DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
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CAPITAL MARKET DEVELOPMENTS ABROAD

I. France
II. Nine Charts on Financial Markets Abroad

I. France: Money and Capital Markets During February-May 1964

Tightening conditions in credit markets and increasing accruals of official reserves were the principal developments in French financial markets during the period under review. For the first time in recent years, the banks were borrowing more or less continuously from the Bank of France at the "super-hell" penalty rate of 6 per cent in late May. At that time, the National Credit Council accepted several new regulations designed to (a) reduce the current tension in the money market and (b) increase the cost of Bank of France credit in times of market tightness. The acceleration in official reserve accruals during the stringency in May may have been one factor which led to the changes in credit regulations.

In the bond market, market yields have continued to rise but the yields to the lender on new bond issues have hardly changed. New issues continue to be offered to the public in substantial volume. A marked switch of private investor funds from "liquid and short-term savings" into other instruments is suggested by a sharp decline in the total of new liquid savings during 1963. However, a rise in liquid savings during the first quarter of 1964 may reflect the temporary gains of the stabilization effort.

In contrast with improved volume in the new issues market, the decline in stock prices in France has accelerated during 1964. In fact, the fall in the first five months is roughly equal to the total losses for 1963. Tightening financial markets, evidenced by rising interest rates, and reported and expected squeeze on profits have contributed to the weakness in stock prices. Cash dividends are still running at only 2.1 per cent per annum or about one-third the average return on corporate bonds on the Paris market, with industrial profits likely to be affected by the freeze on prices of industrial goods at a time of rising wage rates and by the effects of the stabilization program on business expansion.

On the international side, the trade deficit levelled out during the first quarter and narrowed during April, on the basis of adjusted customs data, as a result of a rise in exports to the record February level. Official reserve accruals were comparatively small in the first quarter but they rose sharply to $56 million in April and to $147 million in May. Seasonal factors, such as tourism and lower imports of coal, contributed to this improvement. But a

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movement of funds into French francs, both in the form of non-resident deposits (on which no interest may be paid) and in the form of leads and lags in commercial shipments, was reported. In addition, the press has reported that French banks borrowed heavily in the Euro-dollar market to relieve their tight liquidity situation. These borrowings are thought to have contributed to the decision of the authorities to ease the stringency in money-market conditions early in June.

New credit measures are adopted. In late May and early June, the National Credit Council instituted or approved several new regulations which will (1) increase the cost of Bank of France credit in times of market tightness; (2) reduce slightly the supplies of certain types of credit; (3) give banks more flexibility in the allocation of their resources; and (4) reduce the current money market tension.

First, the Council permitted the Bank of France to raise from 6 to 7-1/2 per cent its "super-hell" penalty lending rate, applicable to rediscounts of short-term inland commercial bills that exceed the banks' ceilings by more than 10 per cent. This rate had been left unchanged last November when the Bank raised by 1/2 of 1 per cent both the basic discount rate (to 4 per cent) and the "hell" penalty rate (to 5 per cent). The change in the "super-hell" penalty rate has not been accompanied by any increase in the minimum rates banks can charge customers for credit, which traditionally are linked to the basic discount rate (and which were upped 1/4 of 1 per cent last November). However, banks are free to charge in excess of the minimum rates. In the future, this change may well mean higher bank credit costs at times when tight conditions force banks to borrow from the Bank of France at the "super-hell" rate. This effect could possibly materialize soon, since the tight money market caused heavy penalty borrowing in May. On the other hand, other steps taken at this time should ease the market in the near future.

Second, the Council reduced from 9 to 8 times net worth the maximum amount of credit that can be extended by institutions specializing in consumer credit. This follows the cut (from 10 to 9 times net worth) effected last September.

Third, the Governor of the Bank of France announced his intention to apply more severe sanctions against banks that increase credit faster than the rate prescribed by the credit ceilings which were introduced in early February of 1963. Sanctions have taken the form of reductions in banks' discount ceilings at the Bank of France; such reductions widen, *ceteris paribus*, the applicability of the penalty rediscount rates. This announcement implies that the Bank of France's invitation to the banks voluntarily to limit their credit expansion has not been heeded 100 per cent, even though credit extensions by all banks combined have remained within the ceiling.

Fourth, the banks' minimum holdings ("floor") of Treasury certificates was reduced from 13 to 10 per cent of deposits effective May 31. This was the second reduction in 1964 and the fifth since early 1961 when the percentage was 25 per cent. The authorities are moving toward eventual elimination of this mechansim which provides the Treasury with an automatic source of funds; the timing of the latest reduction was dictated by the Treasury's current favorable position. The cut will tend to increase Treasury borrowing costs, since certificates making up the "floor" are issued (on tap) at artificially low rates (e.g., 3-1/8 per cent for 2-year paper). It will also help relieve the current tension in the money market by giving funds to the banks to re... penalty-rate credits outstanding at the Bank of France.

Finally, the liquidity ratio was lowered temporarily from 36 to 34 per cent of deposits effective June 30. The reduction follows a two-stage increase from 32 to 36 per cent in the first half of 1963. The assets eligible (in any combination) for meeting the liquidity ratio are cash, deposits with the Treasury and the Bank of France, Treasury bills ("free investments") and certificates (compulsory holdings), medium-term paper, export bills, and special paper for financing the grain trade.

The reductions in the Treasury certificate "floor" and in the liquidity ratio do not mean that the banks will now be able to increase their total credits faster, since these remain subject to the current ceiling of 10 per cent per year. But they allow the banks to shift resources away from those forms of credit which help meet the liquidity ratio, and into short-term credits for financing internal trade. The Bank of France points out that the money market should be eased: the banks can pay off penalty-rate rediscounts with funds formerly used to meet the (higher) liquidity ratio. This can be accomplished rapidly by rediscounts of paper no longer required to be held, viz., medium-term paper rediscountable with the Crédit National, and export paper rediscountable with the Bank of France (rediscounted without limit at a preferential 3 per cent rate).

Paris money market tightens. The Paris money market tightened considerably from its seasonally easy position in mid-February, in large part because the Treasury reduced its credit from the Bank of France. For the week ending May 28, a number of banks were borrowing more or less continuously from the Bank of France at the "super-hell" 6 per cent penalty rate. This continuous discounting in excess of the individual bank's discount ceilings has not occurred in recent years. It reflects both the recent climb in the average day-to-day money rates to the height of the super-penalty rate, and also a change in the attitude of the banks. The Bank of France notes that of late banks have been less inhibited against penalty rate borrowing. In the past, in times of tightness, some banks have refrained from penalty-rate discounting and have borrowed in the market at even higher rates than they would have paid for Bank of France credit. To discourage habitual recourse to Bank of France credit, the authorities now have increased the super-penalty rate 1-1/2 per cent to 7 per cent, moving it back above the normal range of the market.

The period of seasonally high liquidity through mid-February reflected substantial reflows of currency back into the banks. The banks had difficulty finding outlets for the funds, owing to the ceiling on new credits to the economy; consequently, through the first three weeks of February, the excess funds were used to reduce indebtedness to the central bank; to reconstitute significant discount margins; and to absorb large issues of one-year Treasury bills; from January 29 through February 27, FF 1.35 billion of one-year

Treasury bills were absorbed with a slight fall in yields. Day-to-day money rates against private paper fell to 1 and 2 per cent on the 13th and the 19th of February.

The tightening of the market which occurred subsequently was caused essentially by the Treasury's diminishing needs for bank credit. With the aid of the 1.5 billion franc bond loan in March, as well as rising tax receipts and social security contributions and restraint in spending, the Treasury paid off nearly 1.2 billion francs of Bank of France advances during March-May. Day-to-day money rates against private paper exceeded the 6 per cent Bank of France penalty rate in late April and late May, under the impetus of the usual heavy month-end withdrawals of currency.

The market eased in the first week of June, as currency reflowed to the banks and because of the large inflow of foreign exchange in late May and increased Treasury expenditures. The banks thereby were enabled to repay about half of the 2.1 billion francs of Bank of France accommodation granted at "hell" and "super-hell" rates on the 29th of May. The call money rate against private paper dropped 25 basis points, to 5.88 per cent, from May 28 to June 4. The rise in call money yields from February through the first week of June amounts to 150 basis points; these yields have risen roughly 275 points since the start of the stabilization program last September. (See Table 1.)

Yields at auction on Treasury bills have declined 34 basis points, to a current yield of 3.31 per cent, since the initial "free" or unregulated auction on January 29, 1964, in contrast to the sharp rise in call money rates. The decline in yields on Treasury bills reflects the difficulty some banks are experiencing in meeting their "plancher" requirements as their deposit liabilities rise. The Treasury has aided the process somewhat by reducing the amounts of bills offered.

Table 1. France: Money Rates, 1962-64

Day-to-Day Money vs. Private Paper			Treasury Bill Auctions		
Monthly Average	1962-63	1963-64	Date	Amount (Million Francs)	Rate (% per annum)
September	3.48	3.13	Sept. 25	550	2.87
October	3.51	3.64	Oct. 25	200	2.50
November	3.50	4.14	Nov. 25	150	2.88
December	3.51	4.66	Dec. 26	200	2.88
January	3.39	4.13	Jan. 29 1/	400	3.65
February	3.45	4.33	Feb. 5	400	3.61
March	3.43	4.98	17	350	3.64
April	3.92	5.03	27	200	3.55
Day			Mar. 5	200	3.45
April 12	3.57	5.88	16	200	3.47
9	3.44	4.25	20	150	3.50
16	3.31	4.13	Apr. 6	100	3.50
23	4.03	2.00	15	100	3.45
30	5.00	6.50	27	100	3.38
May 6	3.50	6.19	May 5	150	3.38
14	3.56	5.25	15	100	3.34
21	3.46	5.63	28	100	3.31
28	4.56	6.13			
June 4		5.88			

1/ Change in auction system. Sources: Bank of France; OECD, Main Economic Indicators; INSEE, Bulletin Mensuel de Statistique.

Bond yields show divergent trends. Even though market yields on long-term bonds have risen since last September, yields to the lender on new bond issues have changed hardly at all. In the fourth quarter of 1963, the Caisse Nationale de Crédit Agricole and the SNCF (National Railways) borrowed at slightly lower yields than in the period October 1962-March 1963. (See Table 2.) In the first four months of 1964, the yields offered by the Crédit Foncier de France and two other public borrowers were only 1 to 3 basis points higher than on their 1963 loans; the Crédit National actually borrowed more cheaply than in the second quarter of last year. In the October-December quarter of 1963, the average yield on major corporate new issues was five basis points lower than in the third quarter and was up only four points in January-April.

Since January, market yields (as calculated by the Bank of France) have moved up further but at a much slower pace than previously. Yields on public sector bonds, in fact, held near the end-January level of 5.65 per cent for three and one-half months but they advanced to 5.71-5.73 per cent in late May. Corporate yields underwent a rather steady rise from 6.23 per cent at the end of January to 6.36-6.40 per cent in the last two weeks of May. (See Table 3.)

Table 2. France: Yields to Lender on New Bond Issues, 1962-64

	1962	1963				1964
	IV	I	II	III	IV	Jan.-Apr.
Public Sector						
Renault	5.74	--	--	--	--	--
Caisse Nationale de Crédit Agricole	5.67	5.62	--	--	5.61	5.62
SNCF (Nat. Railways)	5.65	--	--	--	5.59	--
Crédit Foncier de France	--	5.61	--	--	--	5.62
Electricité de France	--	5.55	--	--	--	--
Crédit National	--	--	5.60	--	--	5.56
Treasury	--	--	4.49	4.60	--	4.60
PTT (Posts, Tel. & Tel.)	--	--	5.60	--	--	--
Caisse Nationale des Autoroutes	--	--	--	5.58	--	5.65
Gaz de France	--	--	--	--	--	5.62
Private Sector						
Average of major loans 1/	5.73	5.69	5.70	5.72	5.67	5.71
of which:						
Groupement de l'industrie sidérurgique "GIS" 2/	5.71	--	--	--	5.68	n.a.

1/ On all loans exceeding 1 million francs. These have ranged from 2 to 4 separate issues per quarter. Yields on smaller loans not published.
2/ This was the only borrower which raised funds more than once in the period covered by the table.

Source: Conseil National du Crédit.

Both the levels of, and recent changes in, market yields on securities differ considerably in the two series calculated by the Bank of France and by the Institut National de Statistique et des Etudes Economiques (the government statistical office). The Bank of France series shows a much greater rise in yields since the start of the stabilization program. The INSEE series of yields as at month-end show increases from end-August 1963 to end-March 1964 of 14 basis points for a group of 41 public sector issues, and 22 basis points for 33 corporate bonds. The Bank of France weekly data show increases, from the last week of August 1963 to the last week of March 1964, of 30 basis points on a group of 32 public-sector bonds, and of 32 basis points for 40 corporate issues. All series exclude indexed and participating bonds as well as Treasury bonds (because of their tax-exemption features).

Table 3. France: Long-Term Bond Yields, 1962-64

	Public Sector		Corporates	
	INSEE Series	Bank of France Series	INSEE Series	Bank of France Series
Quarterly average 1/				
1962 - IV	5.34	5.48	6.31	6.11
1963 - I	5.35	5.46	6.23	6.04
II	5.31	5.45	6.23	6.03
III	5.30	5.36	6.19	5.97
IV	5.39	5.54	6.33	6.17
1964 - I	5.44	5.66	6.39	6.29
End of month 2/				
1963 - August	5.28	5.36	6.18	6.00
1964 - January	5.45	5.65	6.38	6.23
February	5.44	5.68	6.38	6.31
March	5.42	5.66	6.40	6.32
April	n.a.	5.67	n.a.	6.34
May	n.a.	5.71	n.a.	6.36

1/ For INSEE series, average of end-of-month data; for Bank of France series, average of figures for last full week of each month.

2/ For INSEE series, last trading day of the month; for Bank of France series, last full week of the month.

Sources: INSEE and Bank of France.

New security issues continue at advanced levels. New securities issued to the public totalled 4.17 billion francs in the first four months of 1964, up 12 per cent over the like period last year. (See Table 4.) The largest issue during the quarter was the 1.5 billion franc 20-year Treasury loan on March 16, the third long-term issue by the Treasury since it resumed such financing last year (after a four-year hiatus). The terms were similar to those of the loan last September and give a yield of 4.60 per cent. Interest is tax free for the first ten years. Although it was fully subscribed, this issue sold more slowly than the previous two Treasury bond loans.

Table 4. France: New Securities Sold to Public, 1962-64
(in billions of francs)

	Qtr. IV		Year		Jan.-Apr.	
	1962	1963	1962	1963	1963	1964
Public Sector	1.16	1.14	4.09	8.11	3.43	4.17
Treasury	--	--	--	3.00	--	1.50
Local authorities	--	--	0.18	0.26	--	0.01
Public credit institions	0.45	0.46	1.90	2.21	2.08	1.96
National enterprises	0.71	0.68	2.01	2.11	1.35	0.40
Others	--	--	--	0.53	--	0.30
Competitive Sector 1/	2.05	2.12	5.81	6.03	1.72	1.74
Bonds	0.91	0.89	1.82	1.86	0.36	0.23
Stocks	1.06	1.14	3.70	3.85	1.36	1.51
Partnership participations	0.08	0.09	0.29	0.31		
Total	3.21	3.26	9.90	14.14	5.15	5.91

1/ Includes nationalized industries that compete with private sector, e.g., Renault.

Source: Conseil National du Crédit.

The high level of new issues in the first quarter marks a continuation of 1963 developments in total new issue activity. Last year, total issues exceeded the 1962 level by 43 per cent or 4.24 billion francs. The increase exceeded substantially the Treasury's borrowings of 3 billion last year, so that the entrance of the Treasury into the market did not cut back the volume of long-term funds flowing to other issuers. New money raised by the competitive sector increased 4 per cent; the public sector (exclusive of the Treasury) raised 25 per cent more than in 1962.

Savings reflect switch in financial policies. The increased volume of security issues last year was intimately associated with the decline in 1963 in the accumulation of "liquid and short-term savings" from 12.06 billion francs in 1962 to 9.43 billion francs in 1963. (See Table 5.) The decline equalled more than half of the increase in security flotations. Thus, total placements of funds into both new securities and liquid and short-term savings of 23.57 billion francs in 1963 were only 7.3 per cent, or 1.61 billion francs more than in 1962.

This switch in the channelling of funds was in great measure the result of deliberate policies adopted last year (1) to increase the flow of savings into the securities market generally, and (2) to finance the Treasury by long-term borrowing at the expense of short-term instruments. One of the major steps in these directions taken last year was the reduction in April 1963 in the interest rates paid on public Treasury bills and on bank time deposits and deposit certificates. Last year, net sales of public Treasury bills fell 1.61 billion francs, and the increase in bank time deposits and deposit certificates likewise declined 1.61 billion francs. These reductions were also affected by the very favorable terms of the Treasury bond issues, which yield more than any forms of short-term savings even without the important tax exemption features attached to them.

Table 5. France: Liquid and Short-Term Savings, 1962-64
(increases in billions of francs)

	Year		Qtr. I	
Public Treasury Bills	1962	3.60	1963	0.94
	1963	1.99	1964	0.19
Bank Time Deposits and Deposit Certificates	1962	2.18	1963	0.87
	1963	0.57	1964	1.07
Deposits with Savings Banks	1962	5.21	1963	1.59
	1963	5.53	1964	2.94
Certificates of the Caisse Nationale de Crédit Agricole	1962	1.07	1963	0.48
	1963	1.34	1964	0.67
Total	1962	12.06	1963	3.88
	1963	9.43	1964	4.87

Source: Conseil National du Crédit.

However, despite the higher level of new issues in the first quarter of 1964, new accretions of "liquid and short-term savings" in January-March of this year of 4.87 billion francs were up over a year earlier by 990 million francs, a rise of 26 per cent. This is an encouraging development for the French stabilization program.

Stock price decline accelerates. The decline in French stock prices has accelerated in 1964. After a brief recovery in early January, the weekly index of French stock prices plunged 15 per cent from late January to late May; from late-April to late-May, the index fell about 6.4 per cent. (See Table 6.) The decline in the first five months of 1964 is roughly equal to that for all of 1963. The April operation on President DeGaulle did not have much visible impact on the Bourse.

Factors contributing to the recent weakness of stock prices include the pressure exerted by tightening financial markets, evidenced by rising interest rates and substantial flotations of new security issues, and a reported squeeze on business profits. In addition, there are the questions of yields and earnings prospects. Yields in the form of cash dividends are still running at only 2.1 per cent per annum, roughly 1/3 the average rate of return on corporate bonds on the Paris market. Such differentials sometimes reflect either use of stocks as an inflation hedge, or prospects for a goodly rise in net earnings. However, in France the government is reaffirming that the ultimate goal of the stabilization program is over-all price stability rather than a mere deceleration in the rate of inflation. And the prospects this year for increases in profits of French enterprises do not appear overly bright--prices of industrial goods have been frozen, while wages are still rising rapidly and costs of some imported materials are also going up.

Operation of open-end investment companies on the Bourse was authorized on February 14 by M. Giscard d'Estaing, the Minister of Finance. It is hoped that this new investment medium will enlarge the flow of savings into the French capital market. Six such open-end companies now are authorized. The first one (Sogevar) began operations this past March 10; its portfolio contained a number of foreign stocks, including one U.S. company (Franco-Wyoming).

Reserve gains rise in April-May. Accruals to France's official reserves of gold and foreign exchange were comparatively small in the first quarter but then rose sharply, especially in May. First-quarter gains totalled $72 million after an upward adjustment for a $51 million improvement in France's IMF position (which resulted mainly from Italy's drawing of $50 million equivalent of French francs in late March). These relatively small accruals are a reflection of the worsening of France's trade position over the past year and one-half. On trade with foreign countries (customs basis), the deficit (imports c.i.f.) of $330 million in January-March compares with $160 million a year earlier. If imports are put on an estimated f.o.b. basis (to correspond more closely with the trade payments figures in the balance of payments)1/, there was a $156 million trade deficit with foreign countries in the first quarter of this year in comparison with a $29 million deficit in the same period last year.

The reserve gains rose to $56 million in April and $147 million in May. In part, the rise in the accruals was the result of seasonally higher receipts from tourism and seasonal declines in some imports, including coal. In addition, French officials have cited several other factors. These include a decline after the first quarter in French Government expenditures abroad (chiefly purchases of military equipment), an improvement in leads and lags in trade payments, and an increase in foreign-owned franc accounts with French banks (despite the prohibition of interest payments on such accounts).

Finally, there are press reports that French banks borrowed Euro-dollars heavily abroad in April-May to relieve their tight liquidity situation. These reports have been denied by some French officials, but they fit in with recent exchange market developments. The premium on the forward dollar rose abruptly from about 0.5 per cent per annum (for 3-months forward) in March to about 2.0 per cent by end-May. French banks must keep a balanced position in foreign exchange (vis-a-vis residents and non-residents combined), but the required balance is on both spot and forward together. This allows the banks to convert borrowed exchange into francs provided they purchase exchange forward. The rising premium on the forward dollar indicates such operations in recent weeks. Furthermore, after the easing of the money market in the first days of June, the spot franc declined from its customary level, at or virtually at the upper limit of 20.41 U.S. cents, to 20.403 cents on June 8 and 20.398 cents on June 9-10, indicating an outflow of funds.

1/ French officials estimate that the f.o.b. value of imports averages 92 per cent of the c.i.f. value.

Foreign trade deficit levels out. The French foreign trade deficit, seasonally-adjusted, leveled out in the first quarter 1964. The average deficit (customs basis) remained at the high fourth-quarter level of $109 million per month, although the out-turn varied widely from month to month. In April the adjusted customs deficit narrowed to $64 million, as exports rose to the record February level.

Table 6. France: Foreign Trade, Total and by Regions, 1963-April 1964
(millions of U.S. dollars per month, seasonally-adjusted)

	1963			1964				
	II	III	IV	I	Jan.	Feb.	Mar.	e/Apr.
Exports f.o.b.	695	686	696	739	741	768	708	769
Imports c.i.f.	714	727	805	849	881	854	811	833
Balance	-19	-41	-109	-110	-140	-86	-103	-64

e/ Preliminary data.

Source: OECD, Main Economic Indicators; and Bank of France.

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

Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

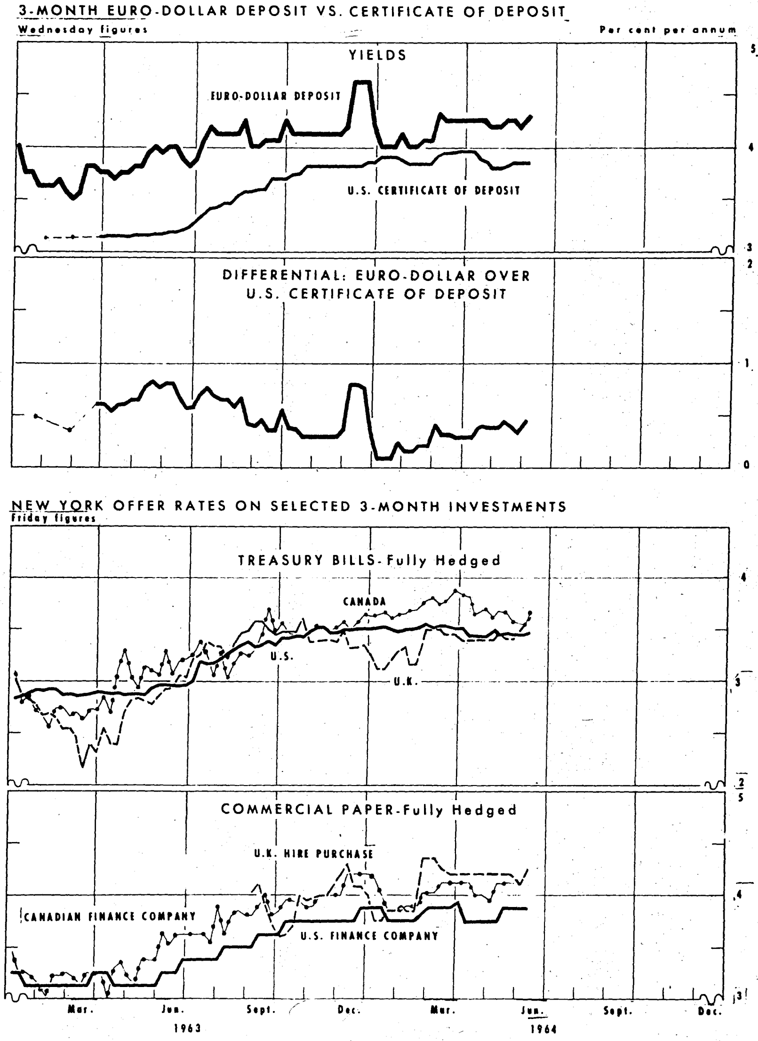

Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Thursday figures

Per cent per annum

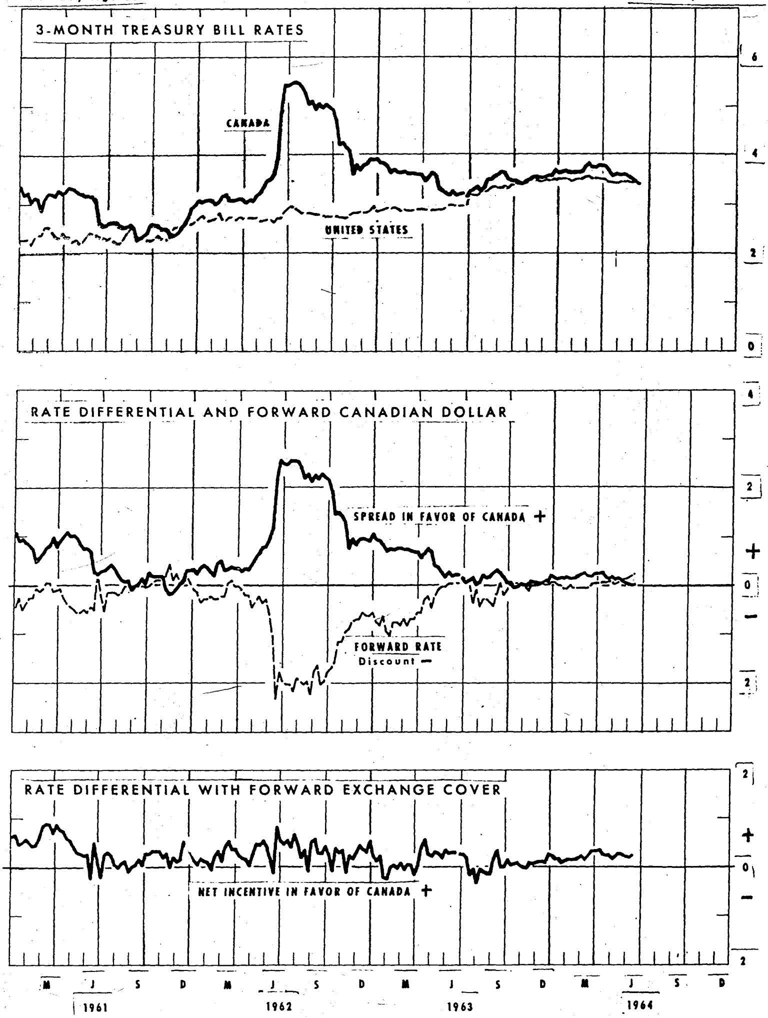

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

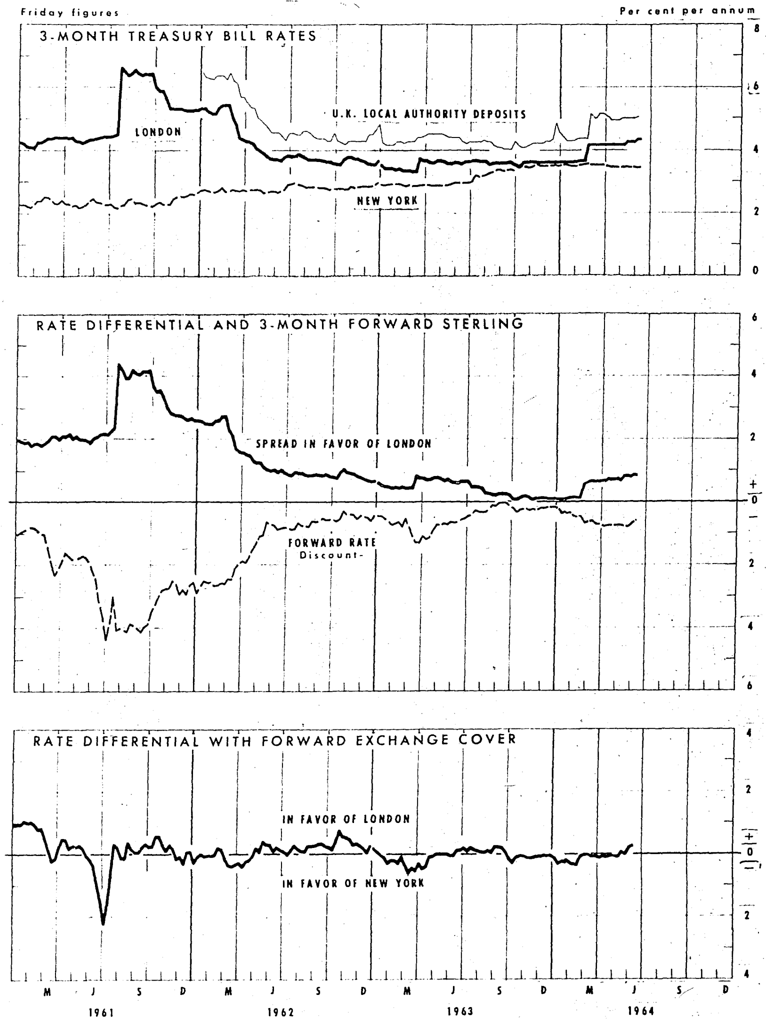

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Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

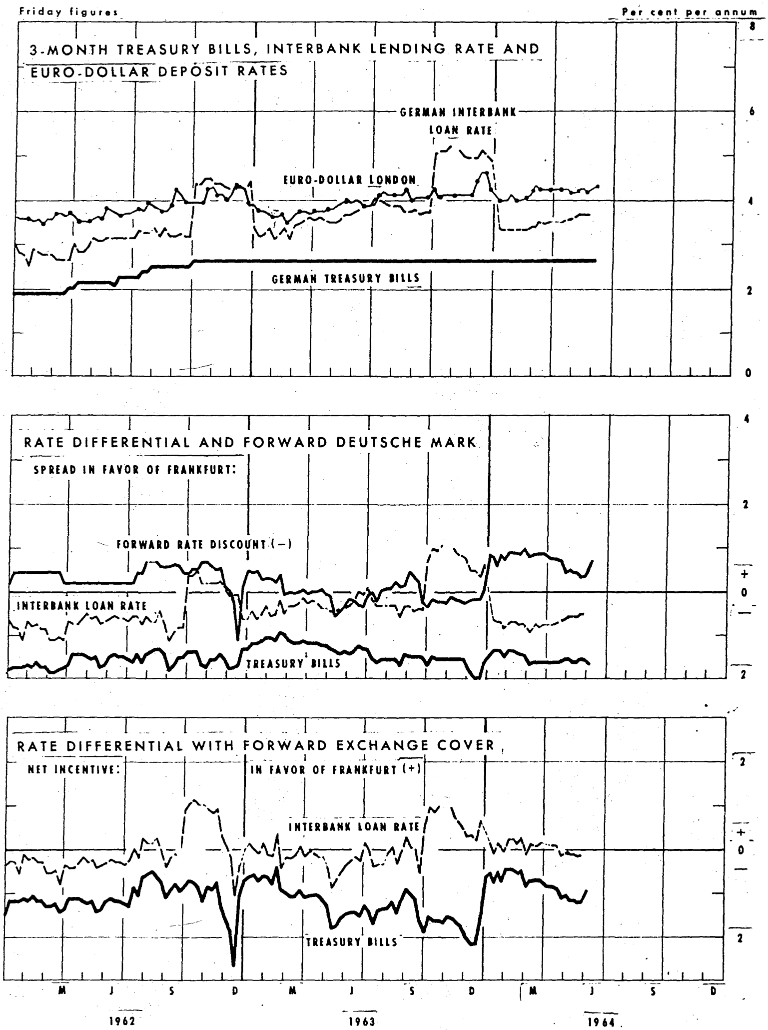
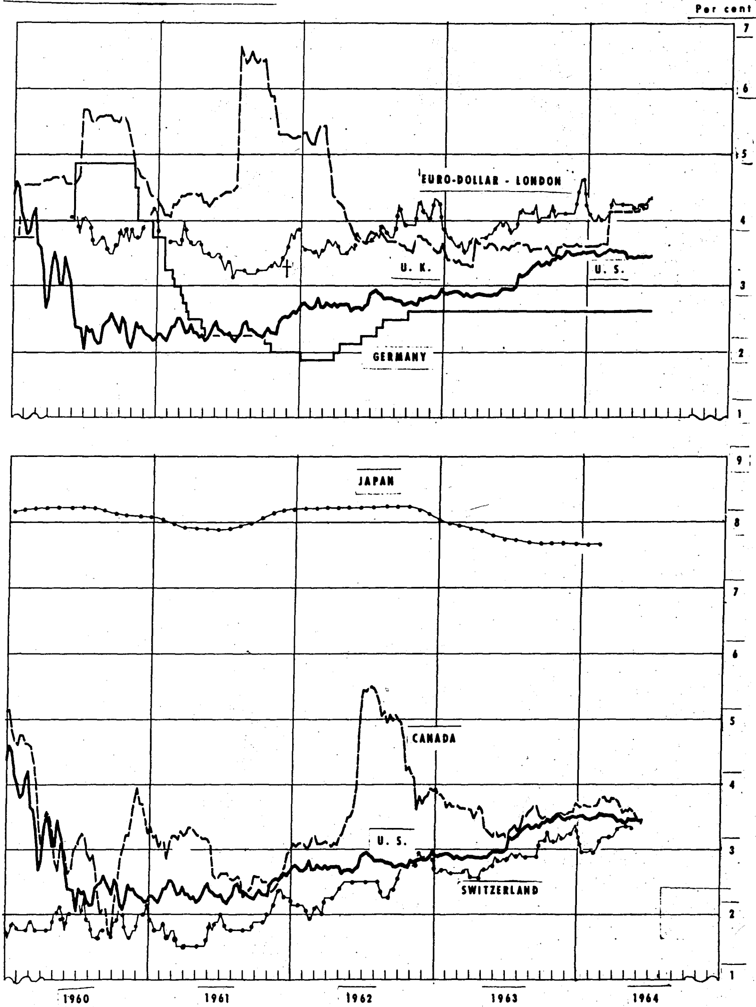


Chart 5
SHORT-TERM INTEREST RATES *



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

