

H. 13
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CAPITAL MARKET DEVELOPMENTS ABROAD

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

I. Germany: Money and Capital Markets, March 1964

The repercussions of new measures taken to cope with Germany's capital inflow and growing balance-of-payments surplus dominated German financial markets during March. The bond and the foreign exchange markets in particular were affected by official action, and the maintenance of high short-term rates beyond the mid-March tax date may have reflected, in part, commercial bank "money exports" especially induced by the new Bundesbank measures. Stock prices advanced further to new recent highs in the period under review and the spot D-mark remained strong.

Table 1. Germany: Yield on German Railway 5-1/2 per cent Bond (1958-1963)
(per cent per annum)

1963: December	6	6.05	February	7	5.81
1964: January	3	6.04		14	5.79
	10	6.01	March	6	5.80
	17	5.89		13	5.81
	24	5.85		20	5.84
	31	5.84		26	6.07

Source: IFRD.

The bond market has responded dramatically to official attempts to reduce foreign purchases of new bond offerings. Early in February the decision to exclude foreign buyers from subscribing to new Federal Government securities for the first five days after the books are opened was successful in having an early-February offering fully subscribed within the five-day period reserved to domestic investors. However, the downward drift in bond yields noticeable since early January came to an end. (See Table 1.) As a result, official attempts to place a 5-1/2 per cent coupon on new Federal offerings were frustrated; sales of a Bundespost issue opened to domestic investors on March 6 were sluggish because of market resistance to the lower coupon. Market speculation about the measures the authorities would take to curb the foreign capital inflow contributed a general uncertainty and weak tone to the bond market during the first three weeks of March.

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Because of this pervasive uneasiness, the announcement on March 23 that Parliament would be asked to approve a 25 per cent withholding tax on non-resident holdings of bonds was followed by a severe reaction in the bond market. By March 26 the yield on the 5-1/2 per cent 1958-83 Bundesbank bond had risen from 5.81 per cent on March 13 to 6.07 per cent on March 26. (See Table 1.) With this reversal, the bond market had lost all the gains it had made in 1964; in fact, the 6.07 per cent yield reflected the lowest price quotation for the Bundesbahn issue since early November.

According to the press, a wave of selling hit the bond market in the four days preceding the Easter holidays. Selling orders were estimated at \$50 million (DM 200 million) "which smothered the exchanges and caused quotations to run hours behind." (Journal of Commerce, March 30, 1964, p. 3) This unexpectedly severe shakeout caused the authorities to postpone the new Federal Government loan which was scheduled to be offered in early April and which now undoubtedly will have a 6 per cent coupon when offered.

The severity of the market reaction seems to underscore the prominent role foreign investors have been playing in the German bond market. The principal objection of foreign investors to the proposed tax measure may well be, as was the case in the earlier experience with a withholding tax in Italy, to the registration of the security and not to the payment of the tax. The attractiveness of the stock market has also caused some shift of funds from the bond market. Finally, financial markets probably continue to be affected by uncertainties about what additional steps the German authorities will take to cope with the large capital inflow.

In the foreign-exchange market pressures on the D-mark eased in early March. The monetary authorities reactivated special arrangements to sell U.S. dollars forward to commercial banks (for investment in U.S. Treasury bills) at favorable rates. As a result, official reserve accruals slackened and the rates on the spot and forward D-mark eased slightly (see Table 7 and Chart 8) after mid-March.

The German payments surplus in January was \$129 million; in February the trade surplus (seasonally adjusted) exceeded \$300 million and official reserves increased by \$194 million. For the first two months of 1964, the overall German payments surplus was running much above the \$1.2 billion annual rate recorded for 1963.

Stock prices up 5 per cent in month. Buoyed up by continuing optimism about the economic outlook, the stock market has recently been quite active. Continuing heavy foreign purchases, in part a shift in investor interest away from the bond market, have helped to push the Frankfurter Allgemeine Zeitung (FAZ) stock index 5 per cent between mid-February and mid-March. (See Table 2 and Chart 7.) On March 20, in fact, the index stood 11 per cent above the end-1963 level. However, reaction to Chancellor Erhard's remarks at the Christian Democratic Union (CDU) convention on March 16 regarding the government's intention to introduce economic stabilization measures brought a pause in late March to the market's almost continuous 3-month rise.

