DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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No. 148

May 13, 1964.

CAPITAL MARKET DEVELOPMENTS ABROAD

I. Germany
II. Nine Charts on Financial Markets Abroad

I. Germany: Money and Capital Markets in April 1964

Uncertainties both about the effects of measures already taken and about future governmental action designed to reduce capital inflow and to moderate the domestic business expansion dominated German financial markets during April.

The bond market--which had stabilized after the initial selling wave which followed the withholding tax plan announcement on interest payments to non-residents--remained under pressure throughout the month. Bond yields continued to rise. A representative Bundesbahn (Railway) bond which yielded 5.84 per cent on March 20 just prior to the announcement was at 6.05 per cent on April 3 and at 6.14 per cent on April 30. (See Table 1.) During the month, the Bundesbank is reported on occasion to have taken steps to support prices on Federal Government issues. For example, the Frankfurter Allgemeine Zeitung reported that on May 5 "public issues were kept at 99 because of support purchases by the Bundesbank. But the Bank had to take up substantial amounts."

Table 1. Germany: Selected Financial Indicators, March-April 1964

	March			April				
	6	20	27	3	10	17	24	30
Bond yields:								
Railroad bond (1958-83)	5.80	5.84	6.07	6.05	6.08	6.11	n.a.	6.14
Stock price index:								
Industrials (Dec. 31, 1958=100)	204.49	209.22	207.41	210.62	206.29	205.91	n.a.	202.81
Exchange rates:								
Spot DM (U.S. cents)	25.167	25.161	25.160	25.162	25.161	25.155	25.168	25.161
Forward (% per annum)	+0.8	+0.9	+0.9	+0.9	+0.7	+0.7	+0.5	+0.5
Foreign exchange reserves:								
Bundesbank (changes in period, millions U.S. $)	+45	-10	-127	n.a.	-5	-139	-27	+25

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Unsettled conditions in the bond market caused the Capital Market Committee to postpone a number of issues for the time being. Discussions in market circles speculate that either further increases in the long-term interest rate are in the offing or, alternatively, that a rationing system may be introduced. In any case, recent developments have effectively ended for the present any further official efforts to accustom the market to a 5.5 per cent coupon. The authorities have announced that a new Federal loan issue of DM 300 million (expected to have been offered in early April) will be opened on May 20 with a 6 per cent coupon; but the issue price has not yet been determined because of market conditions.

During April, the uneasiness which permeated the bond market also spread to the stock market. Despite continued favorable business news, the F.A.Z. index of industrial stock prices declined from 210.6 on April 3 to 202.8 on April 30. Apparently investors decided to adopt a "wait and see" attitude in the light of continuing official statements about stabilization measures to be adopted soon. A statement by Chancellor Erhard at the opening of the Hanover Trade Fair ruled out various proposals for drastic action (including modest inflation; revaluation of the D-mark; impeding of exports; and "manipulation of turnover taxes as they affect foreign trade"). Such official statements have relieved some of the fears of the business community, but the continuing weakness of stock prices suggests that a general sense of uneasiness apparently remains in business circles.

The recent official actions, for the time being at least, have helped to halt the continuing reserve accruals of the Bundesbank. Since mid-March official reserves have been declining and at end-April were $238 million below the end-February figure. Both heavy official payments abroad for purchases of military equipment and for restitution payments and Bundesbank sales of dollars to the commercial banks for investment in U.S. Treasury bills (under the special swap arrangement) have contributed to the down trend in official reserves. In addition, with the higher minimum reserve requirements against foreign deposits, the commercial banks are reported to have engaged in heavy money exports in early April since foreign assets can be offset against deposits in calculating required reserves.

After mid-April, the money market tightened considerably. Both technical factors (the banks may have underestimated requirements for the mid-April tax date) and the stoppage of capital inflows contributed to this change in market conditions.

The drying up of capital inflows should help to reduce the balance of payments surplus for April. However, the current-account surplus continues to grow: the surplus for the first quarter was DM 2.1 billion compared with a total of DM 4.6 billion for the entire year of 1963. (See Table 7.) The over-all balance of payments surplus for the quarter was DM 1.3 billion compared with DM 3.2 billion for 1963.1/ With a diminished long-term capital inflow, however, the surplus for March was much below the surpluses for January and February.

In the foreign-exchange market, the D-mark was quoted at 25.161 U.S. cents on May 1 or about 27 basis points below the upper level at which the Bundesbank is committed to intervene. On March 27, the rate had been 25.160 cents but the spot rate reached a high of 25.168 cents on April 24. (See Table 6.)

1/ Full year of 1963.

Securities markets weaken. Both the bond and stock markets weakened throughout April as a result of uncertainties about governmental action.

The bond market stabilized fairly quickly after the heavy selling wave which materialized when the 25 per cent withholding tax proposal was announced on March 25. Throughout April bonds were under slight selling pressure, both from foreign and domestic sources. Yields advanced further during the month · the yield on the 1958-83 Railroad bond, for example, rose by 30 basis points--to 6.14 per cent--between mid-March and the end of April. (See Table 1.)

Issues of the Federal Government particularly were under pressure. By contrast, bonds of foreign issuers in the German market, which are exempted from the withholding tax, were in strong demand. A new DM 40 million issue of the City of Oslo was placed easily as were placements, totalling DM 400 million, of convertible bonds by two major German firms. The convertible feature was rather an innovation in the German market, (particularly because it favors early conversion) and proved attractive to both domestic and foreign investors.

The fact that the Capital Market Committee allowed a DM 80 million municipal (6 per cent) loan and several small industrial issues to come on the market in April suggests that hesitancy at the moment centers around Federal issues. Thus, a DM 400 million Federal loan, which had been announced for early April, was postponed. The issue has now been scaled down to DM 300 million and will be offered on May 20 at a 6 per cent coupon. The issue price has not been announced as yet; the authorities are waiting to see how market conditions are developing. For the first five days of sale, subscription will be restricted to domestic customers. The financial press has observed that the absence of stronger measures, or admonishments, to exclude foreigners indicates that the authorities continue to depend on foreign participation in financing the Government's capital requirements.

There is speculation in financial circles that the authorities will either have to allow a rise in interest rates or will have to adopt a rationing system because of current market conditions. For the time being, placements such as the extraordinarily high volume of DM 3 billion in January or the more normal DM 1.3 billion in February appear to belong to the past. (See Table 2.)

The announcement on April 29 that the Cabinet had adopted the draft law governing the imposition of the withholding tax and the abolition of the 2.5 per cent securities tax on new foreign and domestic industrial issues, may help to steady the market. The draft law provides that the credit institutions shall withhold the tax. Residents will have to bring proof of residency and ownership if they hold the certificates themselves; where the bonds are lodged with banks, these institutions are deemed able to determine ownership for purposes of the tax. Refunds of the tax, under double taxation treaties, will be made by the internal revenue authorities upon certification by the foreign tax authorities that the foreign owner is taxed in his home country.

The stock market momentarily reached a new high for the year in early April, partly because there was some shifting of funds out of bonds into stocks after the announcement of the withholding tax proposal. (See Table 3.)

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

	1962		1963					1964	
	III	IV	I	II	III	IV	Dec.	Jan.	Feb.
"Occasional" borrowers bonds:									
Industrial	113	60	143	88	166	117	326	60	100
Public authorities	358	187	489	451	328	424	49	872	264
Foreign issuers	--	--	32	--	--	20	59	100	--
Other bonds 2/	154	57	259	153	180	172	190	472	275
Total	625	304	923	692	674	733	624	1,504	638
Mortgage and communal bonds	532	480	652	578	575	672	731	1,457	636
Total gross bond placements 3/	1,157	784	1,575	1,270	1,249	1,405	1,355	2,961	1,275
Gross share placements	172	170	155	51	117	116	110	288	67
Total security placements at issue value	1,329	954	1,730	1,321	1,366	1,521	1,465	3,249	1,341

1/ Market value.
2/ Mostly bonds of specialized credit institutions.
3/ Includes medium-term notes (Kassenobligationen).

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

Stock prices have been drifting lower continually since announcement of the withholding tax proposal, despite further favorable business news. Even Chancellor Erhard's announcement that the much-referred-to "stabilization package" will under no circumstances include such drastic measures as revaluation or the damping down of exports could not dispel the general uneasiness. By May 5, the F.A.Z. industrial stock index had fallen to 200.43, its lowest point since late February. (See Table 3.) Two large industrial issues amounting to nearly DM 200 million, which had been switched from the bond to the stock market because of the unsettled conditions in the former, had a further dampening effect upon the market.

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

All time high:	Aug. 31, 1960	264.60	1964 high:	Apr. 6	211.02
1963 high:	Sept. 9	194.81	low:	Jan. 2	189.08
1963 low:	Feb. 26	151.54			

1963	Oct.	31	186.05	1964	Mar.	13	209.10
	Nov.	29	180.80			26	207.41
	Dec.	31	187.71		Apr.	3	210.62
						10	206.29
1964	Jan.	10	193.73			17	205.91
		31	198.47			24	204.82
	Feb.	7	198.48			30	202.81
		28	202.06		May	5	200.43

Source: Frankfurter Allgemeine Zeitung.

Money market tightens. The commercial banks are reported to have exported substantial amounts of money market assets during early April when seasonal factors eased money market conditions. These exports were in large measure in response to the measures taken by the authorities in March. The banks are reported to have availed themselves substantially of the preferential swap possibilities extended by the Bundesbank for purposes of investment in U.S. Treasury bills; they also have placed funds in the Euro-dollar market. These movements were encouraged by the increase to 30 per cent in reserve requirements against foreign deposits. Because foreign money market assets can be offset against foreign deposit liabilities in calculating reserve requirements, money exports up to the extent of foreign deposit liabilities become profitable (unless domestic earning possibilities are sufficiently higher than those abroad to offset the holding of 30 per cent idle reserve balances).

At mid-month the money market tightened as banks were reported to have underestimated the requirements for the mid-April tax date. Call money rates in Frankfurt rose to close to 4 per cent by the end of the month, which was as high as the rates produced by the seasonal tightness at the end of March. (See Table 4.) The April liquidity stringency was in part also attributed to the stoppage of capital inflows.

Official reserves decline. Official foreign exchange reserves started to decline in mid-March and, except for a small increase at the end of April, have been decreasing since. (See Tables 1 and 5.) The March decline of $92 million reflected the Italian drawing of DM at the IMF, official payments abroad for military purposes and, to a lesser extent, the re-activation of swap agreements with the commercial banks. In April official reserves are estimated to have declined by $146 million. Official payments abroad--for restitution and military purposes--again played a significant role, and sales of dollars to the commercial banks for investment in U.S. Treasury bills under the swap agreement were more important than in the preceding month. In addition, capital inflows appeared to have stopped so that the Bundesbank was no longer required to take foreign exchange from the market.

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

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

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

Source: Deutsche Bundesbank.

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

	Jan.-Dec. 1963	1963 I	1963 II	1963 III	1963 IV	1964 Jan.	1964 Feb.	1964 Mar.	1964 Apr. 1/
A. Bundesbank gold and foreign exchange									
Gold	164	69	5	8	82	1	5	104	107
Foreign exchange	491	-70	248	163	150	-87	189	-196	-253
Total	655	- 1	253	171	232	-86	194	- 92	-146
B. Drawing rights on IMF	35	2	--	25	8	--	19	90	a/
C. Commercial banks foreign exchange	73	223	56	62	-268	219	-50	67	a/
Total A through C	763	224	309	258	-28	133	163	65	a/

1/ Estimated.
a/ Not available.

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

Demand for D-mark eases. With reduced foreign inflows and the exports of short-term funds, demand for the D-mark decreased somewhat in the foreign exchange market during April. (See Table 6.) Quotations for the D-mark eased from 25.168 U.S. cents in mid-March to 25.155 cents in mid-April. By May first, the DM was quoted at 25.161 cents, which still was only 27 basis points below the upper level of 25.188 cents at which the Bundesbank is committed to intervene. At the same time, the large forward premium on the DM also narrowed: it declined from 0.9 per cent in mid-March to 0.5 per cent at the beginning of May, suggesting an easing of speculative factors. At the current level of 0.5 per cent, the exchange market rates equal the Bundesbank's special swap rate for investment in U.S. Treasury bills.

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

Par value	25.000
Upper limit	25.188
Lower limit	24.875

			Spot 1/	Forward 2/				Spot 1/	Forward 2/
1963	Oct.	31	25.146	-0.2	1964	Mar.	6	25.167	+0.8
	Nov.	29	25.161	-0.2			20	25.161	+0.9
	Dec.	27	25.156	+0.0			27	25.160	+0.9
						Apr.	3	25.162	+0.9
1964	Jan.	31	25.166	+0.8			10	25.161	+0.7
	Feb.	7	25.169	+0.9			17	25.155	+0.7
		21	25.176	+0.9			24	25.168	+0.5
						May	1	25.161	+0.5

1/ Certified noon buying rate in New York.
2/ Closing market rate in Frankfurt.

Source: Federal Reserve Board.

Large first quarter balance of payments surplus. Current estimates are that the April balance of payments surplus should be much diminished, if there is a surplus at all, because of the stoppage of capital inflows. The first quarter surplus was a hefty DM 1.3 billion, but the March surplus already was much below the surpluses for January and February. (See Table 7.) The March results reflected the slowdown in the long-term capital inflow, the current account surplus remaining very high.

Table 7. Germany: Balance of Payments 1963-March 1964
(in millions of DM)

	1963				1964		
	I	II	III	IV	I a/	Feb.	Mar. a/
1. GOODS & SERVICES							
Trade balance	688	1138	1200	2860	2369	916	815
Services	62	-435	-841	- 74	-256	-39	-100
Total	750	703	359	2786	2133	877	715
2. OFFICIAL PAYMENTS							
Donations	-1016	-976	-915	-693	-815	-239	-253
Long-term capital	- 96	-251	- 86	-434	-178	- 75	- 44
Short-term capital	116	270	592	-1296	-373	-227	61
Total	-996	-957	-409	-2423	-1366	-541	-236
3. PRIVATE CAPITAL							
Securities transactions							
Foreign purchases 1/	700	731	773	655			
German purchases							
(increase-) 2/	-160	- 44	-100	-167	359	139	33
Other long-term	203	285	150	154			
Short-term 3/	78	278	205	454	-589	85	-265
Errors and omissions	247	246	178	-1509	817	60	-50
Total	1086	1496	1206	- 413	587	284	-282
SURPLUS OR DEFICIT (-)	822	1242	1156	- 51	1334	620	197

a/ Preliminary.
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.

Foreign trade continues to expand. A continued large favorable trade balance is indicated for Germany in view of the strong inflow of foreign orders. This again was apparent at the recent Hanover Trade Fair where foreigners placed large orders. The decline in the seasonally adjusted trade figures between February and March was mainly attributed to the fact that the seasonal adjustment does not properly take account of the Easter holiday. (See Table 8.)

Table 8. Germany: Merchandise Trade 1962 - March 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	3.38	.79
	Feb.	5.51	4.28	3.31	1.23
	Mar. b/	4.90	4.45	a/	.45

a/ Not available.
b/ Preliminary.

Source: Bundesbank, Monthly Report.

Europe and British Commonwealth Section.

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: Comm. bank	3-mo. U.S. $ into Marks: Market	3-mo. Treas. bills: U.K.	3-mo. Treas. bills: Ger.	3-mo. Treas. bills: U.S.
1963-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	-0.82	+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	3.38	+0.93	+0.75	+0.8	4.16	2.63	3.52
13	4.25	3.50	+0.75	+0.50	+0.8	4.16	2.63	3.53
20	4.25	3.44	+0.81	+0.50	+0.9	4.16	2.63	3.52
27	4.25	3.50	+0.75	+0.50	+0.9	4.16	2.63	3.52
April 3	4.25	n.a.	n.a.	+0.50	+0.8	4.16	2.63	3.50
10	4.25	n.a.	n.a.	+0.50	+0.8	4.16	2.63	3.44
17	4.25	n.a.	n.a.	+0.50	+0.7	4.16	2.63	3.45
24	4.19	n.a.	n.a.	0.50	+0.5	4.16	2.63	3.43

Table 10. Germany: Selected Loan, Deposit and Security Rates
(per cent per annum)

	Comm. bank loans a/	6-12 mo. deposits: Savings	6-12 mo. deposits: Time	Bond yields: 5-1/2% Railway 1958-83	Bond yields: Public authorities	Share Yields	Yield gap
1962-November	7.50	3.50	2.75	6.14	6.2	3.34	2.9
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	5.9	2.93	3.0
March	7.50	3.50	2.75	6.07	n.a.	n.a.	n.a.

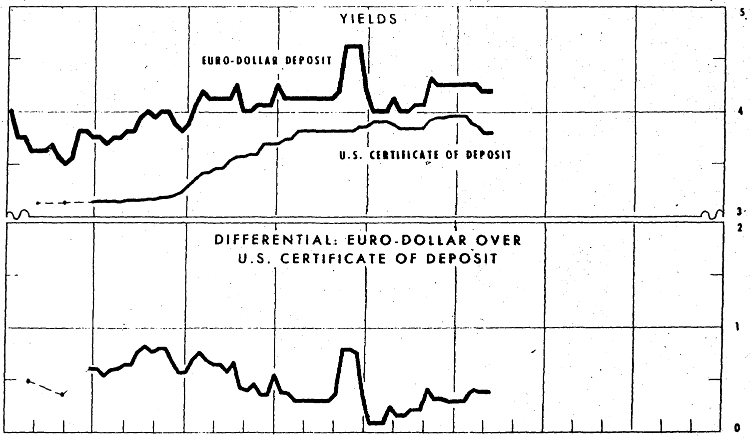
a/ Approved credits on current account.

