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Recent Developments in European  
Stock Markets

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Recent Developments in European Stock Markets

The sensitivity of European stock markets to developments on the New York stock exchange was dramatically demonstrated between May 28 and May 30. When prices in New York declined by 6 per cent on Monday, May 28, declines in industrial stock values of nearly equal percentages took place in a number of European exchanges on the following day. (See Table 1.) The recovery of prices in New York on May 29 was followed by a comparable recovery in stock prices in many European centers on May 30. This episode, which points up the marked sensitivity of European stock prices to U.S. stock market developments, however, should not obscure the differences in price movements between the U.S. and the European centers over the recent past or the differences among the individual European countries.

That the recent declines in stock prices here and in Europe have been part of a general downtrend experienced in all major centers can be illustrated by two facts. In the first place, prior to May 28, European stock prices had reached their peaks in different countries over an extended period. The postwar peak in stock prices was reached in August-September 1960 in Germany and Italy, in May 1961 in Britain, in December 1961 in the United States, and in March-April 1962 in Switzerland, Belgium, and France. (See Table 1.) In the second place, while European stock prices declined sharply during April and May, they fell at differential rates. Where industrial share prices declined by 17 per cent in New York between March 30 and May 30, stock prices declined by as little as 5 to 6 per cent in Britain, Belgium and Italy, 9 per cent in France, 18 per cent in Germany and 19 per cent in Switzerland. (See Table 1.) Similarly, during the first quarter of 1961, the United States index declined by 3 per cent while European centers showed these declines: Germany 6 per cent; United Kingdom 4; Italy 2; and Switzerland 1 per cent. Prices in France rose 11 per cent.

Table 1

Stock Prices in Principal Financial Centers, selected dates  
(Indexes, end-December 1961 equals 100)

	Peak Date	Index	1962					
			Mar 30	Apr 27	May 28	May 29	May 30	Jun 8
United States	1961- Dec. 12	101	97	92	a/83	b/77	c/81	81
United Kingdom	1961- May 15	120	96	101	92	86	91	88
Belgium	1962- Mar. 15	105	103	103	99	96	97	97
France	1962- Apr. 2	114	111	d/113	98	94	101	100
Germany	1960- Aug. 31	120	94	92	75	70	77	78
Italy	1960- Sept. 9	131	98	97	93	90	93	92
Switzerland	1962- Mar. 9	105	100	93	n.a.	n.a.	e/81	75

a/ May 25. b/ May 28. c/ May 29. d/ April 25. e/ June 1.

Sources:

United States--Standard and Poor's index of 425 industrial stocks.

United Kingdom--Industrial stock index of the Financial Times.

Belgium--Index of 10 industrial stocks compiled by the Commission de la Bourse.

France--All stocks (composite) index compiled by the Institut National de la Statistique et des Etudes Economiques (government statistical bureau).

Germany-- All stocks (composite) index in the Frankfurter Allgemeine Zeitung.

Italy--All stocks (composite) index of shares quoted on the Milan exchange.

Switzerland-- Index of 42 industrial stocks prepared by the Swiss National Bank.

I. Significant Common Factors

Despite the diverse movements of stock prices in major financial centers, there are three significant common factors which appear to form the background for evaluating the late-May declines in prices. These are: (1) stock prices in all financial centers had risen much more rapidly than business profits; (2) stock dividend yields were abnormally low, especially in relation to bond yields; and (3) developments during 1962 which brought to an end the extended rise in stock values during the equity boom made it necessary for investors, who had been attracted to stocks by capital gains prospects, to reappraise them as an investment.

Stock prices high—Since 1953 a general, and after mid-1958, a rapid rise in stock values occurred in all major western countries. United States prices rose earlier in this period than did the prices of European countries. Between 1953 and mid-1958, United States prices almost doubled and the greater part of this rise was concentrated in the two years from early 1954 to early 1956. (See Table 2.) By contrast, the greater part of the rise in European stock values can be found after the middle of 1958. The fact that the stock market boom in Europe was delayed until after mid-1958 can be attributed, in large part, to the changed European economic situation which had become evident by 1958. The restoration of external convertibility for the major European countries at the end of 1958 demonstrated and confirmed an immense economic recovery and industrial expansion. It grew out of the remarkable record of growth, the domestic financial stabilization and the freeing of foreign trade and payments which had been achieved by the western European countries during the preceding four or five years.

