During May, both the German bond and stock markets continued to show the effects of recent government actions and uncertainties about what further measures might be taken. As a result, the yield on a representative Federal Railways bond rose from 5.84 per cent in March (at the time the withholding tax proposal was announced) to 6.14 per cent on April 30 and to 6.29 per cent on June 5. (See Table 1.) At the same time, the stock price index declined from 209 on March 20 to 203 on April 30 and 193 on June 5.

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

<table>
<thead>
<tr>
<th>March</th>
<th>April</th>
<th>May</th>
<th>June</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bond yields:</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Stock price index:

| Industrials (Dec. 31, 1958=100) | 204.49 | 209.22 | 202.81 | 198.43 | 201.31 | 198.35 | 194.52 | 193.24 |

Exchange rates:

| Forward ($ per annum) | +0.8   | +0.9   | +0.5   | +0.5   | +0.5   | +0.4   | +0.4   | +0.7   |

Even though bond yields remained under pressure, there were signs that the bond market was adjusting to the withdrawal of foreign money and other effects of policy uncertainties. The few domestic bond offerings announced during the period under review were fairly well received, in part because other issues were kept off the market. On May 20, a DM 300 million Federal loan (issued at 99 with a 6 per cent coupon) was sold entirely to domestic customers. However, the success of this postponed issue was in part the result of substantial purchases of outstanding bonds by the Bundesbank to hold market prices at 99.

(Officials Use Only)
Decontrolled after six months
At the same time, an active market has developed since the proposed tax action in foreign bonds denominated in D-marks. Because these bonds are not to be subject to the proposed tax, they have been in heavy demand, primarily by foreign interests. Foreign purchases of these bonds also points up international confidence in the D-mark in preference to other currencies. For example, the press has reported that an international banking consortium is preparing to offer a sterling loan for the City of Turin which will contain a D-mark clause.

During May and June, some DM 420 million of foreign bonds were successfully placed including:

<table>
<thead>
<tr>
<th>Amount (million DM)</th>
<th>Borrower</th>
<th>Coupon</th>
<th>Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
<td>Steel and Coal Community</td>
<td>5-1/2</td>
<td>98.5</td>
</tr>
<tr>
<td>80</td>
<td>European Investment Bank</td>
<td>5-1/2</td>
<td>99</td>
</tr>
<tr>
<td>40</td>
<td>Finnish Mortgage Bank</td>
<td>6</td>
<td>98-1/4</td>
</tr>
<tr>
<td>200</td>
<td>Japanese Government</td>
<td>6</td>
<td>99</td>
</tr>
</tbody>
</table>

The development of this business in foreign bonds means that one of the major repercussions of the withholding tax proposal has been the emergence of Germany as an important financial intermediary with funds from foreign investors being channelled into foreign bonds through the D-mark.

The weak tone prevailing in the bond market was also found in the stock market despite continued favorable business news. (See Table 1.) Largely as a result of sales by foreigners, stock prices declined by 4 per cent during May and on June 5 were 8 per cent below the 1964 high on April 6.

In the exchange market, both the spot and forward quotation for the D-mark eased slightly during the first part of May. (See Table 1.) The stoppage of further inflows of foreign funds and some actual withdrawals contributed to the easier tendency. During May, the Bundesbank's foreign exchange holdings declined by $4.7 million.

However, demand for the D-mark strengthened later in May and in June. Renewed rumors of a DM revaluation followed a speech by Economic Minister Schmuckecker on May 31 in which he maintained that the stabilization measures thus far taken by the Federal government could only buy time; he added that, in the long-run, it would not be possible to operate a system of fixed exchange rates if some countries did not exercise greater financial restraints. Renewed speculative inflows set off by this statement pushed the spot rate to 25.168 cents on June 10 and the forward premium to 0.9 per cent per annum.
The German foreign trade surplus remained large in April and May. But it is estimated that in April it may not have been sufficiently large to offset heavy Government payments abroad; hence with the cessation of foreign capital inflows, there may have been a balance of payments deficit. In May, Government payments were smaller and there was presumably a surplus again.

In a further effort to cut down the large trade surplus, the Federal Government has proposed a number of unilateral tariff cuts. These, however, would primarily benefit other EEC countries. But most of the EEC countries may not be able to take advantage of this gain because they themselves are short of resources at this time.

Money market conditions eased somewhat in May, but call money rates remained above the discount rate during most of the period. A levelling off of money exports on the part of the commercial banks contributed to this ease: because the forward premium on the DM was reduced in May there no longer was an incentive to place funds in U.S. Treasury bills under the Bundesbank's preferential forward cover; similarly, the incentive to money exports from the higher reserve requirements on foreign-owned deposits (which can be offset by German bank's foreign short-term assets) had spent itself. In addition, the banks began preparing for seasonal demands in connection with approaching tax dates.

Securities markets continued under pressure

The bond market remained under selling pressure from foreign interests during the period under review and bond yields continued to rise. Since the beginning of March the yield on a representative Federal Railways bond has risen by 17 basis points, indicating a definite end to any further attempts to bring German interest rates down. (See Table 1.)

The new DM 300 million Federal Government loan, floated on May 20, at a price of 99 and bearing a 6 per cent coupon, was well received and could be placed entirely during the first five days when sales were restricted to domestic purchasers. But this was only possible because the Bundesbank engaged in heavy support purchases of outstanding bonds. Banks sold the older issues and bought the new bonds because they receive bonuses on initial purchases of large blocks. With domestic offerings carefully limited, the few new loans floated during May could be placed fairly successfully.

On the other hand, activity in new foreign bonds was very heavy in May. During May and early June, DM 420 million worth of foreign issues denominated in DM were placed very successfully. Foreign demand for new and outstanding foreign bonds has been active. During May considerable switching by foreigners out of German domestic bonds into DM-denominated foreign bonds was reported. Quotations for these bonds reached highs in May, but have since levelled off.

Despite continuing favorable business news, the stock market remained sluggish during May and early June. The F.A.Z. stock index on June 5 was 8 per cent below the 1964 high registered on April 6 and 1 per cent below the end of
April level. A significant part of the weakness in stock prices is attributed to sales by foreigners. The weakness in the market makes the placing of new stock offerings unfavorable just at a time when companies have been planning to turn to the market for the financing of large capital investment plans.

D-mark eases in May and strengthening in June

With the stoppage of inflows of foreign funds and perhaps with some outflows, the demand for the D-mark eased somewhat in foreign exchange markets. (See Table 2 and Chart 8.) Quotations moved from 25.168 U.S. cents at the end of April down to 25.157 U.S. cents by mid-May and the Bundesbank was reported to have made dollars available to the market.

Renewed rumors of revaluation at the end of May, however, set off inflows of speculative funds and the DM rate moved up to 25.168 U.S. cents by June 10. (See Table 2.) The speculative flows were triggered by renewed discussions centering on exchange rate changes ranging from a widening of the margins around parity to a revaluation. A statement by Economic Minister Schmuecker on May 31 contributed to renewed reports of exchange-rate alterations.

Table 2. Germany: Exchange Rate in U.S. cents per DM and Three Months Forward Rates in per cent per annum

<table>
<thead>
<tr>
<th>Par value</th>
<th>25.000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upper limit</td>
<td>25.188</td>
</tr>
<tr>
<td>Lower limit</td>
<td>24.875</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Year</th>
<th>Month</th>
<th>Spot 1/</th>
<th>Forward 2/</th>
<th>Year</th>
<th>Month</th>
<th>Spot 1/</th>
<th>Forward 2/</th>
</tr>
</thead>
<tbody>
<tr>
<td>1963</td>
<td>Oct. 31</td>
<td>25.116</td>
<td>-0.2</td>
<td>1964</td>
<td>April 24</td>
<td>25.168</td>
<td>+0.5</td>
</tr>
<tr>
<td></td>
<td>Nov. 29</td>
<td>25.161</td>
<td>-0.2</td>
<td></td>
<td>May 8</td>
<td>25.158</td>
<td>+0.5</td>
</tr>
<tr>
<td></td>
<td>Dec. 27</td>
<td>25.156</td>
<td>+0.0</td>
<td></td>
<td>15</td>
<td>25.157</td>
<td>+0.5</td>
</tr>
<tr>
<td>1964</td>
<td>Jan. 31</td>
<td>25.166</td>
<td>+0.8</td>
<td></td>
<td>22</td>
<td>25.160</td>
<td>+0.4</td>
</tr>
<tr>
<td></td>
<td>Feb. 21</td>
<td>25.176</td>
<td>+0.9</td>
<td></td>
<td>29</td>
<td>25.164</td>
<td>+0.4</td>
</tr>
<tr>
<td></td>
<td>March 27</td>
<td>25.160</td>
<td>+0.9</td>
<td></td>
<td>June 5</td>
<td>25.169</td>
<td>+0.7</td>
</tr>
<tr>
<td></td>
<td>April 10</td>
<td>25.161</td>
<td>+0.8</td>
<td></td>
<td>10</td>
<td>25.168</td>
<td>+0.9</td>
</tr>
</tbody>
</table>

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

Source: Federal Reserve Board.

Official reserves decline in May

Official reserves declined in May by $147 million. (See Table 3.) But this decline was not (as in April) associated with the sale of dollars to German commercial banks for investment in U.S. Treasury bills. Because of the decline of the forward premium of the DM in the market to 0.4 - 0.5 per cent per annum during May, the 0.5 per cent cover rate provided by the Bundesbank was no longer favorable. With the renewal of speculative inflows the market forward rate rose again to 0.7 per cent on June 5 and to 0.9 per cent on June 10 but commercial
banks do not appear to have availed themselves of the Bundesbank facilities at this time. Official reserves are estimated to have risen by over $100 million during the first week in June.

Table 3. Germany: Changes in Reserve Position 1963-May 1964

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Bundesbank gold and foreign exchange</td>
<td>161*</td>
<td>69</td>
<td>5</td>
<td>8</td>
<td>82</td>
<td>1</td>
</tr>
<tr>
<td>Gold</td>
<td>655</td>
<td>-70</td>
<td>248</td>
<td>-87</td>
<td>107</td>
<td>107</td>
</tr>
<tr>
<td>Foreign exchange</td>
<td>-70</td>
<td>248</td>
<td>163</td>
<td>150</td>
<td>189</td>
<td>92</td>
</tr>
<tr>
<td>Total</td>
<td>862</td>
<td>171</td>
<td>-70</td>
<td>171</td>
<td>-57</td>
<td>-1</td>
</tr>
<tr>
<td>B. Drawing rights on IMF</td>
<td>35</td>
<td>2</td>
<td>--</td>
<td>25</td>
<td>8</td>
<td>--</td>
</tr>
<tr>
<td>C. Commercial banks foreign exchange</td>
<td>73</td>
<td>223</td>
<td>56</td>
<td>-268</td>
<td>219</td>
<td>-50</td>
</tr>
<tr>
<td>Total A through C</td>
<td>763</td>
<td>224</td>
<td>309</td>
<td>258</td>
<td>133</td>
<td>163</td>
</tr>
</tbody>
</table>

1/ Estimated.


Money market somewhat easier in May

Probably because of the reduced outflow of short-term funds, the money market was somewhat easier in May than it had been in April, but rates remained above the discount rate for almost the entire period. (See Table 4.) Day-to-day money varied between 2-7/8 per cent and 3-7/8 per cent during the month. Three-month money remained steady between 3-5/8 per cent and 3-3/4 per cent.

The commercial banks are reported to have increased their net foreign exchange assets by about $90 million in April but these money exports are believed to have leveled off in May. The effects of the increase in reserve requirements, announced in March, on foreign held deposits (which increases the incentives of the banks to hold foreign assets because these may be offset as reserves against foreign deposits in calculating reserve requirements) may have been exhausted. Furthermore, the commercial banks are apparently preparing for coming tax needs for liquidity, after they were caught short during the April tax payment period.
Table 1. Germany: Money Market Rates in Frankfurt, January-May, 1964 a/ (in per cent per annum)

<table>
<thead>
<tr>
<th></th>
<th>Day-to-day money</th>
<th>Three-month loans</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2-7/8 - 3-1/8</td>
<td>3-5/8 - 3-3/4</td>
</tr>
<tr>
<td>March 1-7</td>
<td>2-3/4 - 3-1/4</td>
<td>3-3/8 - 3-1/2</td>
</tr>
<tr>
<td>8-15</td>
<td>3 - 3-7/8</td>
<td>3-1/2</td>
</tr>
<tr>
<td>16-23</td>
<td>3-3/4 - 4</td>
<td></td>
</tr>
<tr>
<td>24-31</td>
<td></td>
<td></td>
</tr>
<tr>
<td>April 1-7</td>
<td>3-1/4 - 3-1/2</td>
<td>3-5/8 - 3-3/4</td>
</tr>
<tr>
<td>8-15</td>
<td>2-7/8 - 3-1/4</td>
<td>3-1/2 - 3-5/8</td>
</tr>
<tr>
<td>16-23</td>
<td>3 - 3-7/8</td>
<td>3-5/8</td>
</tr>
<tr>
<td>21-30</td>
<td>3-1/2 - 3-5/8</td>
<td></td>
</tr>
<tr>
<td>May 1-7</td>
<td>3-1/2 - 3-7/8</td>
<td>3-5/8 - 3-3/4</td>
</tr>
<tr>
<td>8-15</td>
<td>2-7/8 - 3-3/8</td>
<td>3-5/8 - 3-3/4</td>
</tr>
<tr>
<td>16-23</td>
<td>3-1/4 - 3-5/8</td>
<td>3-5/8 - 3-3/4</td>
</tr>
<tr>
<td>24-31</td>
<td>3 - 3-3/8</td>
<td>3-5/8 - 3-3/4</td>
</tr>
</tbody>
</table>

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

Source: Deutsche Bundesbank.

Trade surplus remains high

The trade surplus increased further in April. (See Table 5.) Even though a continuation of the seasonally-adjusted surpluses of March and April would lead to a record trade surplus for the year, the results were well below the surpluses of the previous four months. Since the beginning of the year, the rise in imports (seasonally adjusted) has been greater than the rise in exports.

Attesting to the continuing demand for German exports, seasonally-adjusted foreign orders in April rose 20 per cent over the relatively low rate in March and 17 per cent over April 1963. A lengthening of order books is suggested by the fact that increases in exports have not kept pace with increases in foreign orders.

In an effort to control the trade surplus, the government announced on May 13 that it would propose unilateral reductions in customs duties. The proposals were as follows:

a. On industrial imports from the EEC from July 1, a 50 per cent reduction of duties presently over 1/4 per cent and an elimination of duties which are presently 1/4 per cent and under. The first concession would be equivalent to a reduction of 20 per cent in the rates existing when the EEC treaty was activated; present duties on EEC goods are 1/4 per cent of the "base" rates. The reduction, therefore, would be equivalent to an advance of the date of the 10 per cent reductions scheduled for January 1, 1965 and January 1, 1966.
Table 5. Germany: Merchandise Trade 1962 - April 1964
(seasonally adjusted monthly averages, in billions of DM)

<table>
<thead>
<tr>
<th></th>
<th>Exports</th>
<th>Imports</th>
<th>Industrial goods</th>
<th>Trade</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>f.o.b.</td>
<td>c.i.f.</td>
<td></td>
<td>Balance</td>
</tr>
<tr>
<td>1962</td>
<td>4.38</td>
<td>4.15</td>
<td>2.95</td>
<td>.23</td>
</tr>
<tr>
<td>Year</td>
<td>4.81</td>
<td>4.38</td>
<td>3.26</td>
<td>.43</td>
</tr>
<tr>
<td>1963</td>
<td>4.40</td>
<td>4.15</td>
<td>3.07</td>
<td>.25</td>
</tr>
<tr>
<td>I</td>
<td>4.94</td>
<td>4.66</td>
<td>3.34</td>
<td>.41</td>
</tr>
<tr>
<td>II</td>
<td>4.99</td>
<td>4.66</td>
<td>3.44</td>
<td>.33</td>
</tr>
<tr>
<td>III</td>
<td>5.01</td>
<td>4.16</td>
<td>3.17</td>
<td>.85</td>
</tr>
<tr>
<td>IV</td>
<td>5.08</td>
<td>4.31</td>
<td>3.22</td>
<td>.77</td>
</tr>
<tr>
<td>Nov.</td>
<td>4.80</td>
<td>3.64</td>
<td>2.87</td>
<td>1.16</td>
</tr>
<tr>
<td>Dec.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1964</td>
<td>5.10</td>
<td>4.61</td>
<td>3.38</td>
<td>.79</td>
</tr>
<tr>
<td>Jan.</td>
<td>5.51</td>
<td>4.28</td>
<td>3.31</td>
<td>1.23</td>
</tr>
<tr>
<td>Feb.</td>
<td>4.97</td>
<td>4.37</td>
<td>a/</td>
<td>.60</td>
</tr>
<tr>
<td>March</td>
<td>5.63</td>
<td>5.00</td>
<td>a/</td>
<td>.63</td>
</tr>
<tr>
<td>April b</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

a/ Not available.
b/ Preliminary.


to July 1, 1964. Based upon 1961 trade, these proposals affect approximately 10 per cent of German imports.

b. An advance reduction from July 1 of duties to the Common External Tariff on those goods where the German tariff is presently higher. This proposal involves approximately 300 industrial items accounting for approximately 1 per cent of imports in terms of 1961 trade.

c. A proposal to the EEC Council that the Common External Tariff be reduced by 25 per cent in anticipation of reciprocal concessions to be granted at the Kennedy Round of GATT negotiations.

The proposal to eliminate duties of 4 per cent or less on industrial imports from the EEC was subsequently abandoned because of strenuous objections from the leather, textile, paper--and pulp industries. This may help to secure passage of the proposals which previously was thought to be doubtful without making specific exceptions for a significant number of items. Further, the government may not be able to secure passage in time for activation by July 1, as planned. In any case, the proposed unilateral reductions are limited in extent and are not expected to have very substantial effects upon the trade surplus. The proposed reduction in the CXT is not expected to receive very serious consideration by the EEC in view of the fact that the EEC, taken as a whole, is presently incurring a balance of payments deficit.
Possible balance of payments deficit in April

The continuing large trade surplus may not have been sufficient to offset substantial Government payments abroad in April. With the stoppage of inflows of long-term funds in addition, it is possible that Germany had a balance of payments deficit in April. However, with smaller Government payments in May, a surplus is again expected for that month.

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
INTEREST ARBITRAGE, UNITED STATES / CANADA

3-MONTH TREASURY BILL RATES

RATE DIFFERENTIAL AND FORWARD CANADIAN DOLLAR

SPREAD IN FAVOR OF CANADA +

FORWARD RATE DISCOUNT

RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

NET INCENTIVE IN FAVOR OF CANADA +

1961 1962 1963 1964
Chart 3
INTEREST ARBITRAGE, NEW YORK/LONDON

3-MONTH TREASURY BILL RATES

U.K. LOCAL AUTHORITY DEPOSITS

NEW YORK

RATE DIFFERENTIAL AND 3-MONTH FORWARD STERLING

SPREAD IN FAVOR OF LONDON

FORWARD RATE
Discount-

RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER

IN FAVOR OF LONDON

IN FAVOR OF NEW YORK
Chart 4
INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

Friday figures

3-MONTH TREASURY BILLS, INTERBANK LENDING RATE AND EURO-DOLLAR DEPOSIT RATES

GERMAN INTERBANK LOAN RATE
EURO-DOLLAR LONDON
GERMAN TREASURY BILLS

RATE DIFFERENTIAL AND FORWARD DEUTSCHER MARK
SPREAD IN FAVOR OF FRANKFURT:

FORWARD RATE DISCOUNT (-)

INTERBANK LOAN RATE
TREASURY BILLS

RATE DIFFERENTIAL WITH FORWARD EXCHANGE COVER
NET INCENTIVE: IN FAVOR OF FRANKFURT (+)

INTERBANK LOAN RATE
TREASURY BILLS

1962  1963  1964
Chart 5
SHORT-TERM INTEREST RATES

Euro-Dollar - London

U. K.

U. S.

Germany

Japan

Canada

U. S.

Switzerland

* 3-month treasury bill rates for all countries except Japan. (Average rate on bank loans and discounts)

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

http://fraser.stlouisfed.org/
INDUSTRIAL STOCK INDICES

1958-100

Ratio scale

450

400

350

300

250

200

150

100

50

U.S.

U.K.

GERMANY

SWITZERLAND

SWITZERLAND

JAPAN**

CANADA

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

Per cent
Above par
2.0
1.6
1.2
0.8
0.4
Below par

Above par
1.2
0.8
0.4
Below par

Above par
.8
0.4
Below par

M  J  S  D  M  J  S  D  M  J  S  D
1962    1963    1964

SWISS FRANC
GERMAN MARK
U.K. STERLING
FRENCH FRANC
DUTCH Guilder
BELGIAN FRANC
ITALIAN LIRA
CANADIAN DOLLAR
JAPANESE YEN