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



NEW YORK OFFER RATES ON SELECTED 3-MONTH INVESTMENTS

Friday figures

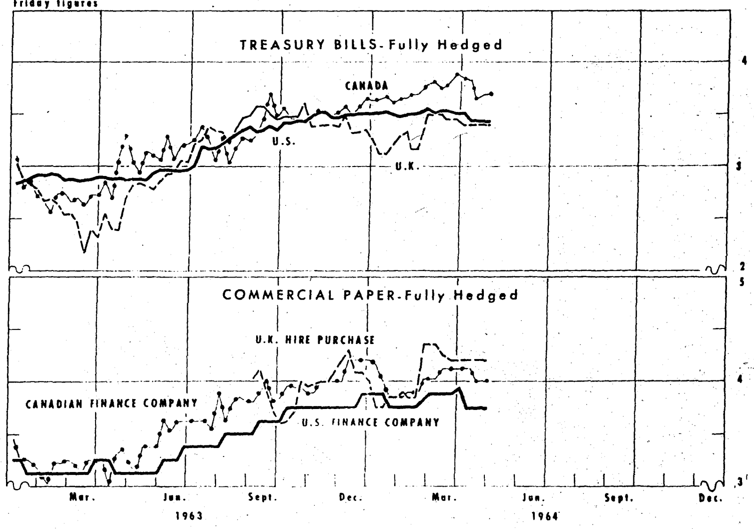
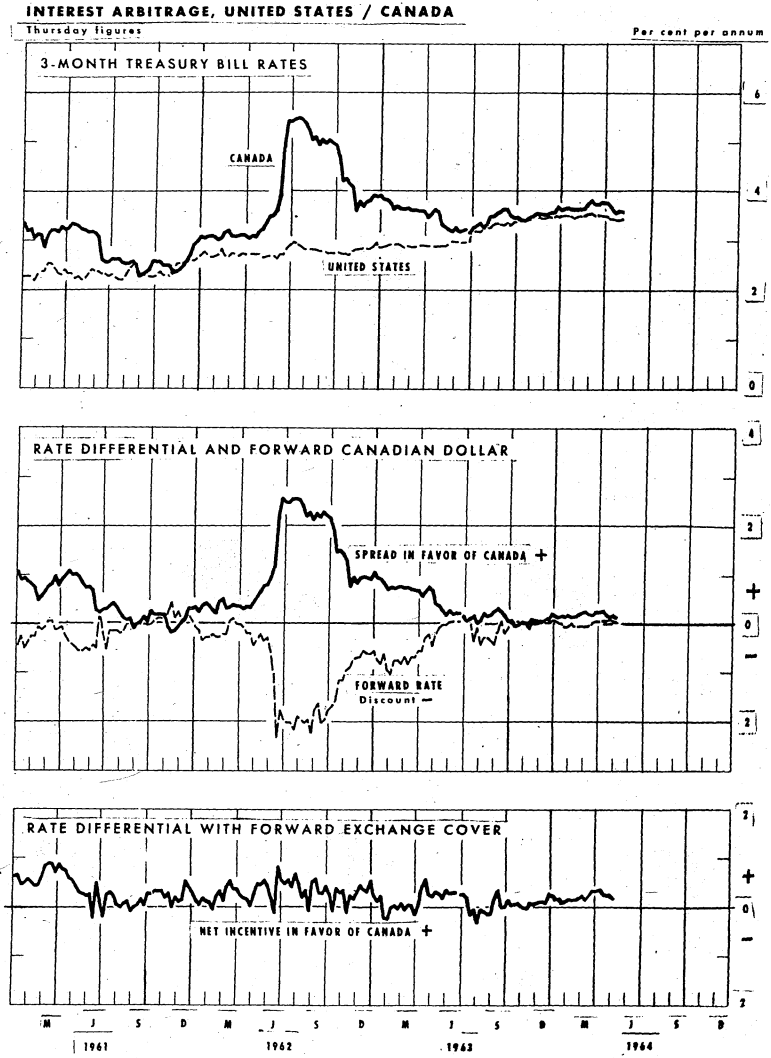


Chart 2


INTEREST ARBITRAGE, UNITED STATES / CANADA
Thursday figures
Per cent per annum
3-MONTH TREASURY BILL RATES
CANADA
UNITED STATES
6
4
2
0
RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR
SPREAD IN FAVOR OF CANADA +
FORWARD RATE
Discount –
4
2
+
0
–
2
RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER
NET INCENTIVE IN FAVOR OF CANADA +
2
+
0
–
2
M J S D M J S D M J S D M J S D
1961
1962
1963
1964