Table 2. Germany: Stock Index, September 1963-March 1964
(December 31, 1958=100)

All time high:	Aug. 31, 1960	264.60	1964 high:	March 17	210.35
1963 high:	Sept. 9	194.81	low:	Jan. 2	189.08
1963 low:	Feb. 26	151.54			
1963	Sept. 27	191.89	1964	Feb. 7	198.48
	Oct. 31	186.05		14	198.67
	Nov. 29	180.80		21	200.91
	Dec. 31	187.71		28	202.06
1964	Jan. 10	193.73		March 6	204.49
	17	197.14		13	209.10
	24	197.32		20	209.22
	31	198.47		26	207.41

Source: Frankfurter Allgemeine Zeitung.

Money market tighter in late March. Possibly in response to governmental measures to encourage an outflow of short-term funds, money market rates remained higher than usual after the mid-March tax deadline, after remaining stable in February. (See Table 3.) Call money was up 1-1/2 per cent from early March to 4-1/2 per cent on March 26 (as reported in the FAZ), and other rates were slightly higher. The fact that bank deposits with the Bundesbank were down roughly 12 per cent during the second week of March reflects seasonal pressures on liquidity. Although bank reserves appeared adequate, the Easter buying season coming at the end of March no doubt placed additional strains on liquidity.

Table 3. Germany: Money Market Rates in Frankfurt, November, 1963-January, 1964 ^{a/}
(in per cent per annum)

		Day-to-day money	Three-month loans
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
February	1-7	2-5/8 - 3	3-1/4 - 3-3/8
	8-15	2-5/8 - 3	3-1/4 - 3-3/8
	16-23	3 - 3-1/8	3-1/4 - 3-3/8
	24-29	2-1/4 - 3-1/8	3-3/8

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

Source: Deutsche Bundesbank.

Federal government moves to reduce capital inflow. The continuing inflow of foreign funds and the government's concern with "imported inflation" induced the German Federal authorities to take several steps to reduce or offset the capital inflow in the period under review. The government has:

- a. Reinstituted special mark/dollar swap arrangements. Beginning on March 10, commercial banks could buy dollars with special forward DM cover at a favorable rate from the Bundesbank for funds to be placed in U.S. Treasury bills. Although the forward rate may be fixed daily, it has remained at 0.5 per cent per annum compared with the market's 0.88 per cent rate. The "special dollars" are available only in amounts over \$1 million and for periods of time concurrent with the Treasury bills acquired. The Bundesbank sells amounts of Treasury bills in New York equal to the amounts the commercial banks buy.
- b. Prohibited interest payments on foreign-owned time deposits. Beginning on March 20, commercial banks were prohibited from making interest payments on new time deposits received from foreigners. Savings accounts are exempted from the ruling.
- c. Increased to legal maximum the minimum reserves banks must keep against foreign deposits. Effective April 1, commercial bank reserves against foreign owned sight deposits will be increased from 13 to 30 per cent; for time deposits from 9 to 20 per cent.

These three measures are designed both to curb a short-term capital inflow (which in 1963 amounted net to only DM 138 million compared with the long-term inflow of DM 3.2 billion) and, perhaps more substantial in amount, to encourage a short-term capital export to offset reserve accruals. The higher reserve requirements for foreign deposits may encourage some short-term capital export, as well as make banks reluctant to receive new foreign deposits, since banks may include foreign assets in their reserves. But, according to the German press, the special mark/dollar swap arrangements thus far have generated relatively little outflow.

In addition, the authorities announced the intention to ask Parliament to approve as quickly as possible new legislation:

- a. To extend to non-residents the 25 per cent tax on income from fixed-interest bearing securities; and
- b. To exempt new foreign security issues from the 2.5 per cent tax presently applied to all foreign and industrial new issues.

These proposed new measures are designed to hit directly the long-term capital surplus: the "withholding tax" provisions to discourage inflows and the "securities tax" exemption to encourage capital outflows. Since the proposal of the withholding tax has already produced a severe adjustment in the bond market, the actual enactment of the measure would presumably be effective as a curb on foreign purchases of German bonds. However, the measure may involve

renegotiation of some of Germany's double-taxation treaties with other countries. Also, approval of the "securities tax" exemption could be delayed by strong opposition from the Laender; the revenues from this tax accrue to the Laender governments.

Trade surplus substantial. Continued strength in German exports, foretold in the very large expansion of export orders in late 1963, produced a surplus on merchandise trade account in February of DM 1.23 billion (\$308 million) seasonally-adjusted. (See Table 4.) With exports higher and imports down, the surplus was almost a half a billion D-marks larger than the January surplus. The growing backlog of export orders suggests a continuing large export surplus for the coming months.