Table 2

Stock Prices: Percentage Changes in Principal Financial Centers,  
Selected Dates

<u>Country</u>	<u>Date of peak</u>	<u>1953 to mid-1958</u>	<u>Mid-1958 to peak</u>	<u>Peak to Apr. 1962</u>
Belgium	1962-Mar.	+ 33	+ 34	- 2
France	1962-Apr.	+142	+ 79	--
Germany	1960-Aug.	+143	+262	-23
Italy	1960-Sept.	+ 62	+216	-20
Switzerland	1962-Mar.	+ 29	+199	- 6
United Kingdom	1961-May	+ 44	+ 92	-13
United States	1961-Dec.	+ 86	+ 64	- 5

Source: International Financial Statistics,  
International Monetary Fund.

During the period of about 4-1/2 years to mid-1958, only Germany and France recorded larger price rises than did the United States (See Table 2). For purposes of this paper, the French case can be disregarded and considered exceptional to the extent that it reflected, in large measure, the inflation associated with the unsettled domestic economic and political situation and the fall in the external value of the French franc by 29 per cent.

The European stock boom really got underway after mid-1958. Between mid-1958 and the peak, prices in Germany and Italy more than tripled, those in Switzerland tripled and those in Britain doubled. Stock values rose only about two-thirds in France and the United States and about one-third in Belgium. (See Table 2.)

By the middle of April 1962, however, the uptrend in European share values had clearly been reversed in all countries. Prior to the end-of-May break in Wall Street, stock prices had fallen from the all-time peaks by 23 per cent in Germany, 20 per cent in Italy, 13 per cent in the United Kingdom and 5 to 6 per cent in Switzerland and the United States.

The dramatic rise in share values, especially after mid-1958, seems to have been based on considerations of capital gains and not of current corporate earnings. In the four major western countries for which profits data are available, stock prices rose much more rapidly than corporate profits: by nearly four times as much in Germany and about twice as much in France, the United States and Britain, as may be seen in Table 3.

Table 3

Ratio of Stock Prices to Corporate Profits in Selected Countries,  
1953 and 1957-61

	<u>1953</u>	<u>1957</u>	<u>1958</u>	<u>1959</u>	<u>1960</u>	<u>1961</u>
	(1953 ratio equals 100)					
U. S. A.	100	169	204	204	203	238
United Kingdom	100	118	116	155	182	191
Germany	100	140	170	265	378	n.a.
	(1954 ratio equals 100)					
France	n.a.	175	154	193	216	n.a.

**Sources:** Stock prices:

France--Index of industrial share prices.

Germany--Index of average of share quotations on the bank return-days of each month.

United Kingdom--Moody's Services, Ltd., as published in the London and Cambridge Economic Bulletin.

U. S. A.--Standard and Poor's index of 425 industrial stocks.

**Corporate Profits:**

France--Corporate profits after taxes as shown in Ministry of Finance Statistiques et Etudes Financières.

Germany--Corporate profits after taxes, as shown in Deutsches Institut für Wirtschaftsforschung, Wolkswirtschaftliche Gesamtrechnung Für Die Bundesrepublik Deutschland, 1950-60.

United Kingdom--Total corporate income as shown in Central Statistical Office, National Income and Expenditure.

U. S. A.--Corporate profits before taxes as shown in Department of Commerce, Survey of Current Business.

Stock yields low--The rapid rise in values, especially after mid-1958, pushed yields on common stocks to low levels. At the peaks of the price indexes, stocks were yielding less than 2 per cent in France, Germany, Italy and Switzerland, less than 3 per cent in the United States and less than  $4\text{-}1/4$  per cent in Britain (see Table 4). At these levels, dividend yields were well below market yields on government bonds in all major countries: lower by  $4\text{-}1/2$  per cent in Germany, about  $3\text{-}1/2$  per cent in France and Italy and between  $1\text{-}1/4$  and  $1\text{-}3/4$  per cent in the other three countries in Table 4. The speed with which stock yields on the Milan exchange declined reflects the rapid rise in prices: the average yield fell from 7 per cent in 1951 to  $5\text{-}1/2$  per cent in mid-1958 and then declined to 3 per cent at end-1959 and to 2 per cent in September 1960.