13

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

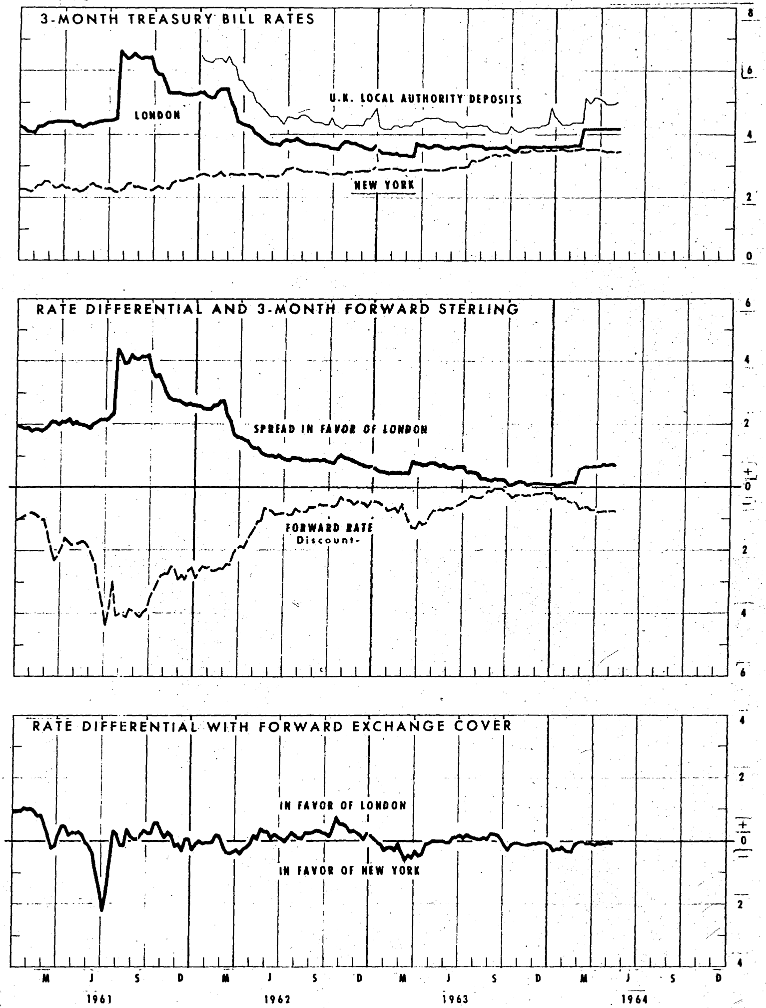


Chart 4
INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

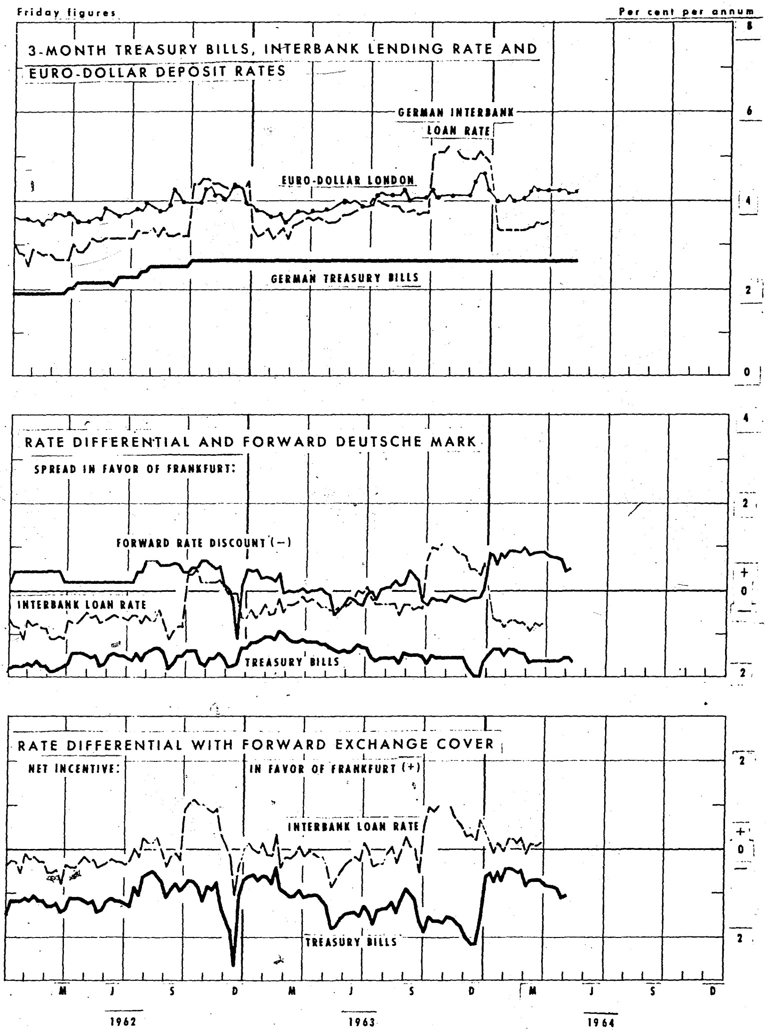
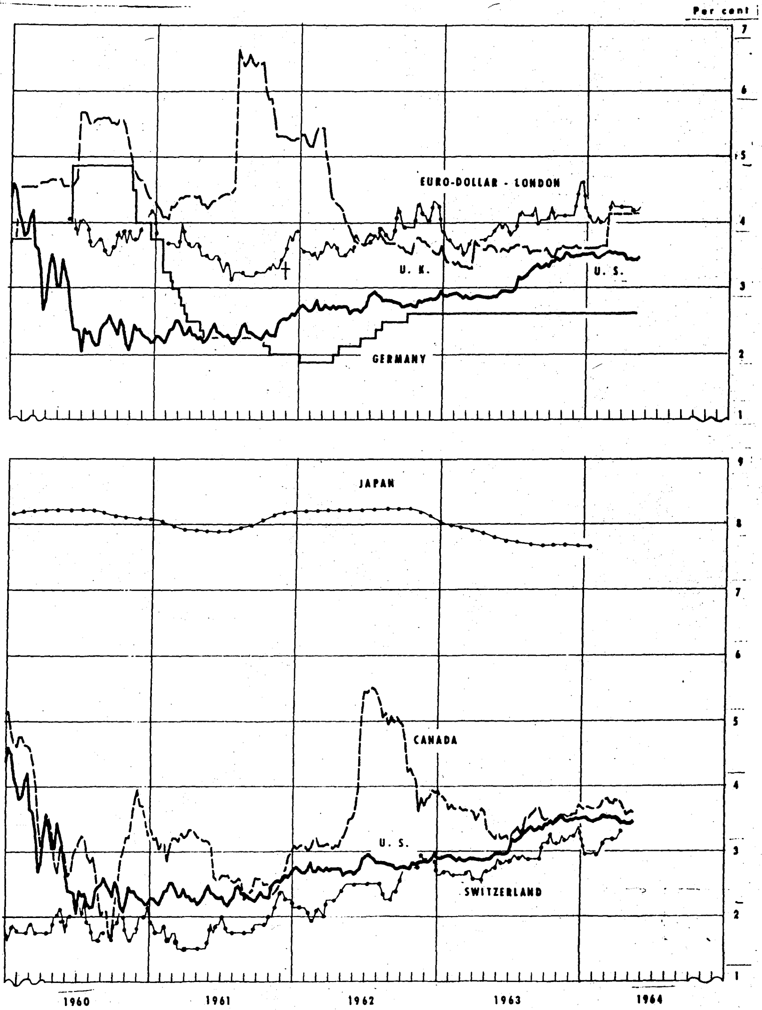