Table 4. Germany: Merchandise Trade 1962-February 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	3.26	.43
I	4.40	4.15	3.07	.25
II	4.84	4.43	3.34	.41
III	4.99	4.66	3.44	.33
IV	5.01	4.27	3.17	.74
Nov.	5.08	4.33	3.22	.75
Dec.	4.80	3.90	2.87	.90
1964 Jan.	5.40	4.61	a/	.79
Feb. b/	5.51	4.28	a/	1.23

a/ Not available.

b/ Preliminary.

Source: Bundesbank, Monthly Report.

Impressive rise in official reserves. The Bundesbank registered a \$193 million gain in its international reserves in February after a loss in January which was due to the unwinding of commercial bank year-end window-dressing. (See Table 5.)

Official reserves rose only \$14 million during the first half of March because of Bundesbank dollar sales to commercial banks under its special mark/dollar swap arrangements. Although newspaper accounts of the swap arrangement implied some advantage in it for the U.S. balance of payments, transactions under the arrangement amount merely to a transfer of short-term U.S. liabilities from official to private parties.

Table 5. Germany: Changes in Reserve Position 1963-March 1964
(in millions of U.S. dollars)

	1963					1964			
	Dec. 1963	I	II	III	IV	Dec.	Jan.	Feb.	March
A. Bundesbank gold and foreign exchange									1-23
Gold	164	69	5	8	82	20	1	5	4
Foreign exchange	491	-70	248	163	150	36	-87	189	32
Total	655	-1	253	171	232	56	-86	194	36
B. Drawing rights on IMF	35	2	--	25	8	3	--	19	n.a.
C. Commercial banks foreign exchange	73	223	56	62	-268	-301	219	-50	n.a.
Total A through C	763	224	309	258	-28	-242	133	163	n.a.

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

D-mark continues strong. The D-mark remained strong on the exchange markets from mid-February to mid-March, buoyed up by heavy foreign investment and trade demand and occasional revaluation rumors. The Bundesbank bought U.S. dollars in considerable amounts at times and kept the rate for most of the period within a close range of 25.162 to 25.176 U.S. cents to the mark. (See Table 6 and Chart 8.)

The 1.0 per cent per annum premium on 3-month D-mark at the end of February eased slightly in early March after the Bundesbank began making cover against U.S. dollars (used for U.S. Treasury bill purchases) available to the commercial banks at special rates. However, relatively few funds were attracted to these securities at the special rate, and a continuing demand for D-mark cover kept the 3-month premium against U.S. dollars at between 0.8 and 0.9 per cent per annum for most of March.

In mid-March the Bundesbank participated with the Federal Reserve System and the Bank of England in a \$1.0 billion currency credit to Italian authorities in support of the lira.

Table 6. Germany: Exchange Rate in U.S. Cents per DM and
Three Months Forward Rates in per cent per annum
(noon buying rates)

		Par value					
		Upper limit	25.000				
		Lower limit	25.188				
			24.875				
		Spot	Forward			Spot	Forward
1963	Oct. 31	25.146	-0.2	1964	Jan. 31	25.166	0.8
	Nov. 29	25.161	-0.2		Feb. 7	25.169	0.9
	Dec. 27	25.156	0.0		14	25.171	0.9
					21	25.176	0.9
1964	Jan. 3	25.136	0.8		28	25.169	1.0
	10	25.130	0.8	Mar.	6	25.167	0.8
	17	25.157	0.6		13	25.168	0.8
	24	25.168	0.8		20	25.161	0.8

Source: Federal Reserve Board.

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

Table 7. Germany: Selected Money Market Yields and Exchange Rates
(per cent per annum)

	3-mo. Euro-dollar deposits <u>London</u>	3-mo. inter-bank loans <u>Frankfurt</u>	Spread in favor <u>London</u>	3-mo. U.S. \$ into Marks		3-mo. Treas. bills		
				Comm. bank ^{a/}	Market	U.K.	Ger.	U.S.
1963-March 29	3.69	3.63	+0.06	+0.75	+0.1	3.66	2.63	2.92
April 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. 27	4.25	4.88	-0.63	+0.75	0.0	3.61	2.63	3.50
1964-Jan. 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	3.31	+0.69	+0.75	+0.9	3.64	2.63	3.49
14	4.00	3.31	+0.69	+0.75	+0.9	3.64	2.63	3.50
21	4.06	3.31	+0.75	+0.75	+0.9	3.64	2.63	3.51
28	4.12	3.38	+0.74	+0.75	+1.0	4.16	2.63	3.56
March 6	4.31	n.a.	n.a.	+0.75	+0.8	4.16	2.63	3.52
13	4.25	n.a.	n.a.	+0.75	+0.8	4.16	2.63	3.53
20	4.25	n.a.	n.a.	+0.75	+0.9	4.16	2.63	3.52

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

Table 8. Germany: Selected Loan, Deposit and Security Rates
(end of month figures, 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-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	5.9	3.01	2.9
February	7.50	3.50	2.75	5.82	n.a.	n.a.	n.a.

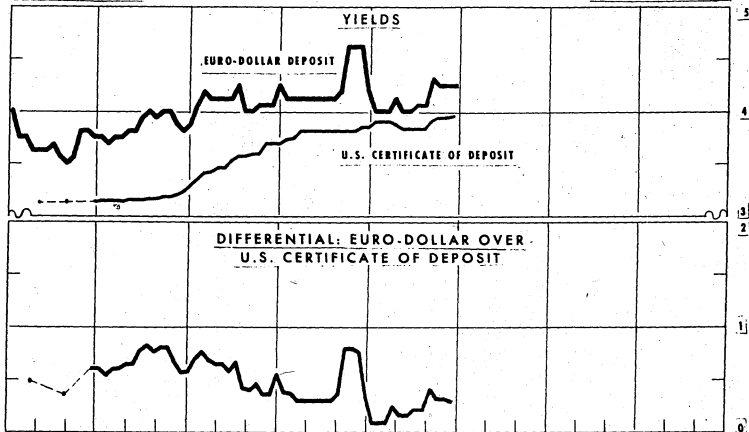
Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

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

Wednesday figures

Per cent per annum



NEW YORK OFFER RATES ON SELECTED 3-MONTH INVESTMENTS

Friday figures

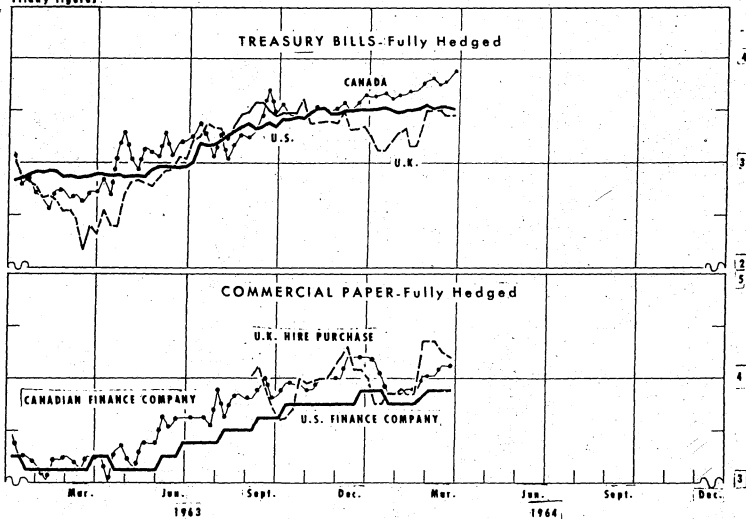


Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

Per cent per annum

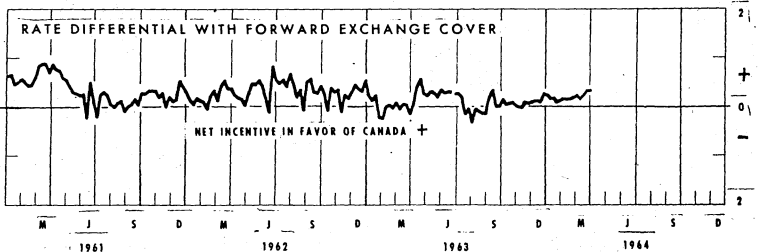
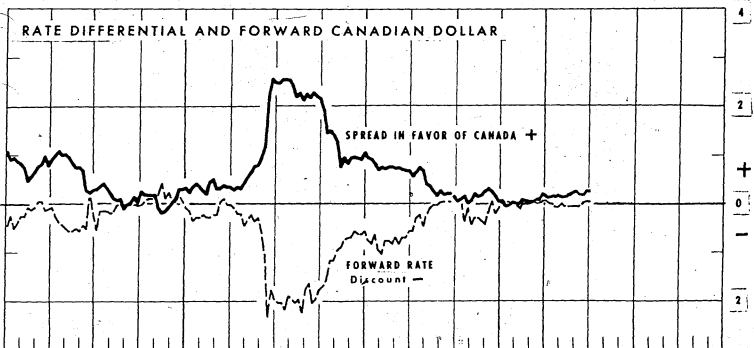
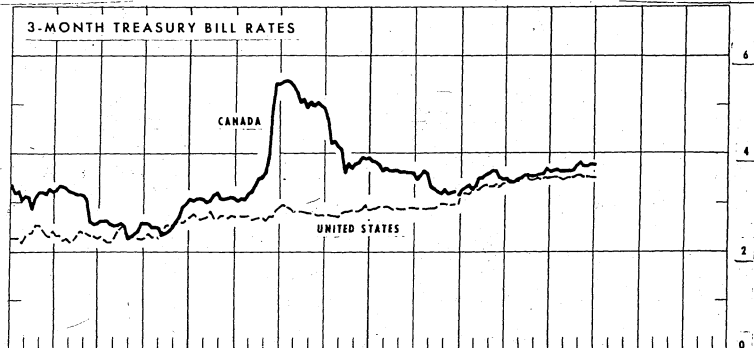


Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

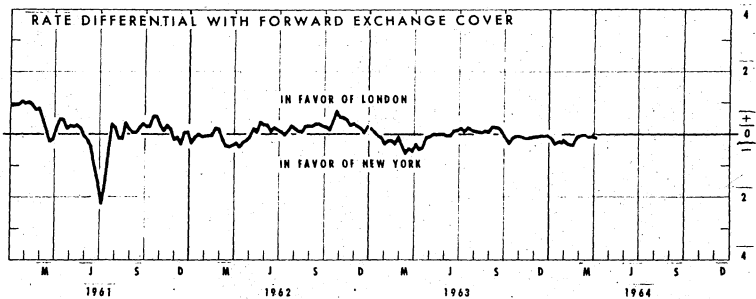
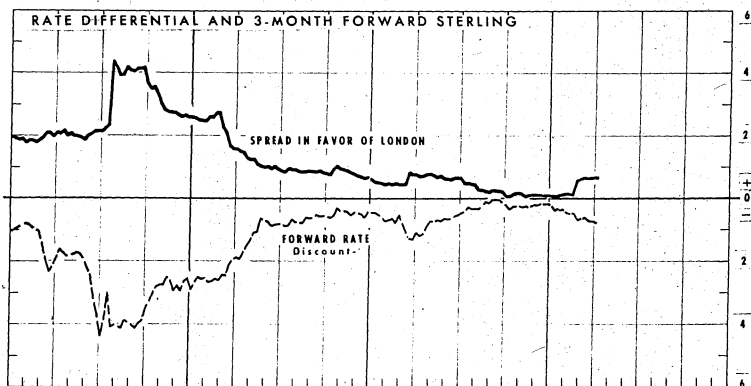
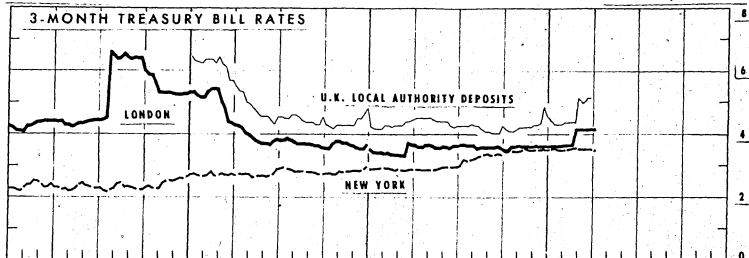


Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

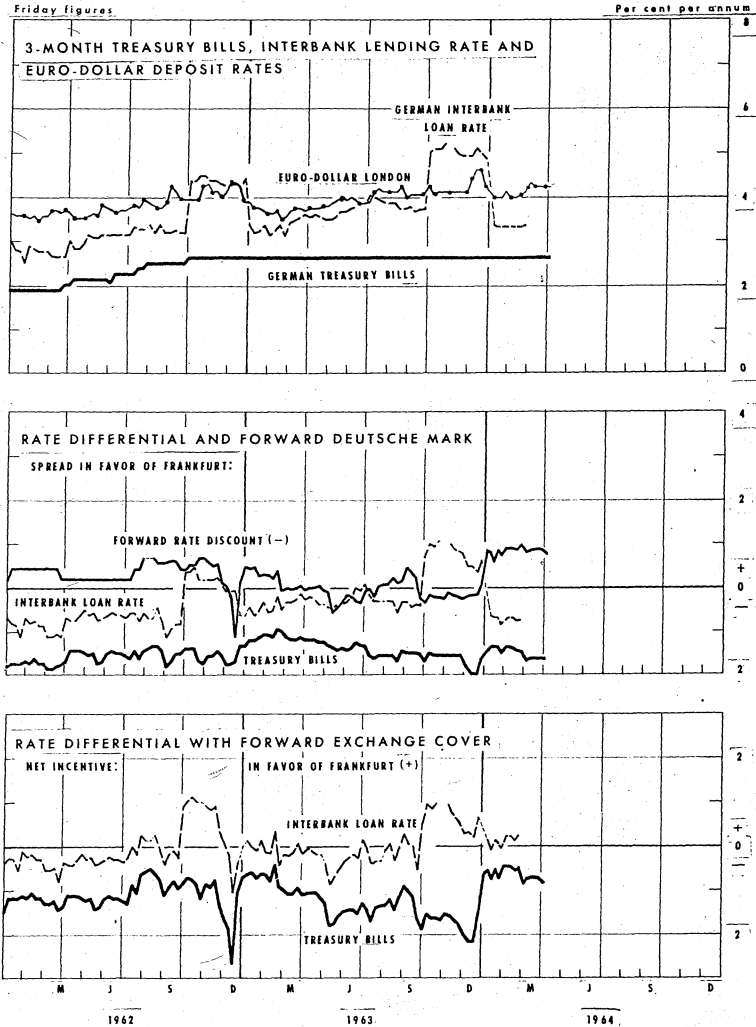
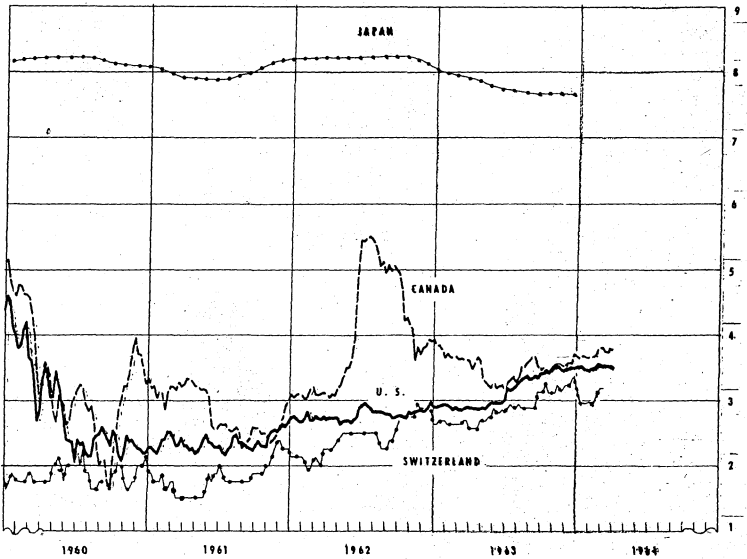
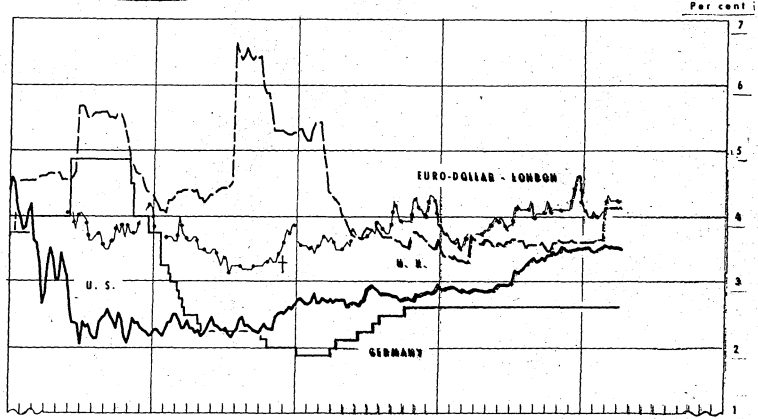


Chart 5
SHORT-TERM INTEREST RATES *



* 3 month treasury bill rates for all countries except Japan. (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

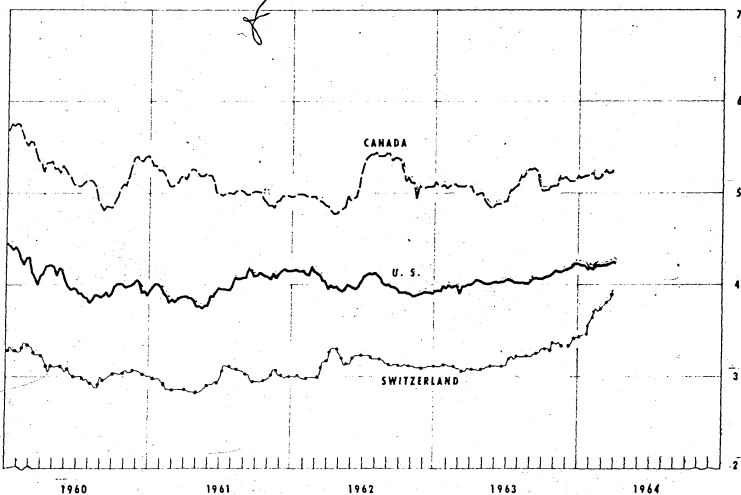
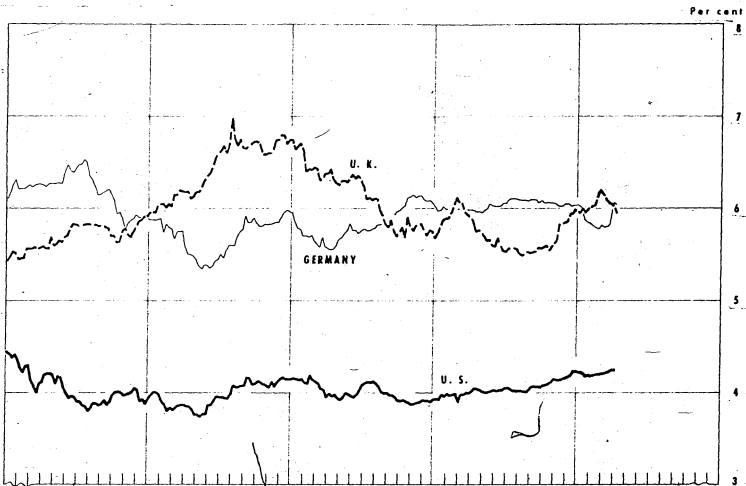
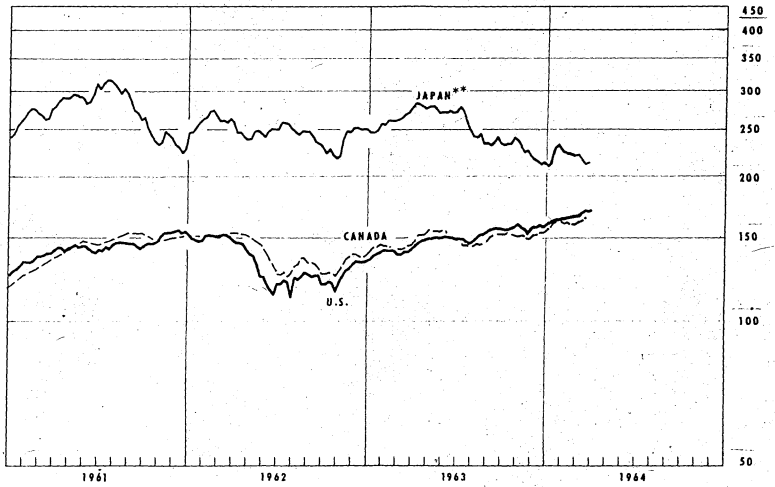
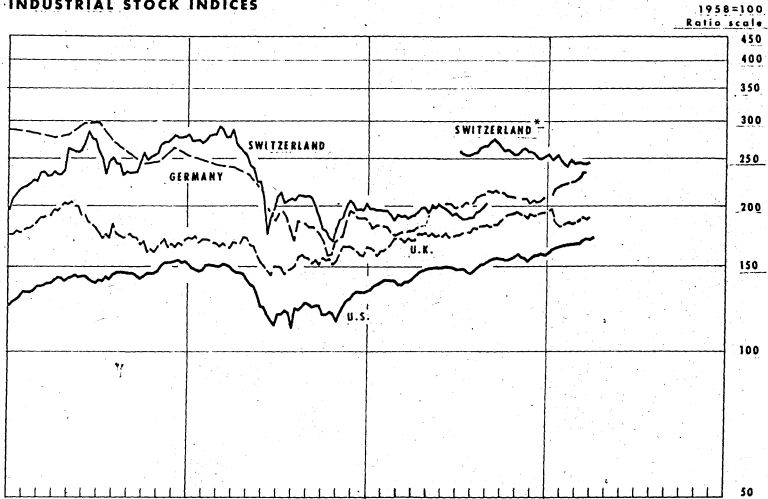


Chart 7
INDUSTRIAL STOCK INDICES



* New series Swiss Bank Corporation industrial stock index
 ** Japan index of 225 industrial and other stocks traded on the Tokyo exchange

Chart 8

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

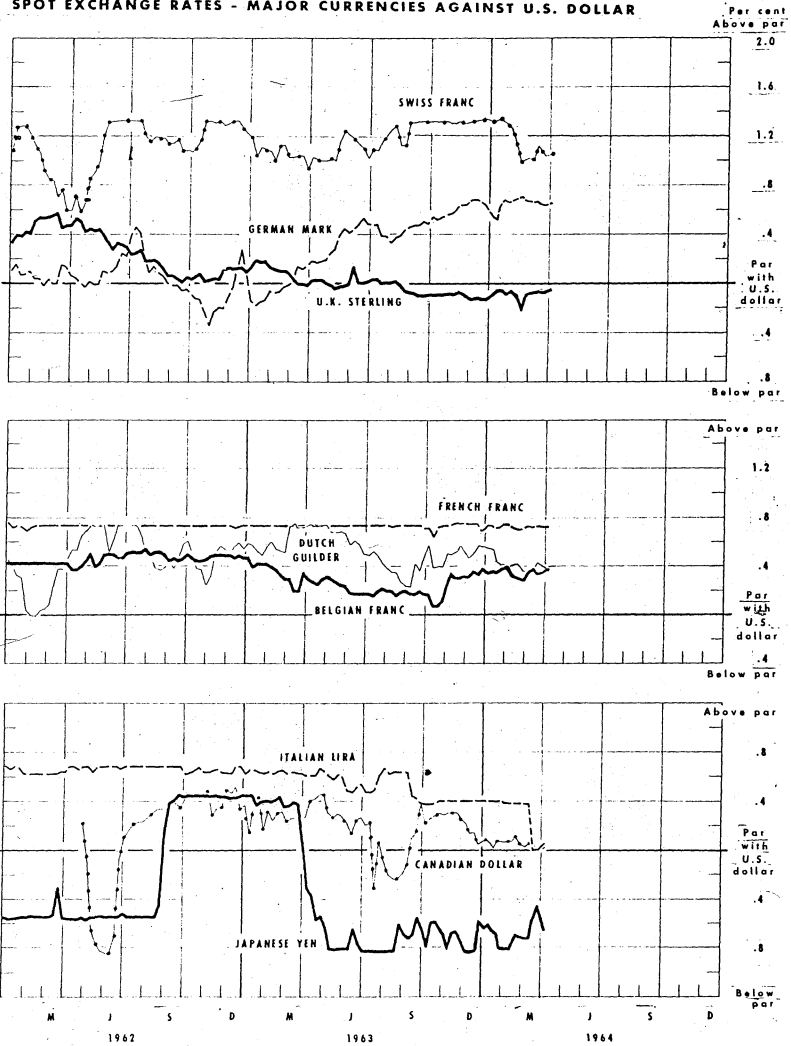
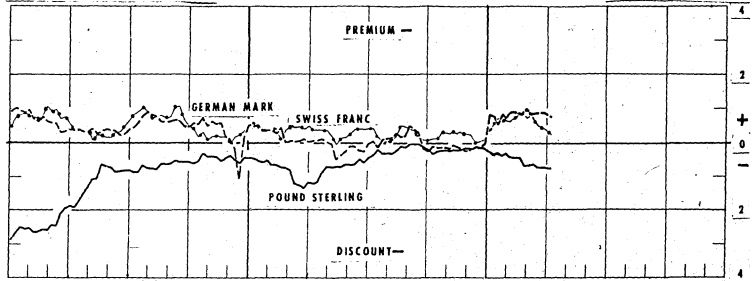


Chart 9
3-MONTH FORWARD EXCHANGE RATE

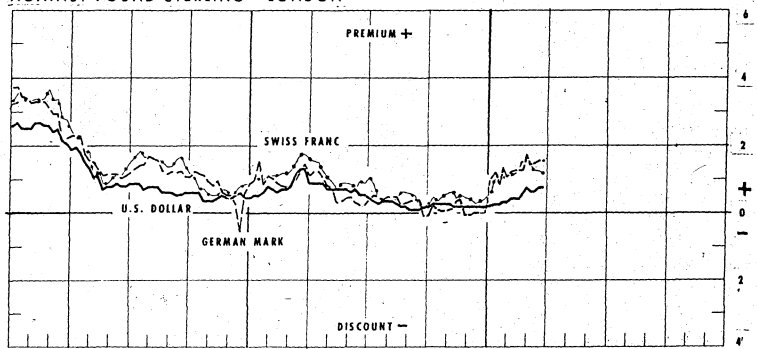
Friday figures

AGAINST U.S. DOLLARS

Per cent per annum



AGAINST POUND STERLING - LONDON



AGAINST POUND STERLING - LONDON