Once the peak in stock prices had been passed, the wide gap between bond and stock yields declined rapidly for Germany, Italy, the United States and Britain (see Table 4). In fact, it is likely that the wide differences in yields contributed to the fall in prices which occurred. By the end of May, the differential yield in favor of government bonds had been reduced to around  $1/2$  per cent in Britain and the United States and to between 2 and  $2\text{-}1/2$  per cent in Germany and Italy where bond yields were at a much higher level.

Check to capital gains--In 1961 and 1962, investors began to reappraise stocks as an investment in terms of comparative yields because the "capital gains" trend which earlier had made stocks so attractive was brought to an end by business and political developments. The much more rapid rise in stock values than in business profits could not continue indefinitely. When it became evident that prices could not continue to rise, investors had to shift the emphasis of their thinking. Once the stage was reached where stock values were as likely to go down as to go up, investors could no longer disregard comparative yields on other investments. On the contrary, investment in stocks on short or medium term had to be judged much more than before on a yield basis, and on that basis they were not favorably placed.

Two business developments contributed to the shift in investor interest in stocks. In the first place, it gradually became evident that entrepreneurs were finding themselves in a situation where costs were rising but where prices could not be raised, at least as easily as in earlier periods. In part, this development reflected the easing of inflationary expectations in western countries; but it also reflected at least two other factors: the increased competition from both domestic and foreign producers confronting the local manufacturer and the intervention of government to help hold the price, wage rate and/or incomes line. Both these factors were particularly evident in the spring months of 1962. This "cost-price" squeeze could only blight the outlook for profits and make more vulnerable the high valuations placed on shares.

Table 4

Stock and Government Bond Yields, U.S.A. and Selected European Countries

	Date	Peak of	1961	1962	
		Stock Prices	End	End	End
		Yield	Dec.	Apr.	May
		Figures			
1961-					
U.S.A.	Dec.12				
Long-term Govt. bonds		4.06	4.06	3.89	3.88
Stocks		2.82	2.85	3.05	3.57
Yield Gap		<u>1.22</u>	<u>1.21</u>	<u>0.84</u>	<u>0.31</u>
1961-					
United Kingdom	May 15				
Long-term Govt. bonds		5.90	6.55	6.20	6.20
Stocks		4.22	5.18	5.39	5.71
Yield Gap		<u>1.68</u>	<u>1.37</u>	<u>0.81</u>	<u>0.59</u>
1962-					
France	Apr. 2				
Long-term Govt. bonds		5.05	5.05	5.14	5.12
Stocks		1.38	1.59	a/1.39	a/1.56
Yield Gap		<u>3.67</u>	<u>3.46</u>	<u>3.75</u>	<u>3.56</u>
1960-					
Germany	Aug.31				
Long-term Govt. bonds		6.14	5.96	5.60	5.84
Stocks		1.66	2.49	2.77	a/3.27
Yield Gap		<u>4.48</u>	<u>3.47</u>	<u>2.83</u>	<u>2.57</u>
1960-					
Italy	Sept.9				
Long-term Govt. bonds		5.13	5.05	5.04	5.12
Stocks		1.88	2.66	a/2.88	a/3.00
Yield Gap		<u>3.25</u>	<u>2.39</u>	<u>2.16</u>	<u>2.12</u>
1962-					
Switzerland	Mar. 9				
Long-term Govt. bonds		2.99	3.00	3.31	3.13
Stocks		a/1.24	1.30	a/1.40	a/1.60
Yield Gap		<u>1.75</u>	<u>1.70</u>	<u>1.91</u>	<u>1.53</u>

a/ Estimated.

Sources: Long-term Government bonds - U.S.A.: Government bonds maturing or callable in 10 years or more (Federal Reserve Bulletin); U.K.: 2½ per cent consols (Financial Times); France: 5% rente perpetuelle (IBRD); Germany: Deutsche Bundesbahn 1958-83 (IBRD); Italy: 5% Redimibile (Recostituzione) of 1979 (IBRD); Switzerland: 3% Swiss Confederation 1967-74 (IBRD).

Stock Yields -- U.S.A.: Standard and Poors' Common stocks (Federal Reserve Bulletin); U.K.: Common stocks (Financial Times); France: All French

Secondly, evidence of surplus industrial capacity began to appear in several countries, especially in Britain and to a lesser extent in Germany though not in either France or Italy. In Britain, for example, the Federation of British Industries reported a gradual increase in responding firms reporting "output below capacity" from 51 per cent in October 1961 to 59 per cent in February 1962 and to 64 per cent in May. This trend was paralleled by the topping off of fixed capital expenditures in manufacturing which (seasonally adjusted and at 1958 prices) dropped perceptibly in the fourth quarter of 1961, as the following figures (in millions of pounds) show:

<u>Quarter</u>	<u>1960</u>	<u>1961</u>
I	239	290
II	245	311
III	273	329
IV	268	299

In Germany, two adverse developments became apparent. A slackening of business expansion in 1961, largely reflecting cyclical inventory adjustments in steel, was followed in 1962 by a slackening in industrial investment. The Bundesbank's Monthly Report for April (1962) stated:

"enterprises' propensity to invest... seems in general to continue to decline... The demand for capital goods in the narrower sense of the term continues... to crumble away."  
(Page 28.)

The Report added: "In particular the mechanical engineering industry's incoming orders, which may be regarded as one of the most comprehensive pointers to entrepreneurs' capital development planning, were considerably smaller in March than a year before." Secondly, German industry began to feel the effects of competition from abroad, especially from France and Italy whose currencies were not revalued in March 1961 when the D-mark was raised by 5 per cent. Because of French and Italian competition, for example, it was estimated in April 1962 that average profit of the German producer of fine rolled steel was DM 30 to 35 a ton below the profit realized up to the middle of 1961. 1/

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1/ The Times (London), April 19, 1962, p. 19.

(Sources continued from page 6)

common stocks traded on Paris bourse (INSEE, Annuaire statistique de la France, 1961 and Bulletin Mensuel de statistique); Germany: Common stocks (Deutsche Bundesbank, Monthly Report); Italy: All stocks traded on Milan stock exchange (Bank of Italy, Bollettino); Switzerland: Industrial common stocks (Credit Suisse, The Swiss Economy in 1961).



## The influence of Wall Street on European markets

The high level of stock prices, low dividend yields and the unfavorable prospects for further capital gains had placed the European stock exchanges in a vulnerable position. Therefore, they were very sensitive to bad news from the New York stock exchange. What dangers did European investors see in the fall in prices on Wall Street? The European financial press commented in particular upon three principal factors:

(a) The "collapse of stock prices on Wall Street may cut short the U.S. business recovery."<sup>2/</sup> If the U.S. business recovery were to peter out early, world trade and business activity would be affected.

(b) More fundamentally, European investors felt that the reasons behind the fall in stock prices in New York could also apply very well to the situations in their own countries. The Financial Times emphasized, in particular: ". . . the emergence of overcapacity in many industries, the slower growth in consumer demand, the slackening of inflation, the steady erosion of profit margins."

(c) Finally, there was a "continuing uncertainty about exchange rates--an uncertainty manifested in the recent boomlet in gold shares." At a time when the U.S. balance of payments "is still, like our own, in deficit." The fear that counter-recessionary measures might lead to adverse capital flows and exchange-market developments "is certainly playing some part in the uncertainties which are depressing the world's stock markets at present." These fears had manifested themselves in a sudden demand for South African gold shares on the London Stock Exchange. Between mid-May and mid-June, prices for these shares rose by roughly 20 per cent.