Chart 5
SHORT-TERM INTEREST RATES *



* 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

16

Chart 6

LONG-TERM BOND YIELDS

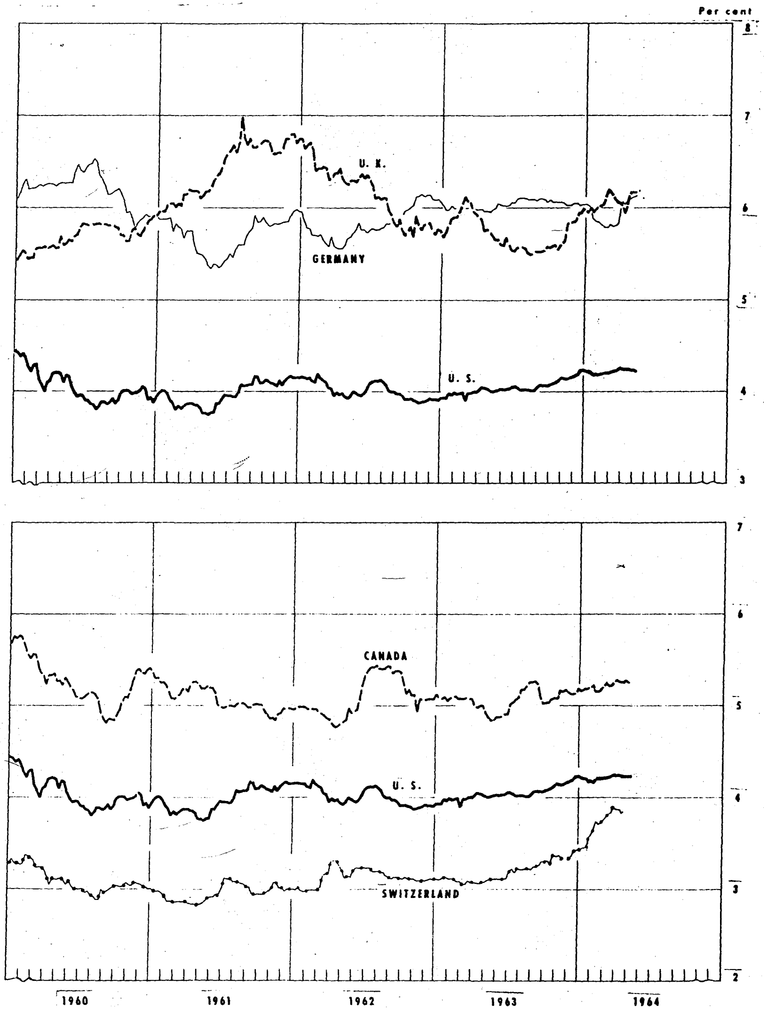
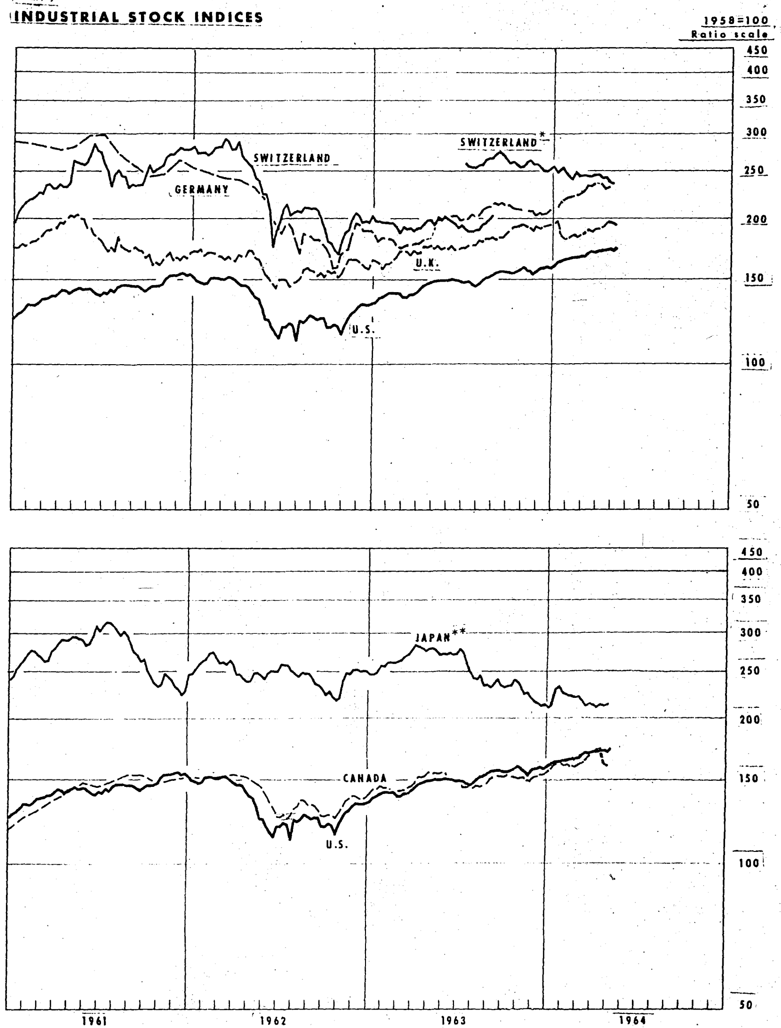


