L.5.2 RFD 493

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Division of International Finance

REVIEW OF FOREIGN DEVELOPMENTS

June 23, 1964

Stock Market Developments Abroad; June 1963 - May 1964

9 pages

Thomas M. Klein and Division Staff

June 23, 1964

Thomas M. Klein
and Division Staff

Stock Market Developments Abroad; June 1963-May 1964

Since mid-1963 there has been a marked divergence in the trend of stock prices in the United States and a number of important foreign markets. Market conditions in most continental countries and in Japan have remained dull at a time when stock prices have been rising steadily to record highs in the United States. In particular, French and Italian stock prices have been on a downward trend for over two years.

There has been a substantial shift of U.S. funds out of foreign stocks, and this has made a major contribution to the improvement in the U.S. balance of payments since the second half of 1963. This shift of funds may be attributed partly to the divergent price trends, but it is believed also to be a reaction on the part of U.S. investors to the proposed interest equalization tax. U.S. institutional investors have increased their sales of foreign securities only slightly but they have made a sharp reduction in their purchases.

The relatively bouyant U.S. market has not generated a major shift of funds from European to U.S. stock markets. However, Common Market Countries became net purchasers of U.S. stocks in the fourth quarter of 1963 and in the first quarter of 1964, whereas they had withdrawn funds from U.S. stocks in the first three quarters of 1963.

Stock prices abroad falling. In the first five months of 1964, the stock markets of a number of industrialized countries--mainly in Continental Europe--have been depressed. Between the end of December 1963 and May 22, 1964, industrial stock prices fell by 18 per cent in Italy, 7 per cent in Switzerland, and 8 per cent in France. (See Table 1.) Only in the Netherlands among the Common Market countries was the stock index fractionally higher on May 22 than at the end of January. (See Table 1.) In Germany, the index rose in the first two and a half months of 1964 but has moved downward since the end of March. Stock prices in Belgium have fluctuated only moderately over the past two years. Outside of Europe, Japanese stock prices steadied this year after tumbling by 20 per cent in the second half of 1963.

By contrast, stock prices have behaved much more favorably in the United Kingdom, the United States, and Canada than on Continental exchanges. Trading has been slow on the London stock market this year and prices in May were fractionally below end-1963 levels despite the rapid business expansion in recent months. However, the market had advanced sharply during the second half of 1963. (See Table 1.) This advance in stock prices reflected the sharp upswing in business profits in the United Kingdom which occurred during the course of 1963. (See Table 2.)

In the United States, stock prices have advanced at a steady pace since late 1962. Standard and Poor's index of 425 industrials rose by 19 per cent in 1963 and by a further 9 per cent to a post-war peak up to May 22, 1964. During the latter period, Canadian stock prices rose by 15 per cent. The rapid Canadian advance was in part in sympathy with developments in Wall Street. However, Canadian markets were given a major stimulus in April and May by Texas Gulf Sulphur's announcement of a major copper-zinc-silver discovery in Ontario.

Table 1. Selected Industrial Stock Price Indices
(December 1963=100)

	All-time Peak	1962 June	1962 Dec.	1963 June	1963 Dec.	1964 Jan.	1964 Feb.	1964 March	1964 April	1964 May a/
Major Markets										
United States	110.3 7 May '64	71.3	84.0	93.2	100.0	103.7	105.2	107.1	109.0	109.4
United Kingdom	105.2 15 May '61	76.8	81.7	88.4	100.0	94.7	95.5	96.7	100.5	98.6
EEC countries										
France b/	137.4 2 April '62	118.8	119.2	103.3	100.0	106.0	99.1	94.7	96.3	92.0
Netherlands	141.9 7 April '61	91.5	94.4	103.2	100.0	102.3	100.6	101.1	102.9	103.2
Germany	141.0 31 Aug. '60	83.6	89.9	96.7	100.0	105.8	107.7	111.8	109.1	105.7
Italy	169.0 9 Sept. '60	117.0	115.7	114.8	100.0	93.1	92.2	82.1	84.1	81.8
Belgium	107.2 15 March '62	94.7	93.1	93.8	100.0	101.8	100.8	99.3	99.7	98.6
Selected other countries										
Japan	149.3 18 July '61	116.5	115.9	126.4	100.0	108.0	102.8	99.6	99.1	104.4
Switzerland	160.4 9 March '62	107.3	106.7	104.3	100.0	98.6	97.1	97.3	94.3	92.7
Canada	115.4 14 May '64	79.5	87.1	93.4	100.0	102.7	101.6	106.1	110.8	115.4

a/ May 22.
b/ Composite index.

Sources: United States, Standard and Poor's 425 Industrials; United Kingdom, Financial Times Industrial Ordinary; France, Institute National de la Statistique et des Etudes Economiques; Netherlands, Centraal Bureau voor de Statistiek; Germany, Frankfurter Allgemeine Zeitung; Italy, Il Sole; Belgium, Commission de la Bourse (Brussells); Japan, Dow Jones; Switzerland, Swiss Credit Bank; Canada, Dominion Bureau of Statistics.

Table 2. United Kingdom: Index Numbers of Profits of Companies, seasonally adjusted
(1958=100)

Yearly		Quarterly		
1960	128.7	1963	I	121.2
1961	127.1		II	143.0
1962	130.7		III	145.6
1963	140.4		IV	151.7

Source: National Institute Economic Review, May, 1964, Table 10, page 57.

The contrast between developments in the United States and in the Common Market countries is underscored by comparing quotations for May 22, 1964 with the post-war peaks for individual countries. (See Table 1.) Stock prices in May were more than 40 per cent below the post-war peak in Italy, around 40 per cent in Switzerland, and nearly 30 per cent in France, Germany and the Netherlands. In both the United States and Canada, prices have been at successive all-time highs during 1964. Even in Britain, the index on May 22 was only 6 per cent below the 1961 all-time peak.

The reasons for the protracted downward trend in European stock prices are not easy to ascertain, especially in the face of the continuing economic growth taking place in the Common Market countries. Special factors have undoubtedly contributed to the depressed condition of each European stock market, as may be seen in the review of developments in individual countries which is found in later sections of this paper.

However, a few factors seem to be having a general influence upon European stock trends. A particularly important common factor must be the shrinking profit margins in European industry; costs have continued to rise at a time when competitive conditions in many markets and government policies (to encourage imports or to control price advances) have made it more difficult than formerly to raise prices. Secondly, interest rates have been moving up in most European countries and bond yields in the Common Market countries are more attractive than they were a couple of years ago. Thirdly, there have been reports that substantial amounts of domestic capital have been shifted from the stock market into real estate investment. Evidence to support this hypothesis cannot be obtained. But a building boom and excessive strains on construction resources are evident in all the Common Market countries. Building wages and other costs are reportedly rising rapidly and it may well be that this building boom has drawn in funds from securities markets. Finally, fears of further anti-inflationary actions by the government, that could curtail economic expansion, must also be affecting stock prices, but there is no clear evidence that, on balance, these fears have been a major factor depressing stock values.

Relation to U.S. balance of payments improvement. Net sales of foreign stocks by U.S. residents contributed to the reduction in the U.S. balance of payments deficit in the second half of 1963 and in the first quarter of 1964. In contrast with net purchases of over $300 million during 1961, Americans sold (net) $99 million of outstanding foreign stocks (i.e. excluding purchases of new issues) in the fourth quarter of 1963 and $90 million in the first quarter of 1964. (See Table 3.)

The shift of U.S. funds from foreign stocks in the fourth quarter of 1963 and in the first quarter of 1964 is believed to be due mainly to the proposed interest equalization tax. This repatriation has been relatively gradual, as U.S. investors increased their sales of foreign securities in the fourth quarter of 1963 only to the second quarter level. Purchases, on the other hand were drastically reduced: From as average of about $200 million in the first two quarters of 1963 they fell to $145 million in the third quarter and down to $87 million in the fourth quarter of the year. (See Table 4.)

There was a large-scale movement of U.S. funds out of Canadian stocks in 1962 and in 1963. The shift of funds in 1962 was related mainly to the weakened position of the Canadian dollar and later to uncertainties about the status of U.S. investors in Canada. The decline in investment in Europe in 1962 and in the first half of 1963 may very well have been due to the steady rise in prices of U.S. industrial stocks relative to stock prices in Continental European markets. To what extent this contributed to the weakening of European markets in the latter part of 1963 it is not possible to judge, but the impact could only have been depressive.

Net foreign purchases of U.S. stocks contributed little to the improvement in the U.S. balance of payments in the latter part of 1963. In the first quarter of 1964, there actually was a net withdrawal of foreign funds on Swiss and U.K. account, and this more than offset net purchases by Common Market and Canadian residents. Altogether, these security transactions (together with a decline in new issues) accounted for somewhat more than a quarter of the $400 million improvement in the over-all payments balance (measured as the balance on "regular types of transactions") between the third and fourth quarters of 1963.

?

Table 3. Transactions in Corporate Stocks in U.S. Stock Markets, 1961 through first quarter 1964
(In millions of U.S. dollars)

	1961	1962	1963 Year	1963 I	1963 II	1963 III	1963 IV	1964 I
NET PURCHASES OF U.S. STOCKS BY FOREIGNERS								
Switzerland	162	117	-25	-19	-10	6	-2	-25
United Kingdom	10	-41	198	9	114	31	44	-78
Common Market Countries	128	38	-23	- 9	-31	-2	19	14
Canada	-22	34	18	--	7	3	8	11
Rest of World	80	-35	28	13	22	-3	-5	5
Total 1/	358	113	196	- 6	102	35	64	-73
NET PURCHASES (-) OF FOREIGN STOCKS BY U.S. RESIDENTS (Excluding new issues) 2/								
United Kingdom	-58	3	24	4	1	5	15	12
Other Europe	-183	-88	-30	-36	-39	-2	46	45
Canada	-67	75	125	36	31	22	35	30
Japan	-17	- 4	- 3	- 2	3	-8	4	3
Rest of World		-11	- 3	1	- 2	--	-1	--
Total 1/	-325	-25	113	3	- 6	17	99	90
NET PURCHASE (-) OF NEW FOREIGN STOCK ISSUES BY U.S. RESIDENTS	-45	-79	-53	-25	- 7	-21	--	- 1
NET INFLOW OF FUNDS TO U.S. FROM STOCK MARKET TRANSACTIONS	-12	9	256	-28	89	31	163	16

1/ Details may not add to totals due to rounding.
2/ Countries are those of transactors, not those of ultimate debtor.

Source: U.S. Treasury Department data, adjusted by the Department of Commerce.

Table 4. U.S. Purchases and Sales of Foreign Stocks, 1962 - First Quarter 1964 1/
(In millions of dollars)

	1962	1963 Year	1963 I	1963 II	1963 III	1963 IV	1964 I 2/
Purchases (-)	-805.9	-644.3	-191.3	-221.1	-145.0	- 87.0	-116.5
Sales	702.0	695.6	169.5	192.6	141.1	192.5	205.4
Net purchases (-)	-103.9	51.2	- 21.8	- 28.4	- 4.0	105.5	88.9

1/ Negative figures indicate a net outflow of capital from the United States. The figures for net purchases in this table differ with those shown in Table 3, because of Commerce Department adjustments. Details may not add to totals, owing to rounding.
2/ Preliminary.
Source: U.S. Treasury Bulletin.

In the first quarter of 1964, stock market transactions with foreigners made no contribution to the $156 million improvement in the U.S. net reserve position in this period (full balance of payments data are not yet available). The net inflow of funds to the United States on account of stock market transactions fell from $163 million in the fourth quarter of 1963 to $16 million in the first quarter of this year.

Figures for stock market transactions with foreigners are available only for those purchases and sales which have taken place in U.S. markets. It is likely that transactions in foreign markets by U.S. residents mirrored what was happening in Wall Street, but there is no way of estimating their magnitude. However, the reduction in the errors and omissions item of the U.S. balance of payments from a debit of $742 million in the fourth quarter of 1962 to a debit of $345 million in the fourth quarter of 1963 is consistent with a repatriation of U.S. funds from foreign stock markets.

Developments in Selected Countries

Canada. The Canadian market was bouyed by favorable developments in Wall Street, where stock prices advanced by over 50 per cent from end-June 1962 to May 22, 1964. However, there have been some major developments in Canadian markets in recent months which have been independent of New York. For example, by the end of 1963, the market had recovered from the losses sustained in July when the proposed U.S. interest equalization tax was announced.

Furthermore the Canadian market has been bouyed in recent weeks by Texas Gulf Sulphur's announcement of a major copper-zinc-silver discovery near Timmins, Ontario. From the end of 1963 to May 22, 1964, the Dominion Bureau of Statistics industrial stock index rose by 15 per cent as compared with a 9 per cent rise in the U.S. Standard and Poor's 425 industrials index.

United Kingdom. Stock prices have remained below end-1963 levels in the United Kingdom this year, but had advanced sharply during 1963. At year end they were over 20 per cent above the low reached on January 28, 1963. This recovery of stock prices coincided with the revival of economic activity from an 18-month period of recession and a sharp rise in business profits. (See Table 2.)

Since the beginning of this year, the London market has been vulnerable to political and economic shocks. Stock prices have fluctuated erratically in response to current business and political developments. Between January 3 and 24, stock prices fell by 7 per cent, mainly in reaction to a strike in a major steel plant and to the statement by Labour Party leader Harold Wilson that a new Labour Government would extend the capital gains tax and would tax distributed corporate profits at a higher rate than undistributed profits.

From early February until April 15, the market was dull: the February 27 Bank rate increase from 4 per cent to 5 per cent signalled an attempt by the authorities to slow down the rapid increase of domestic demand. But on April 15, when the budget was presented to Parliament, stock prices returned to their early January levels. This was partly because taxes were increased by less than had been anticipated. The announcement on April 9 that the general election would be held in the autumn also helped to firm the market. Early in May, however, prices fell as a result of profit-taking.

Switzerland. Stock prices in Switzerland have been falling gradually since mid-September 1963. Governmental measures to reduce the rate of domestic expansion was a major factor in this trend. In addition, a flood of new bond issues on the market and a rise in bond yields are thought to have absorbed funds which otherwise might have been used to pruchase stocks. The bond market has been particularly active because Swiss corporations have been trying to avoid the effects of the credit squeeze through new bond offerings. The fall in stock prices since the end of March has reflected restrictions on foreign purchases of Swiss assets.

Common Market countries. Despite the pick-up in business activity in these countries during the course of 1963, prices of industrial stocks have been declining in many of the Common Market countries. In part, weakness in the stock market has reflected the market reaction either to steps taken by the financial authorities to restrict domestic spending or the expectation that such measures will have to be applied in the near future.

In Italy, both political and economic developments have been responsible for the continuing weakness in stock prices. Last year, capital flight associated with opposition to some of the economic measures taken by the Center-Left coalition government, with the political instability which prevailed throughout 1963, and with a profit squeeze, contributed to difficulties in the stock exchange. By mid-1963 adverse balance of payments developments may have added to uneasiness about stock values.

This year, continuing pressure on corporate profits exerted by the continued rapid rise in wage rates, together with very tight money conditions, have combined to depress stock prices. The financial difficulties of such well-known firms as Olivetti and Montecatini (the latter decided early in 1964 not to pay a dividend) dramatized the adverse turn in business conditions.

In France, stock prices have been falling since April 1961 with intermittent but short-lived rallies. From April 1961 to the end of 1962, values fell by 37 per cent and from early 1963 to May 1964 by 7 per cent. Probably the main depressive influence on stock prices in recent months has been the stabilization plan introduced in September 1963. The market was further weakened last December by the financial difficulties of Machines Bull, a large electronics firm. Market values fluctuated during 1964 but were 8 per cent lower on May 22 than they were at the end of 1963.

In spite of the current pessimistic state of the market, some observers look for a sharp recovery. For example, Model, Roland, and Co. write:

> France's current economic difficulties may well have been overdiscounted by the severe declines which have occurred. ... among many leading shares. Given some favorable corporate news and some market response to official comments about the lack of substance behind the mass of rumors and paucity of factual reports, a sharp recovery could well materialize. 1/

In Germany, stock prices fell by 5.5 per cent from the end of March to May 22, interrupting the rising trend which has generally prevailed since October 1962. At no point in this recovery, however, have stock values come close to the August 1960 post-war high. (See Table 1.) The favorable business outlook for 1964, the very large inflow of foreign funds, and a shift of German money from bonds to stocks contributed to the rises in stock prices in 1963 and early 1964.

Market conditions changed abruptly in March, and prices have fallen since then. The proposed 25 per cent withholding tax on foreign interest earnings from German bonds has apparently made foreigners cautious about investments in Germany in general; perhaps they foresee the possibility of some further governmental action affecting equity investment.

1/ Model, Roland, and Co., Monthly Notes on Foreign Investments, March 1964, p. 8.

The only country among the six in which stock prices have risen despite firm stabilization measures taken by the Government has been the Netherlands. Between the end of 1963 and May 22 Dutch industrial stock prices rose by 3 per cent. This market is currently bouyed by favorable corporate returns for the first quarter of 1964. In addition, demand has been strong for stocks of international companies; the index for these companies rose by 26 per cent from December 1963 to April 17.

The market for domestic stocks weakened last autumn, when substantial general wage increases were granted. At the same time, the Dutch Government attempted to secure reduction in prices of some key manufactured goods, thus squeezing corporate profits. However, the market recovered in December. There was only a mild reaction to the Government's announcement of measures to curb domestic demand--private fixed capital formation in particular.

Japan is another country where stock prices have been on a declining trend for over two years. In the first five months of 1964, stock prices were fluctuating at values about one-third below the July 1961 peak. (See Table 1.) Since last autumn, the market has been depressed by the introduction of restrictive monetary measures aimed at correcting a serious balance of payments deficit.

Stock prices rallied in January, mainly because a widely anticipated increase in the Bank of Japan discount rate did not materialize. The market was also bouyed by the news that a stock issue by a major investment trust was successful and that a "securities company" had been formed by the four major brokerage firms with the intention of "stabilizing the market."

This boomlet was short-lived, however, as continued pressure on the yen in foreign exchange markets forced the Bank of Japan to place a ceiling on new bank credit. While the discount rate increase of 73 basis points to 6.57 per cent did not take place until March 18, the stock market had fallen in anticipation of this move. Trading was slow until mid-May, when prices rallied following a report of an improvement in the trade balance.