## II. Developments in Selected Countries

Up to now, we have been discussing the influences which have been acting in common on the European stock exchanges. However, stock prices have been affected in each country in a somewhat different way. In part, these individual differences have reflected special factors operating in the individual European countries. Therefore, we shall briefly review developments in the United Kingdom, Germany, France, Italy and Switzerland.

### United Kingdom

On May 15, 1961 stock prices in Britain reached a postwar peak of 120 (end 1961=100), but within a few weeks they were affected by emerging foreign-exchange difficulties which culminated in a severe crisis in July. Upon the news of the Chancellor's stabilization measures introduced on

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<sup>2/</sup> See especially editorial in The Financial Times (London), June 15, 1962, p. 12.

During a second period, the stock price index rose steeply from 23 in 1953 to 44 in 1955, held nearly steady at about 44 in 1956, and then jumped rapidly to a high of 65 in August 1957. The rise from the 1953 average to the level of August 1957 was more than 180 per cent. Because this rise greatly outpaced the rise in dividends, the yield on stocks dropped from 4.97 per cent in 1953 to 2.60 per cent in August 1957. It also appears to have far outstripped the gain in corporate earnings. On an annual basis, corporate profits appear to have risen about 20 per cent from 1954 to 1957. Without doubt, the ascent of stock prices in this period was partly predicated on the inflation of prices of goods and services in France and the expectation of more inflation in the future.

In a third period, a sharp setback in stock prices saw the index drop abruptly from 65 in August 1957 to 48 in May 1958, a fall of 26 per cent. In mid-1957, various strong credit tightening measures had been taken, and the latter part of 1957 saw falling stock prices in the United States, United Kingdom, and Italy (in part because of the 1957-58 recession). Also, in France the months before June 1958 witnessed the final political convulsions of the Fourth Republic, with attendant great uncertainties.

Finally, in a fourth period under the de Gaulle regime, the stock index rose steeply from 48 in May 1958 to 101 in June 1961, a rise of 110 per cent. The stock yield fell from 3.32 to only 1.61 per cent between these two periods, and corporate earnings rose only about 3.2 per cent from 1957 to 1960. One factor favoring rising stock prices was the continued upward creep in prices. From June 1958 to June 1961, for example, consumer prices rose 11 per cent and wholesale prices 7 per cent. A second factor was the general satisfaction of the business community with the de Gaulle administration. In general, French investors were motivated by the same psychological forces which had produced such sharp rises in stock prices in other principal financial centers. This rise was temporarily interrupted when the index fell from 101 in June 1961 to 90 in October 1961, but was resumed and an all-time peak of 114 was reached on April 2, 1962, at which time the stock yield was down to approximately 1.38 per cent.

From April to June 1962, the index dropped by 10 per cent to 103 and the yield increased to about 1.56 per cent.

### Italy

From the beginning of the 1950's until September 1960, the trend of stock prices in Italy was markedly upward. On a base end-1961=100, the index of share prices rose from an average of 15 for the year 1950 to an all-time high of 132 on September 9, 1960, a rise of over 750 per cent. Since the attainment of that peak, there has been an irregular decline, the index standing at 91 for June 8, 1962.

The rise of stock prices from 1950 to the third quarter of 1960 was, of course, in great part the consequence of the remarkable growth of economic activity in Italy, with accompanying increases in corporate earnings and dividend payments. In fact, rapid as was the rise in stock prices, until June of 1958 it never for long outpaced the growth of dividend payments. From 1950 (yearly average) to June 1958, for example, the stock price index rose by almost 150 per cent to 38. Yet in June 1958 the average yield on stocks was 5.53 per cent, compared to a 5.44 per cent average for 1950.

Then, beginning in June 1958, an entirely new phase began in which stock prices rose out of all proportion to dividend payments and, without doubt, corporate profits as well. The rise in the share price index from June 1958 to September 9, 1960--from 38 to 132 in the space of two years and three months--amounted to nearly 250 per cent. The average yield in this period dropped from 5.53 per cent to about 1.88 per cent.

After hitting 132 in September 1960, Italian stock prices fell very sharply in the remaining months of that year because of an unusually large volume of new stock issues placed on the market at that time and because of a slowing down in growth of industrial production. In 1961 there was a resumption of rapid growth of industrial output, which reached new high levels, but stock prices never regained their previous peak. While the index rose from 92 in December 1960 to 115 in June 1961, it sank back again to 100 in December 1961. At that time the average yield stood at 2.65 per cent, distinctly above the yield in September 1960 although still low by historical standards.

Thus, in December 1961, Italian stock prices were already down 24 per cent from their all-time peak. This fact undoubtedly is one explanation why, so far in 1962, stock prices in Italy have fallen much less than in the United States, where the record high was not attained till December 1961. As measured from the December 1961 level, Italian stock prices were down 7 per cent at the end of May 1962, and down 8 per cent on June 8, 1962. Substantial sales by Swiss and American investors contributed to the fall in values in April and May. Public discussion of the nationalization of the electricity industry and of withholding taxes on dividends also depressed prices and stimulated Italian sales of stocks.

### Switzerland

Stock prices have declined this year more severely in Switzerland than in any other country, the Swiss industrial index on June 15 being 38 per cent below the all-time high attained on March 9 of this year. For some considerable time prior to reaching the price peak, Swiss stocks had shown lower yields than stocks in any other major financial center.

The rise in Swiss stock prices after 1953, like the trend in other European centers, accelerated after 1958. Stock prices reached a peak in Switzerland at approximately the same time as they did in France and Belgium, and only three-months later than the U.S. peak. However, the Swiss peak came much later than that in Germany, Italy, and the United Kingdom.

The Swiss National Bank composite index of Swiss stock prices rose from 20 at the end of December 1948 (end 1961=100) to 37 at the end of December 1954, a rise of 85 per cent in six years. Between those dates the average yield on the "most representative stocks" as computed by the Union Bank of Switzerland dropped from 4.01 per cent to 2.67 per cent. In 1955-56, the price index showed relatively little net change; at the end of December 1956, the index was 40 and the average yield was almost the same as two years previous.

There was a severe setback to prices in 1957, notably in the second half of the year when prices were falling swiftly in the U.S. At end-October, 1957, the National Bank composite index was down to 30 (25 per cent below end-December 1956), and the average yield on the "most representative stocks" computed by the Union Bank of Switzerland had risen to 3.41 per cent at the end of December 1957. (Yields were computed only for end-of-year dates.) Thus, although stock prices had advanced from the end of 1948 to the end of 1957 by 67 per cent, the average yield on the "most representative stocks" had decreased only 0.6 per cent.

In the three and one-half years from end-October 1957 to March 9, 1962, the composite stock price index rose 258 per cent, reaching 107 on the latter date. The only significant break in the rise occurred between June and August of 1961 as a result of the intensification of the Berlin crisis, and the ground lost in this decline was recovered by the early part of December. The extent to which this rise was motivated essentially by the search for capital appreciation may be seen by observing what happened to yields on the various types of stocks as published by the Swiss Credit Bank, and on the "most representative stocks" as calculated by the Union Bank of Switzerland.

	End of December					a/ March 9
	1957	1958	1959	1960	1961	1962
Bank shares	n.a.	3.1	2.1	1.8	1.2	1.1
Insurance shares	n.a.	2.5	2.5	2.2	1.8	1.6
Industrials	n.a.	3.1	2.5	2.1	1.3	1.2
Investment companies	n.a.	3.2	2.4	2.1	1.8	1.6
"Most representative stocks"	3.41	2.89	2.31	1.89	1.25	n.a.

a/ Estimate based on end-December rate of dividends and change in index since end of December.

The decline of Swiss stock prices from their peak in March has been more precipitate than the recent declines in any other country. The industrial index on June 15 was 84, which was 38 per cent below the March 9 level of 136. From March 9 to May 25, that index had fallen 23 per cent. The week from May 25 to June 1 saw the "Black Tuesday" sell-off and the subsequent recovery which lifted the index on June 1 back exactly to the May 25 level. But there were very severe declines in the following two weeks.

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