Chart 7

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

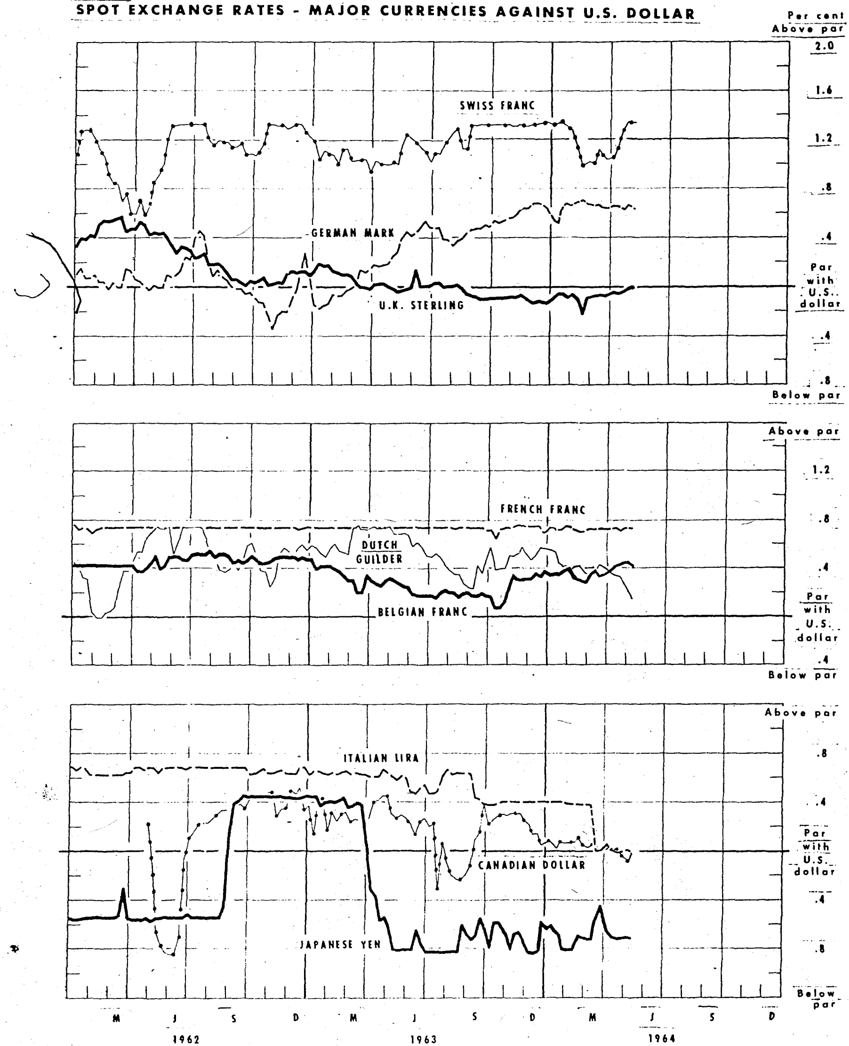

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Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures