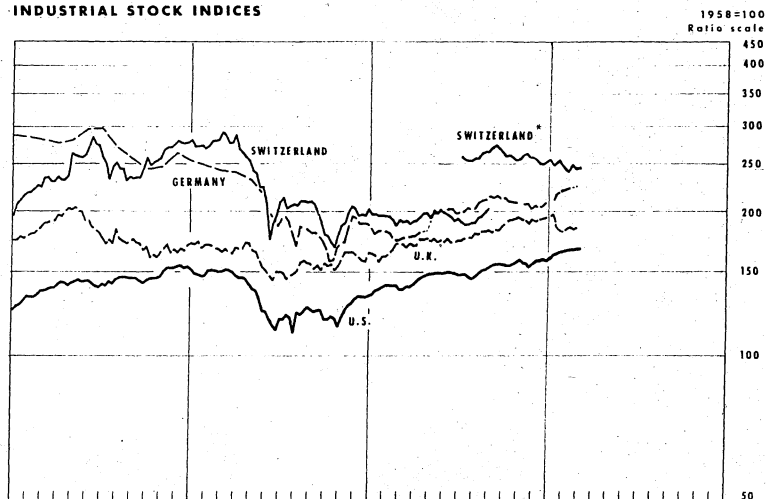


Chart 7

INDUSTRIAL STOCK INDICES



* New series: Swiss bank corporation industrial stock index

** Japan: index of 225 industrial and other stocks traded on the Tokyo exchange

Chart B

SPOT EXCHANGE RATES - MAJOR CURRENCIES AGAINST U.S. DOLLAR

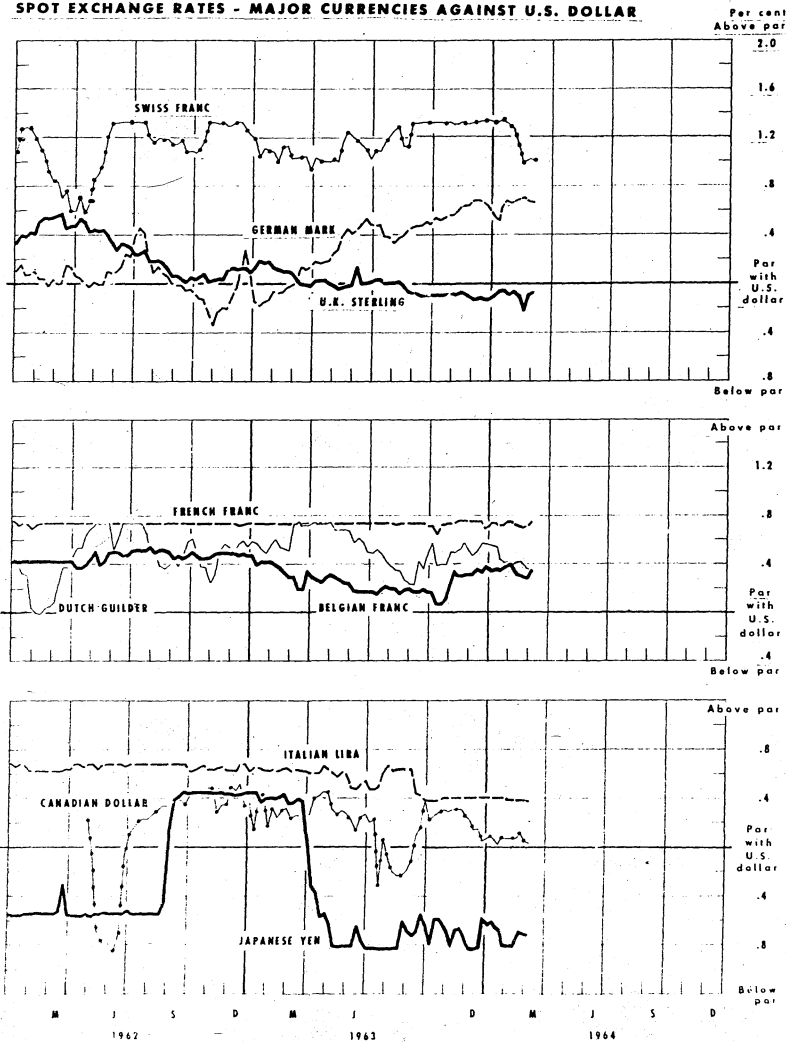
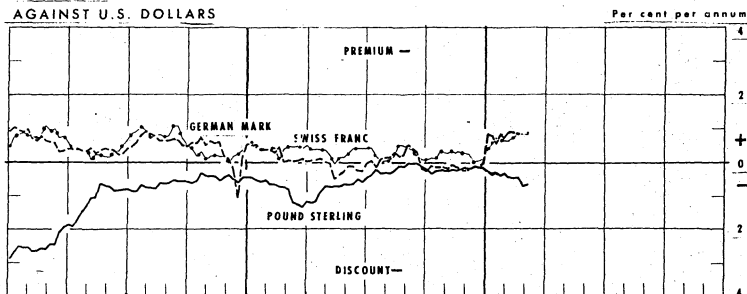


Chart 9

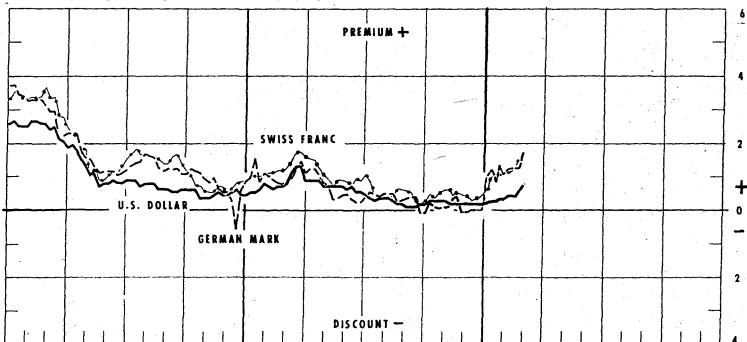
3-MONTH FORWARD EXCHANGE RATE

Friday figures

AGAINST U.S. DOLLARS



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON

