DIVISION OF INTERNATIONAL FINANCE

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

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CAPITAL MARKET DEVELOPMENTS ABROAD

I. Germany
II. Nine Charts on Financial Markets Abroad

I. Germany: Money and Capital Markets, June-July 1964

The German capital markets appear not to have been markedly affected by the unilateral reduction in import duties which took effect on July 1 or by the announcement on July 9 of an increase in reserve requirements. Strengthened market conditions reflect the general view that these stabilization measures are the last of a series--for the time being at least--and that none of these measures has been overly severe.

The market has also been strengthened by the postponement of action on the proposed 25 per cent withholding tax on fixed-interest income accruing to nonresidents. As a result, the withdrawal of foreign funds from the German securities markets has apparently diminished. The yield on a representative domestic bond issue, the Federal Railroad Bond (1958-83) has been stable at about 6.4 per cent since mid-June, after having risen steadily from 5.84 per cent in late March. (See Table 1.) In the three weeks after mid-June, moreover, the stock price index computed by the *Frankfurter Allgemeine Zeitung* recovered approximately one-third of the loss it had sustained in the period since early April.

Table 1. Germany: Selected Financial Indicators

	March	April	May	June			July		
	20	30	29	12	19	26	3	10	17
Bond Yields:									
Railroad bond (1958-83)	5.84	6.14	6.27	6.32	6.42	6.39	6.38	6.36	6.33
Stock Price Index:									
Industrials (December 31, 1958=100)	209.22	202.81	195.40	193.72	192.63	193.57	196.20	197.92	197.50
Exchange Rates:									
Spot DM (U.S. cents)	25.161	25.161	25.164	25.166	25.168	25.160	25.165	25.168	25.158
Forward (% per annum)	+0.9	+0.5	+0.4	+0.8	+0.8	+0.9	1/ [illegible]	+0.8	+0.8

1/ July 2.

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Activity in the market for foreign issues of D-mark denominated bonds has increased greatly in the period under review. Between May and mid-July, issues of these securities totalled about DM 600 million ($150 million), nearly four times more than total marketings during 1963. The major factors responsible for this upsurge are the proposed 25 per cent withholding tax (from which foreign issues are exempt), reduced issue activity in the U.S. market as a consequence of the proposed interest equalization tax, and continued confidence in the D-mark.

In June, the liquid position of German commercial banks permitted the money market to absorb large demands for mid-year tax payment and window-dressing purposes without undue strain, in part because of the ability to repatriate foreign assets. As a result of the large inflow of funds to meet these seasonal banking requirements as well as speculative movements--the latter especially important in the early weeks of the month--official reserves rose by $236 million in June, after declines in the preceding three months.

New credit restrictive measures

On July 9, the Bundesbank announced the following measures, to take effect on August 1:

1. A 10 per cent rise in reserve requirements on resident-owned deposits (reserve requirements on foreign-owned deposits are already at their legal maximum).

2. Reductions in rediscount quotas of those credit institutions which increase their foreign borrowing above their average end-of-month levels for the first six months of 1964, the reductions to be equal to the increase in foreign borrowing. The Bundesbank announced that borrowing for the purpose of financing imports is exempt from this restriction, but that further restrictive measures would be taken if other foreign borrowing rises.

In addition, on July 10 the Bundesbank announced that the preferential forward premium on mark-dollar swaps with the commercial banks, offered for the purpose of encouraging investment of funds in U.S. Treasury Bills, would be reduced from 0.5 per cent to 0.25 per cent effective July 13.

The increase in reserve requirements will reduce some of the domestic liquidity generated by previous inflows of funds to Germany. The other two measures will reduce the banks' incentive both to borrow abroad and to repatriate previously exported funds by liquidating swap agreements. Furthermore, the inflow of funds which may result from tightened monetary conditions will be limited by the following factors:

1. The proposed 25 per cent withholding tax, which has stopped foreign purchases of German bonds and has even caused some repatriation of nonresident long-term capital, despite rising yields. This movement appears to have lessened in the latter part of June, however, and may decline further should interest rates rise again.

2. The prohibition of interest payments on new foreign-held time deposits--enacted last March--which presumably discourages inflows of foreign short-term funds seeking merely higher returns.

3. The provision by which commercial banks may offset foreign short-term assets against foreign liabilities for reserve requirement purposes, which increases the effective return to the commercial banks for funds invested abroad relative to domestically invested funds.

However, there are no restrictions on direct foreign borrowing by German business firms.

Bond market turns firmer

Since mid-June, the bond market has turned distinctly firmer. A representative issue, the 5-1/2 per cent Railroad Bond (1958-83) has maintained a fairly stable yield of about 6.4 per cent, after rising steadily in the period after announcement in late March of the proposed 25 per cent tax. The major factor responsible for the halt in the upward yield trend was probably the postponement of legislative action on the tax until the fall, and the resulting decline in withdrawals of foreign funds from the German securities markets. Some doubts have been expressed as to whether the tax will ever be passed and some discussion has taken place as to the possiblity of limiting the tax to new issues.

The uncertainties relating to future governmental stabilization measures, which had weakened the securities markets in recent months, seem to have diminished in importance since the end of June. In the first weeks of July, moreover, government officials have suggested that the inflationary potential was not really as dangerous as it had previously been made to seem. The consensus of market opinion seemed to be that there would be no further stabilization measures, at least for the time being. The Bundesbank announcement of July 9 had no immediate effect upon security prices, which suggests that the measures had already been discounted in the market. Indeed, the market appeared to be relieved at the mildness of the actions.

Foreign issue activity rises

Foreign bond issues in the German market have been extraordinarily large in the period between early May and mid-July, totaling about DM 600 million ($150 million), as compared with DM 158 million ($40 million) in all of 1963 and DM 179 million ($45 million) in the first four months of 1964. (See Table 2.) It is estimated that foreign purchases of these securities accounted for at least one-half of the total value of sales.

The large volume of these foreign issues may be ascribed to several factors. Foreign placements in the United States have been inhibited by the proposed interest equalization tax. Foreign issues have also been encouraged by continued confidence in the strength of the D-mark: it is significant that a number of new security issues recently placed in markets outside Germany contain clauses permitting the buyer to take payment of principal and interest

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

	1963				1964			
	I	II	III	IV	I	Feb.	March	April
"Occasional" borrowers bonds:								
Industrial	143	88	166	117	70	100	50	158
Public authorities	489	451	328	424	495	265	349	114
Foreign issuers	32	--	--	20	46	--	39	40
Other bonds 2/	259	153	180	172	316	274	201	189
Total	923	692	674	733	927	639	639	501
Mortgage and communal bonds	652	578	575	672	959	636	784	890
Total gross bond placements 3/	1575	1270	1249	1405	1886	1275	1423	1391
Gross share placements	155	51	117	116	145	67	79	229
Total security placement at issue value	1730	1321	1366	1521	2031	1342	1502	1620

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

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

in D-marks, or guaranteeing fixed rates of exchange between the principal currency involved and the D-mark. The major factor responsible for the growth of foreign placements, however, is the exemption of foreign issues from the proposed 25 per cent withholding tax. This proposal has created a large pool of funds seeking investment in non-taxable DM securities which has been successfully tapped by foreign borrowers. Foreign 6 per cent coupon issues are presently trading somewhat above par while comparable domestic issues are trading somewhat below par.

Stock market decline reversed

The stock market showed renewed strength, beginning in the second half of June. The industrial stock index of the *Frankfurter Allgemeine Zeitung* recovered about one-third of the 10 per cent loss which it has sustained since early April. (See Table 3.) The stock market recovery was aided by continued favorable business reports, lessened uncertainties regarding stabilization measures, and a decline in withdrawals of foreign funds from the German securities markets. In addition, labor contracts recently concluded in the metal and chemicals industries provided for unexpectedly moderate contractual wage increases and thereby helped create an atmosphere of renewed confidence in profit prospects.

A recent share flotation by a foreign corporation is of interest in connection with pending legislation which would eliminate the existing 2.5 per cent tax on foreign security issues. Early in July the British Shell concern raised some equity capital in the German market but instead of issuing actual stock to purchasers, delivered certificates recording ownership of stocks held abroad. There has been no official comment on this technique whereby payment of the securities tax by a foreign borrower was avoided through a technicality.

Table 3. Germany: Stock Index
(December 31, 1958=100)

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

1963	December	31	187.71	June	1	194.52
1964	January	31	198.47		5	193.24
	February	28	202.06		12	193.72
	March	26	207.41		19	192.63
	April	30	202.81		26	193.57
	May	8	198.43	July	3	196.20
		22	198.35		10	197.92
					17	197.50

Source: Frankfurter Allgemeine Zeitung.

Money market adjusts to seasonal needs and credit measures

In June, large-scale commercial bank repatriation of foreign funds mitigated the firming tendencies in the money market that were due to the financial requirements of the mid-year tax deadline and window-dressing needs.

Although rates on day-to-day funds were above the discount rate for the major portion of the month, no marked strain appeared as the banks were able quickly and effectively to draw on their foreign assets. Day-to-day rates varied between 2-3/4 per cent and 3-7/8 per cent and three-month money held between 3-3/4 per cent and 3-7/8 per cent. (See Table 4.) The usual easing of rates in the first two weeks of the month was not evident during July as the banks prepared for increased reserve requirement needs. However, after seasonal needs had been met, commercial banks placed funds abroad on a small scale.

D-mark in strong demand

Despite large-scale net sales by the Bundesbank, the D-mark remained firm at levels between \$0.2516 and \$0.2517 throughout June and the early weeks in July. (See Table 5.) The major factor strengthening the D-mark were heavy speculative demand, particularly in early June, and repatriations for mid-year

Table 4. Germany: Money Markets Rates in Frankfurt [a/]
(in per cent per annum)

		Day-to-day Money	Three-month loans
April	1- 7	3-1/4 - 3-1/2	3-3/8 - 3-5/8
	8-15	2-7/8 - 3-1/4	3-1/2 - 3-5/8
	16-23	3 - 3-7/8	3-1/2 - 3-5/8
	24-30	3-1/2 - 4	3-5/8
May	1- 7	3-1/2 - 3-7/8	3-5/8 - 3-3/4
	8-15	2-7/8 - 3-3/8	3-5/8 - 3-3/4
	16-23	3-1/4 - 3-5/8	3-5/8 - 3-3/4
	24-31	3 - 3-3/8	3-5/8 - 3-3/4
June	1- 7	3-1/8 - 3-1/2	3-3/4 - 3-7/8
	8-15	2-3/4 - 3-1/4	3-3/4
	16-23	3-1/8 - 3-7/8	3-5/8 - 3-3/4
	24-30	2-3/4 - 3-5/8	3-3/4

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

Source: Deutsche Bundesbank.

seasonal purposes. The inflow of window-dressing funds was reversed at the end of June but small Bundesbank purchases of D-marks maintained the firmness of the rate until additional demand developed after the new Bundesbank credit decisions. But the previous repatriations reduced the need for further inflows for reserve-building purposes and the demand created by the July 9 announcement was not unusually large. Continued confidence in the D-mark was reflected in the forward market premium, which held steady at levels between 0.8 per cent and 1.0 per cent in recent weeks despite the fact that the demand for forward cover is reduced by the preferential swap arrangements offered by the Bundesbank to the commercial banks.

Large increase in official reserves

Official reserves increased by $235 million in June, after having declined for the previous three months. (See Table 6.) The June gains reflected large speculative inflows in response to rumors of revaluation and of a widening of the official exchange-rate "spread", particularly in the early part of the month, as well as repatriation of foreign assets by the commercial banks because of their seasonal needs. Official reserves declined by $18 million in the first two weeks of July, mainly because the commercial banks resumed placing funds abroad after their seasonal requirements had been met. However, in the second week some return flows took place in anticipation of the imposition of higher reserve requirements.

Table 5. 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	Nov.		25.161	-0.2	1964	June	5	25.169	+0.7
	Dec.	27	25.156	+0.0			12	25.166	+0.9
1964	Jan.	31	25.166	+0.8			19	25.168	+0.8
	Feb.	21	25.176	+0.9			26	25.160	+0.9
	March	27	25.160	+0.9		July	3	25.165	3/+1.0
	April	24	25.168	+0.5			10	25.168	+0.8
	May	8	25.158	+0.5			17	25.158	+0.8
		22	25.160	+0.4					
		29	25.164	+0.4					

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

Source: Federal Reserve Board.

Table 6. Germany: Changes in Reserve Position (in millions of U.S. dollars)

	1963 Jan.-Dec.	1963 IV	1964 I	Feb.	March	April	May	June 1/	July 1/ 1-15
A. Bundesbank gold and foreign exchange									
Gold	164	69	110	5	104	107	10	11	10
Foreign exchange	491	-70	-94	189	-196	-253	-57	225	-28
Total	655	- 1	16	194	-92	-146	-47	236	-18
B. Drawing rights on IMF	35	2	92	19	73	- 6	- 9	n.a.	n.a.
C. Commercial banks foreign exchange	73	223	236	-50	67	88	n.a.	n.a.	n.a.
Total A through C	763	224	344	163	48	-64	n.a.	n.a.	n.a.

1/ Estimated.

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

The continuing heavy trade surplus and an apparent decrease in repatriation of funds from the long-term securities market, as well as the tighter monetary conditions which will result from the increase in reserve requirements, suggests that further accruals of official reserves may be expected. However, outflows based upon the extraordinarily large volume of foreign bond placements may mitigate this movement to some extent.

Trade surplus remains high

May and June trade figures show seasonally adjusted surpluses of DM 763 million ($191 million) and DM 703 million ($176 million) respectively, which are somewhat higher than those of the previous two months. (See Table 7.) Nevertheless, the second quarter surplus was about 20 per cent below the first quarter total. In May, exports, imports, and export orders all fell because of the large number of holidays, but in June the seasonally adjusted trade figures recovered their approximate April levels.

Table 7. Germany: Merchandise Trade
(seasonally adjusted monthly or monthly averages, in DM billions)

		Exports f.o.b.	Imports c.i.f.	Industrial goods Imports	Trade balance
1963	I	4.45	4.12	3.11	.33
	II	4.85	4.40	3.33	.45
	III	5.00	4.57	3.41	.43
	IV	5.07	4.30	3.21	.77
1964	I	5.34	3.46	3.39	.88
	II p/	5.41	4.71	n.a.	.70
Feb.		5.61	4.35	3.45	1.26
March		4.97	4.37	3.28	.60
April		5.63	5.00	3.80	.63
May		4.91	4.15	n.a.	.76
June p/		5.67	4.97	n.a.	.70

p/ Preliminary.

Source: Deutsche Bundesbank.

The Government has forecast a trade surplus of over $2 billion in 1964, which would indicate a continuation of surpluses on the order of those shown for the first half of the year. On the other hand, a recent survey by the Association of German Economic Research Institutes suggests that export growth will not be maintained at its current rate for the remainder of the year because delivery periods are lengthening and because export demand is becoming less buoyant. The rate of growth of imports, however, is expected to increase slightly.

Despite heavy opposition in the Parliament, the Government was able to secure passage of legislation providing for advance unilateral reductions of 50 per cent on duties on most industrial and some agricultural imports from other Common Market countries. Duties on some items on the exceptions list were reduced by 25 per cent, while duties on imports from the rest of the world that were higher than under the Common External Tariff were reduced to the level of that Tariff. On the basis of 1961 trade data, the measures affect about 11 per cent of imports and, because of their limited nature, are not expected to have very significant effects upon the trade surplus.

Balance of payments in deficit for April-May

A balance of payments deficit of DM 280 million ($70 million) was recorded in April, primarily because of exceptionally large governmental payments abroad and also because of foreign withdrawals of long-term funds from Germany. (See Table 8.) Although the outflow of private long-term funds grew in May, the decline in public payments brought the balance of payments into approximate equilibrium in May. However, the surplus may have reappeared in June, as withdrawals of foreign funds apparently diminished and were replaced by speculative inflows of funds.

Table 8. Germany: Balance of Payments
(in millions of DM)

	1963		1964				
	III	IV	I	Feb.	March	April	May a/
1. GOODS & SERVICES							
Trade balance	1263	2860	2227	855	734	767	738
Service	-539	274	27	107	9	-23	20
Total	724	3134	2254	962	743	744	758
2. OFFICIAL PAYMENTS							
Donations	-1290	-1054	-1093	-322	-367	-637	-329
Long-term capital	-123	-471	-176	-74	-44	-130	-44
Short-term capital	592	-1296	-373	-227	61	6	-13
Total	-821	-2821	-1642	-623	-350	-761	-386
3. PRIVATE CAPITAL							
Long-term	838	583	436	139	109	-247	-399
Short-term 1/	206	-453	- [illegible]	85	-265	28	-101
Errors and omissions	209	-1399	870	57	-40	-44	130
Total	1253	-363	722	281	-196	-263	-370
SURPLUS OR DEFICIT (-)	1156	-50	1334	620	197	-280	2

a/ Preliminary.
1/ Includes commercial bank capital other than foreign exchange assets.

Source: Basic data from Bundesbank and International Financial Statistics rearranged by author.

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	Market	3-mo. Treas. bills: U.K.	Ger.	U.S.
1963-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. 31	4.12	3.31	+0.81	+0.75	+0.8	3.61	2.63	3.48
Feb. 28	4.12	3.38	+0.74	+0.75	+1.0	4.16	2.63	3.56
March 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	3.50	+0.75	+0.50	+0.8	4.16	2.63	3.50
10	4.25	3.56	+0.69	+0.50	+0.8	4.16	2.63	3.44
17	4.25	3.56	+0.69	+0.50	+0.7	4.16	2.63	3.45
24	4.19	3.63	+0.56	+0.50	+0.5	4.16	2.63	3.43
May 1	4.19	3.63	+0.56	+0.50	+0.5	4.16	2.63	3.43
8	4.25	3.69	+0.56	+0.50	+0.5	4.16	2.63	3.47
15	4.25	3.69	+0.56	+0.50	+0.5	4.25	2.63	3.45
22	4.19	3.69	+0.50	+0.50	+0.4	4.25	2.63	3.45
29	4.19	3.69	+0.50	+0.50	+0.4	4.25	2.63	3.46
June 5	4.31	3.81	+0.50	+0.50	+0.7	4.32	2.63	3.45
12	4.38	3.75	+0.63	+0.50	+0.8	4.36	2.63	3.46
19	4.38	3.69	+0.69	+0.50	+0.8	4.32	2.63	3.46
26	4.38	3.75	+0.63	+0.50	+0.9	4.34	2.63	3.45
July 3	4.31	n.a.	n.a.	+0.50	+1.0	4.34	2.63	3.46
10	4.38	n.a.	n.a.	+0.25	+0.8	4.34	2.63	3.45

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

	Comm. bank loans 1/	6-12 mo. deposits: Savings	Time 2/	Bond yields: 5-1/2% Railway 1958-83 3/	Public authorities	Share Yields	Yield gap
1963-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	5.80	5.9	2.93	3.0
March	7.50	3.50	2.75	5.88	6.0	2.83	3.2
April	7.50	3.50	2.75	6.09	6.2	2.88	3.3
May	7.50	3.50	2.75	6.23	n.a.	n.a.	n.a.
June	7.50	3.50	2.75	6.36	n.a.	n.a.	n.a.

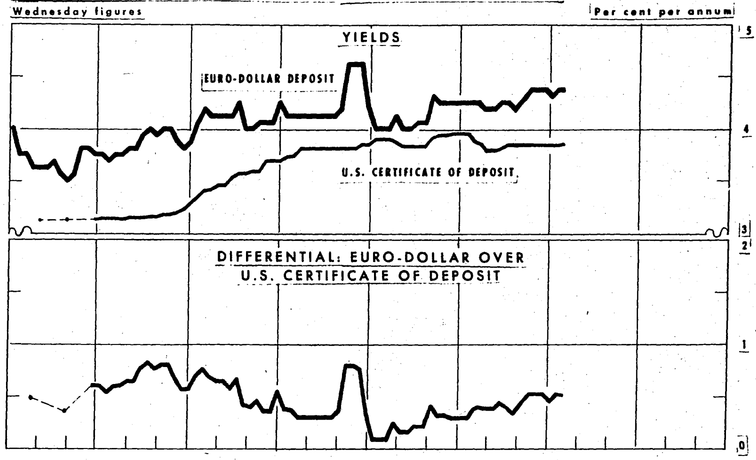
1/ Approved credits on current account.
2/ Beginning on March 20, 1964, commercial banks are prohibited from making interest payments on new time deposits.
3/ Monthly averages of end-of-week figures.

Europe and British Commonwealth Section.

Chart 1

INTERNATIONAL MONEY MARKET YIELDS FOR U.S. DOLLAR INVESTORS

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



NEW YORK OFFER RATES ON SELECTED 3-MONTH INVESTMENTS

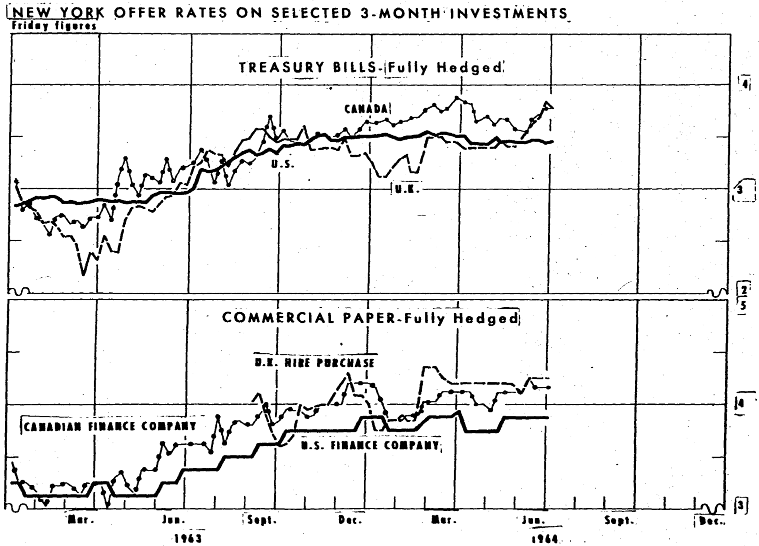


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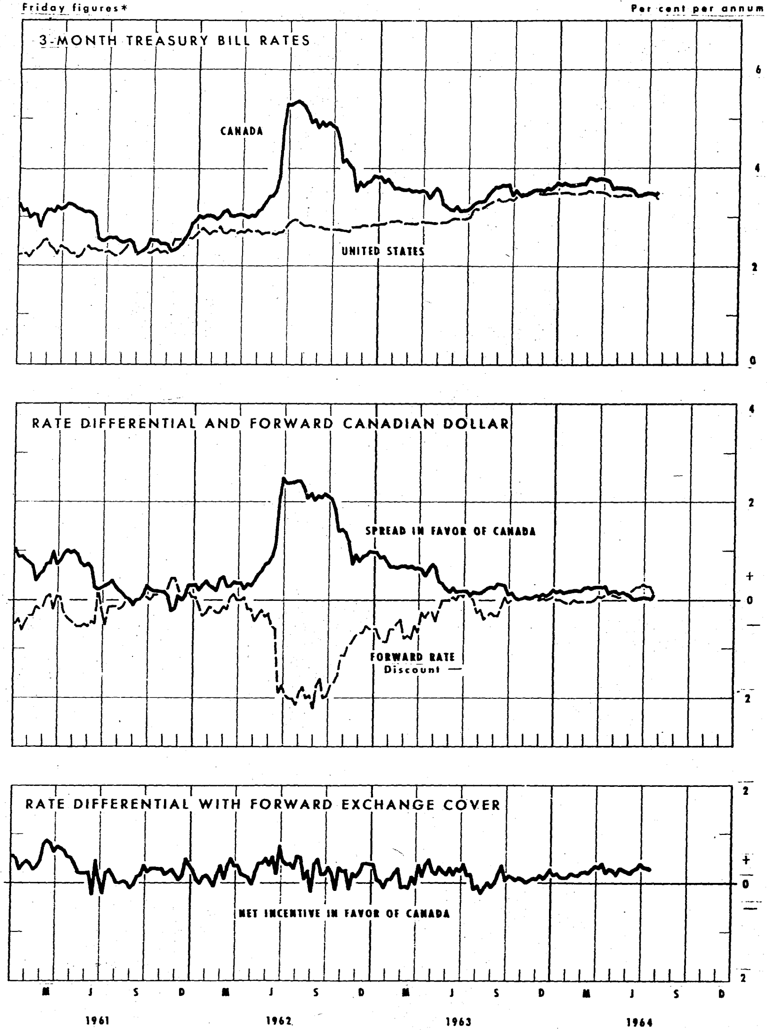
Chart 2

INTEREST ARBITRAGE, UNITED STATES / CANADA

Friday figures*



* Thursday figures 1961-1962, Friday thereafter

Chart 3

INTEREST ARBITRAGE, NEW YORK/LONDON

Friday figures

Per cent per annum

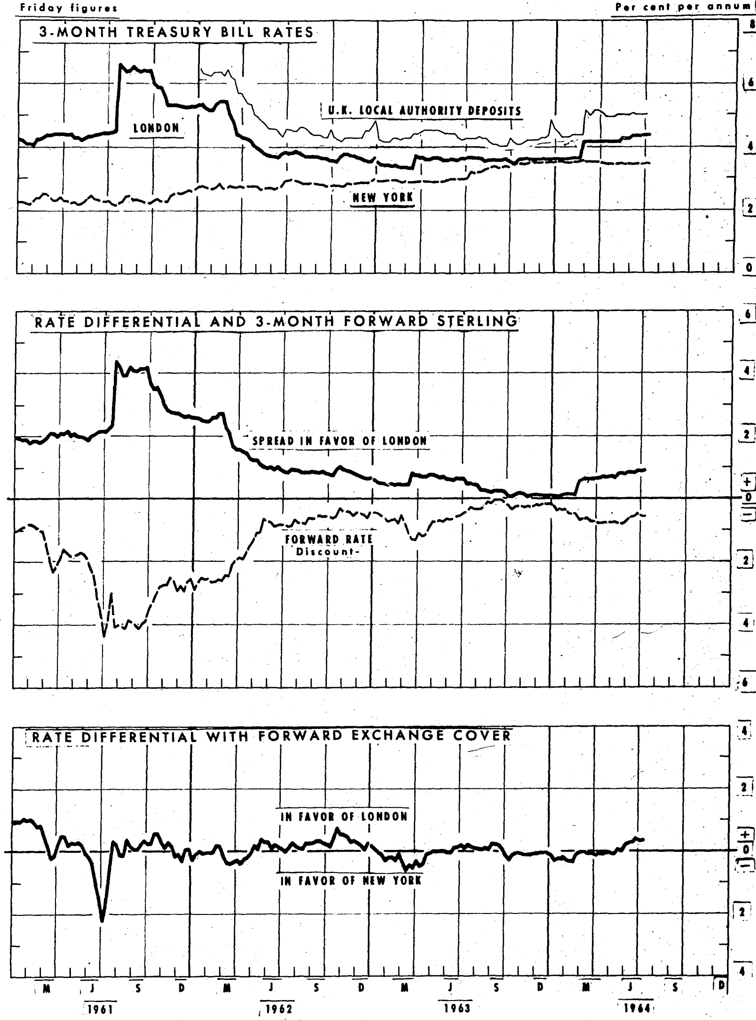


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Chart 4

INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS

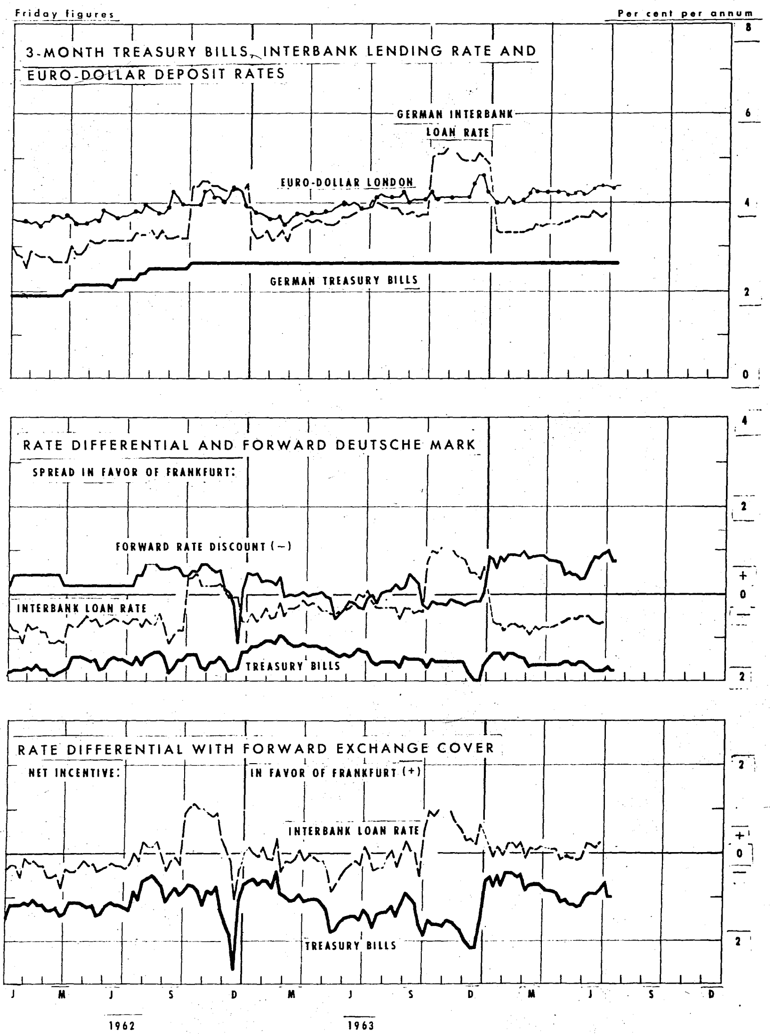
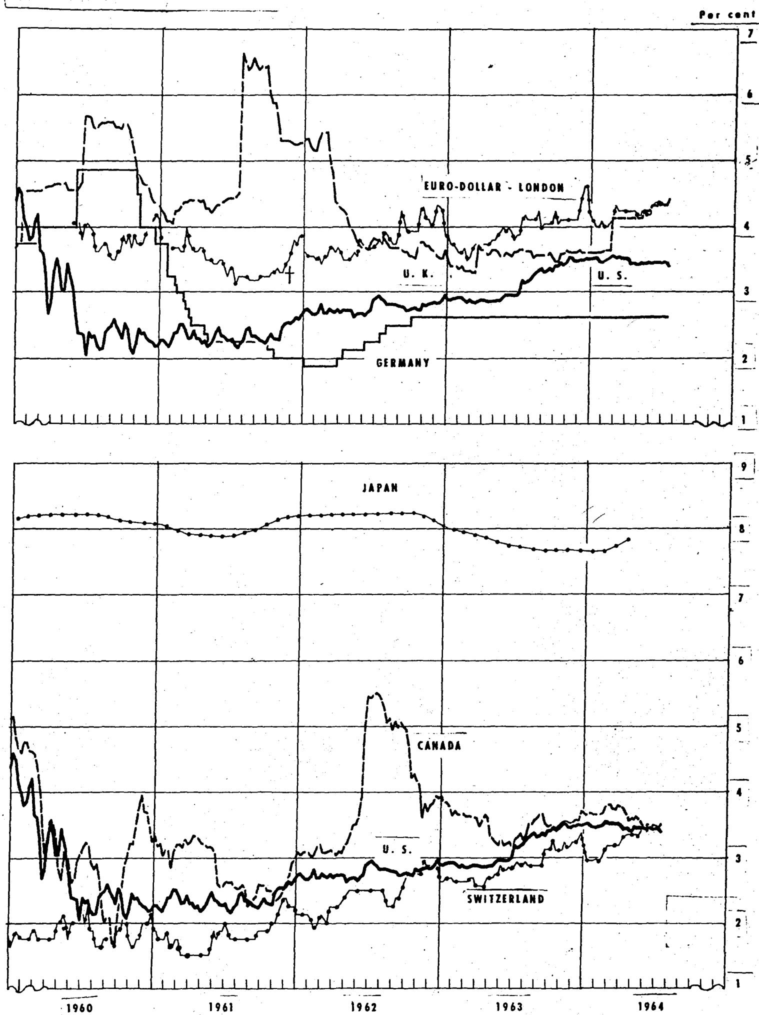


Chart 5

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.

Chart 6

LONG-TERM BOND YIELDS

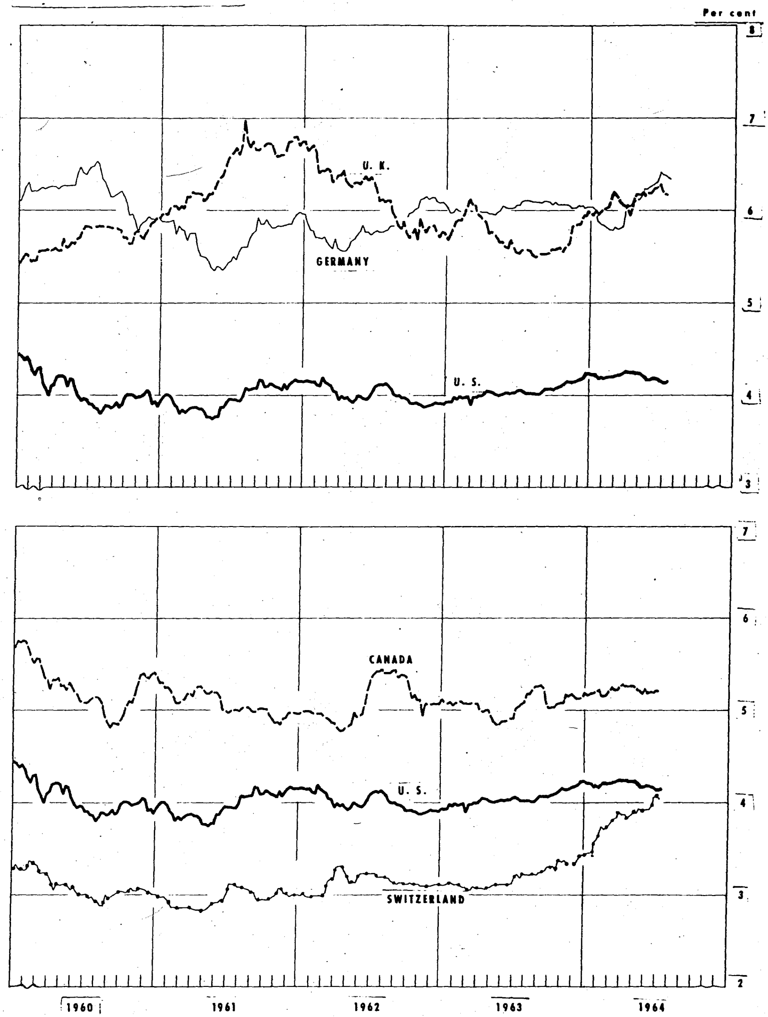
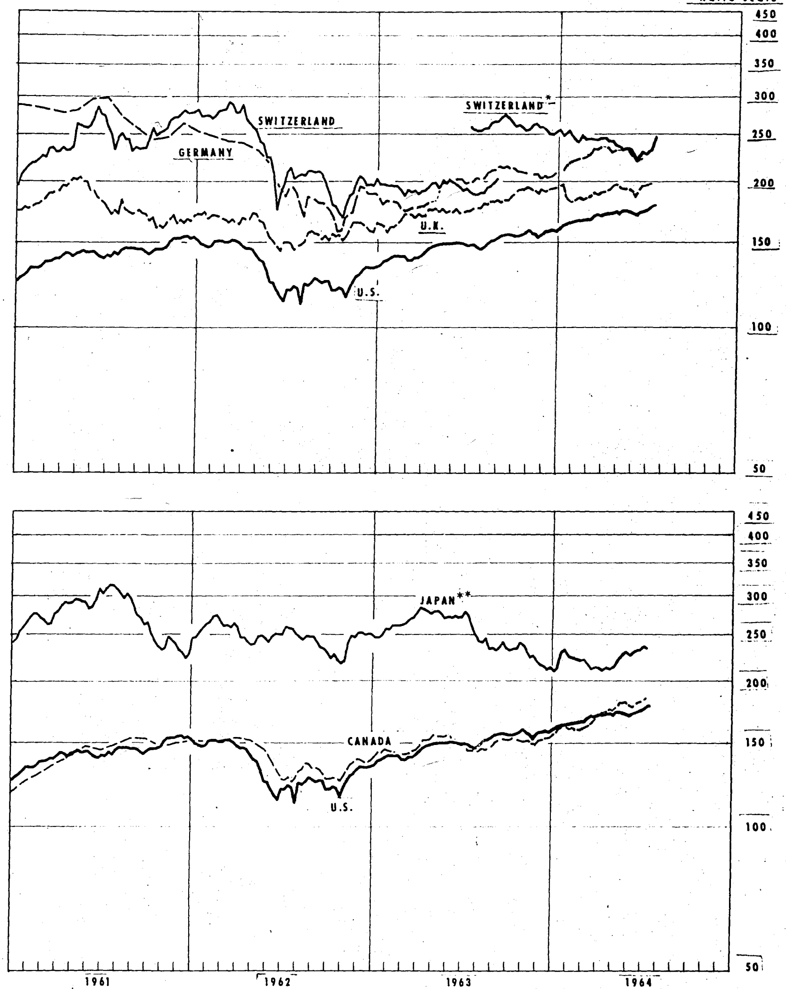


Chart 7

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

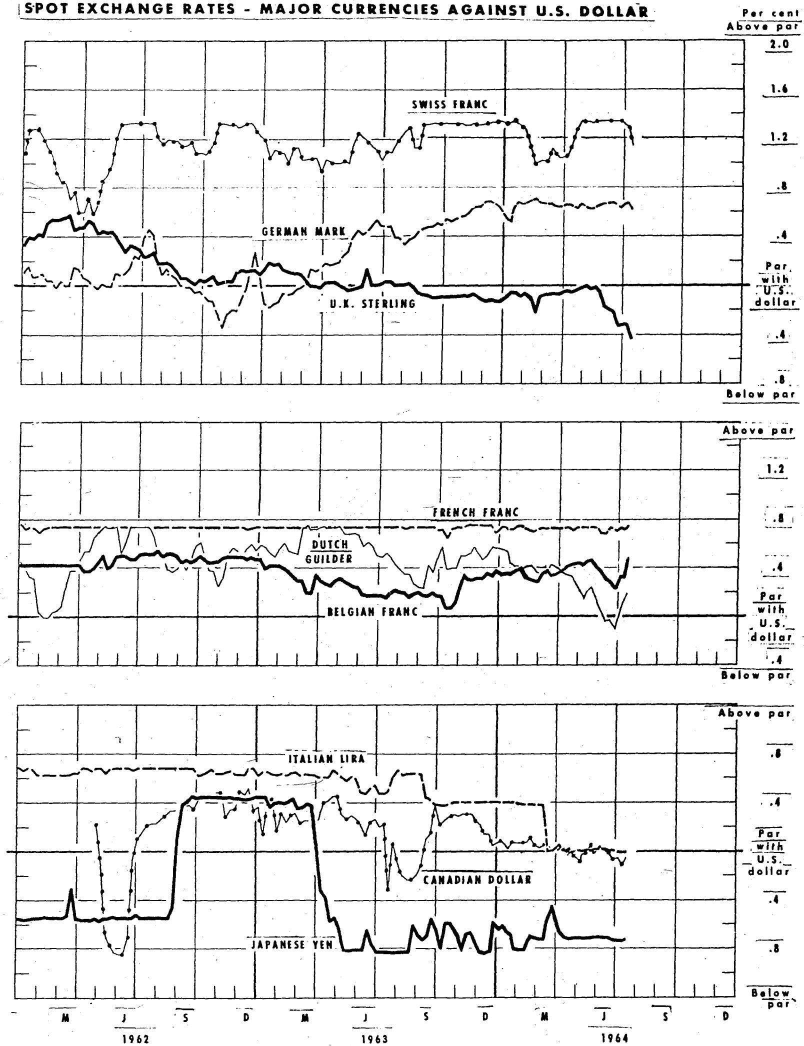

Chart 9

3-MONTH FORWARD EXCHANGE RATE

Friday figures