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

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Chart 6

LONG-TERM BOND YIELDS

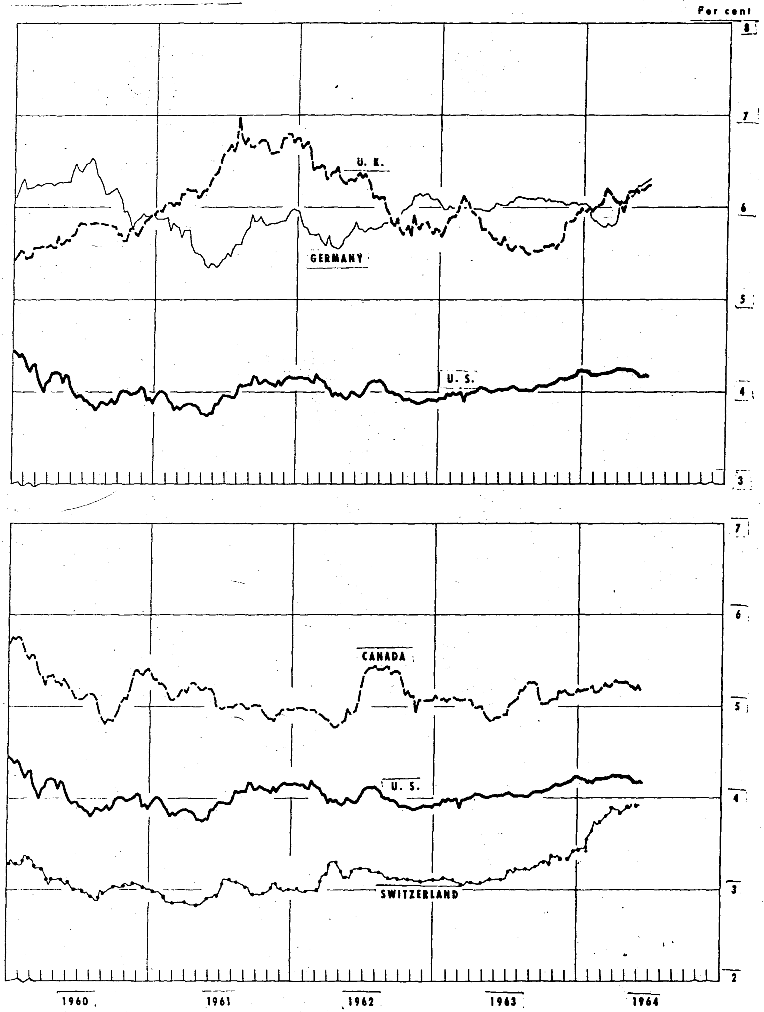
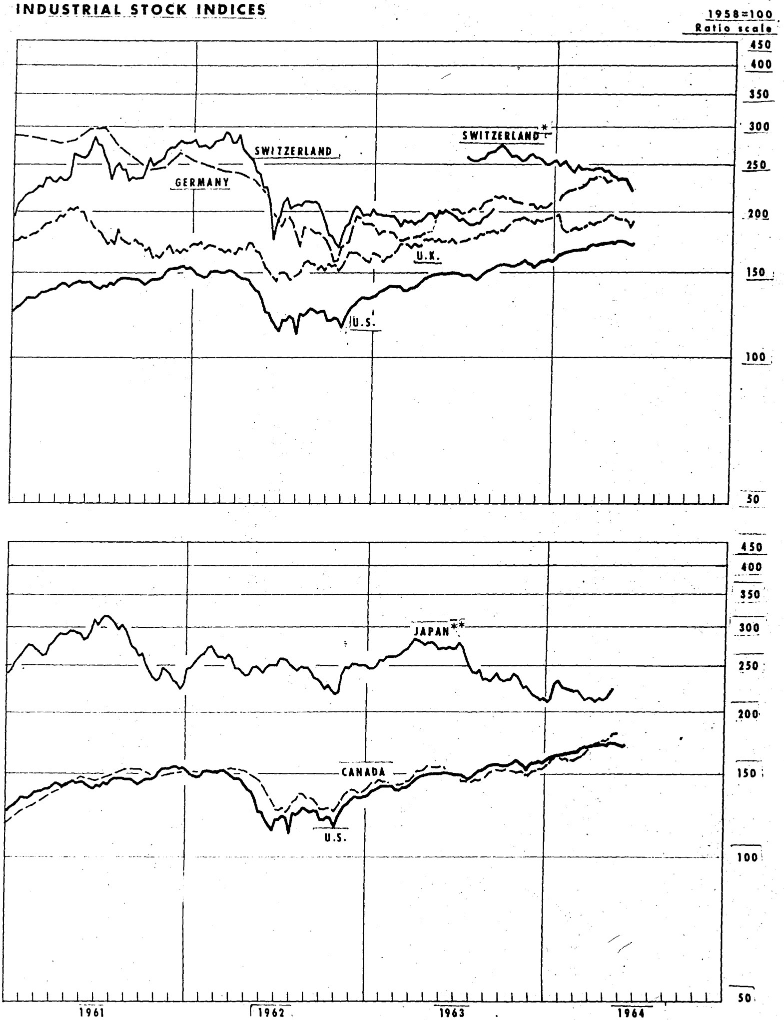


Chart 7

INDUSTRIAL STOCK INDICES



* New series. Swiss Bank Corporation industrial stock index.

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

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Chart 8

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

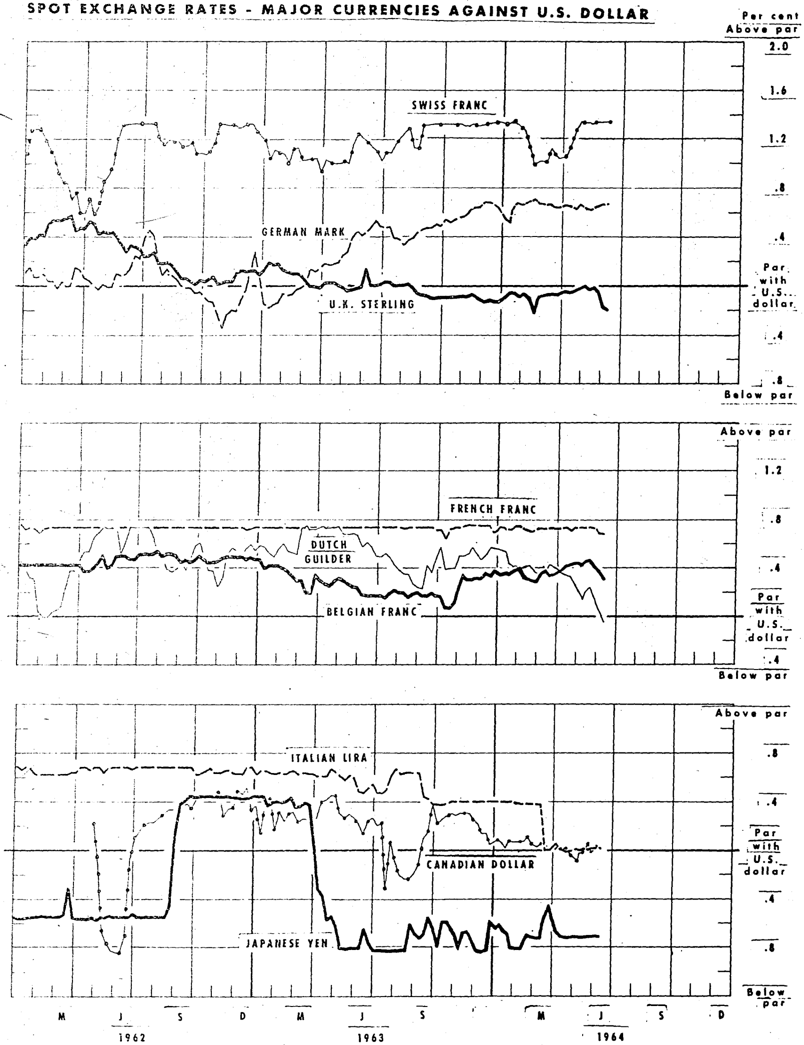

Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures