

BANK FOR INTERNATIONAL SETTLEMENTS

EIGHTH ANNUAL REPORT

1st APRIL 1937 — 31st MARCH 1938

BASLE

9th May 1938

TABLE OF CONTENTS

	Page
I. Introduction	5
II. Exchange Rates, Price Movements and Foreign Trade	19
III. From Dehoarding to renewed Hoarding of Gold	37
IV. Capital Movements and International Indebtedness	61
V. Trend of Interest Rates	74
VI. Developments in Central and Commercial Banking	100
VII. Current Activities of the Bank:	
(1) Operations of the Banking Department	106
(2) Trustee and agency functions of the Bank	109
(3) Net profits and distribution	111
(4) Changes in Board of Directors and Executive Officers	112
VIII. Conclusion	114

ANNEXES

- I. Central banks or other banking institutions possessing right of representation and of voting at the General Meeting of the Bank.
- II. Balance sheet as at 31st March 1938.
- III. Profit and Loss Account and Appropriation Account for the financial year ended 31st March 1938.
- IV. Trustee for the Austrian Government International Loan 1930:
 - (a) Statement of receipts and payments for the seventh loan year (1st July 1936 to 30th June 1937).
 - (b) Statement of funds in the hands of depositaries as at 30th June 1937.
- V. Trustee for the Austrian Government International Loan 1930 — Interim statement of receipts and payments for the half-year ended 31st December 1937.
- VI. International Loans for which the Bank is Trustee or Fiscal Agent for the Trustees — Funds on hand as at 31st March 1938.

EIGHTH ANNUAL REPORT

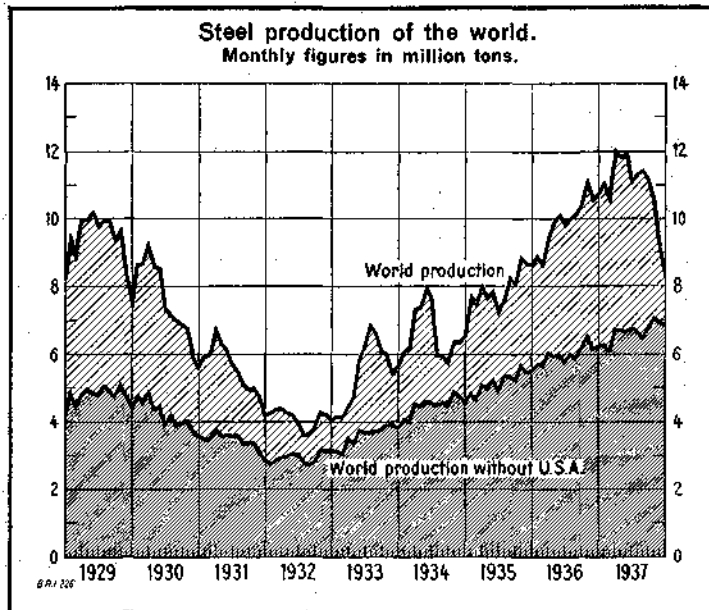
TO THE ANNUAL GENERAL MEETING OF THE BANK FOR INTERNATIONAL SETTLEMENTS

Basle, 9th May 1938.

Gentlemen:

I have the honour to submit to you the Annual Report of the Bank for International Settlements for the eighth financial year, beginning 1st April 1937 and ending 31st March 1938. The results of the year's business operations – differing but little from those of the preceding year – are set out in detail in chapter VII. After careful provision for contingencies, the Board recommends to this General Meeting an annual dividend of 6 per cent. and the statutory allocation to reserves.

The recovery in the world's economy, of which the first signs were seen in the summer of 1932, continued through the years up to 1936, with only minor setbacks and hesitations in some countries, with a definite lag in others. It was not before the second half of 1936 that the progress, which had shown such marked differences both in rhythm and in pace, became almost general, creating at last the feeling that the great depression was over. The advance in prices and production, commerce and consumption reached its highest point in the first half of 1937. Its impetus in the last phase was very marked; many of the characteristics usually associated with boom conditions were present. The period of more intense activity especially in the United States was, however, of comparatively short duration, and it is, therefore, not surprising that public opinion was unprepared for the abrupt reversal that was to come. If there were misgivings, they had their origin rather in the prospects of a further uncontrolled development of the boom. There was some apprehension that the extraordinary growth of gold production might produce an exaggerated monetary expansion all over the world. The continuance of government expenditure on armaments and public works, when business no longer needed its stimulating effect, seemed liable to lead to overdevelopment of certain aspects of economic activity. In the United States, government measures intended to stimulate business activity were discontinued in the expectation that business would develop of its own impetus. Monetary policy aimed rather at putting a brake on the upward movement, and President Roosevelt's declaration that certain prices were too high was also meant to put a stop to speculative increases of prices.



The sudden break in the United States in the second half of 1937 took the world by surprise. Indications of business activity ceased their upward trend, declines in some cases being very slight, in others so marked that a parallel can be found only in the most acute depressions ever known. The consequent disruption of a more or less uniform pattern into a congeries of conflicting tendencies introduced

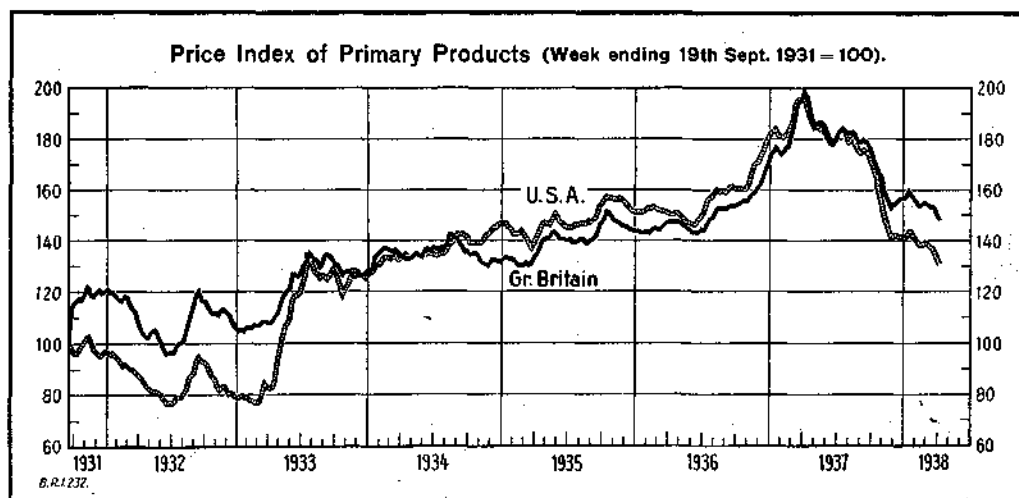
great uncertainty into the business outlook and in particular affected the investment of new capital.

World industrial production achieved a high record in the spring of 1937, reaching a peak about 20 per cent. above that of the previous boom year 1929. The retrogression in the latter part of the year was, however, very marked, particularly as the United States showed an almost vertical drop; the Federal Reserve index of industrial production (base 1923-25) fell from 117 in August to 84 in December. This decline was greater than in the autumn of 1929, when the index fell from 121 in September to 103 in December, and, if not quite so great, it was more rapid than in the post-war collapse when in fourteen months the index fell from its peak of 95 in January 1920 to its nadir of 64 in March 1921.

No other country experienced anything like this setback. In Canada, the neighbouring country, industrial production was well maintained up to November 1937, and in those European countries where economic life was not dominated by special conditions (as in France and Germany) the recession was more in the nature of a somewhat intensified seasonal decline. As, however, the United States alone accounts for nearly 40 per cent. of the world's consumption of primary goods, a steep decline in business in the United States has a very pronounced effect on the raw material markets and thereby on the economic development of the rest of the world.

The varying tendencies during the year are clearly reflected in the movement of the prices of primary products, there being four distinct phases during the year, each covering about three months.

(i) Continuing the upward swing of 1936, there was in the first quarter a steep rise, due to exaggerated expectations of the increased demand which would result from the larger purchasing power in the hands of consumers



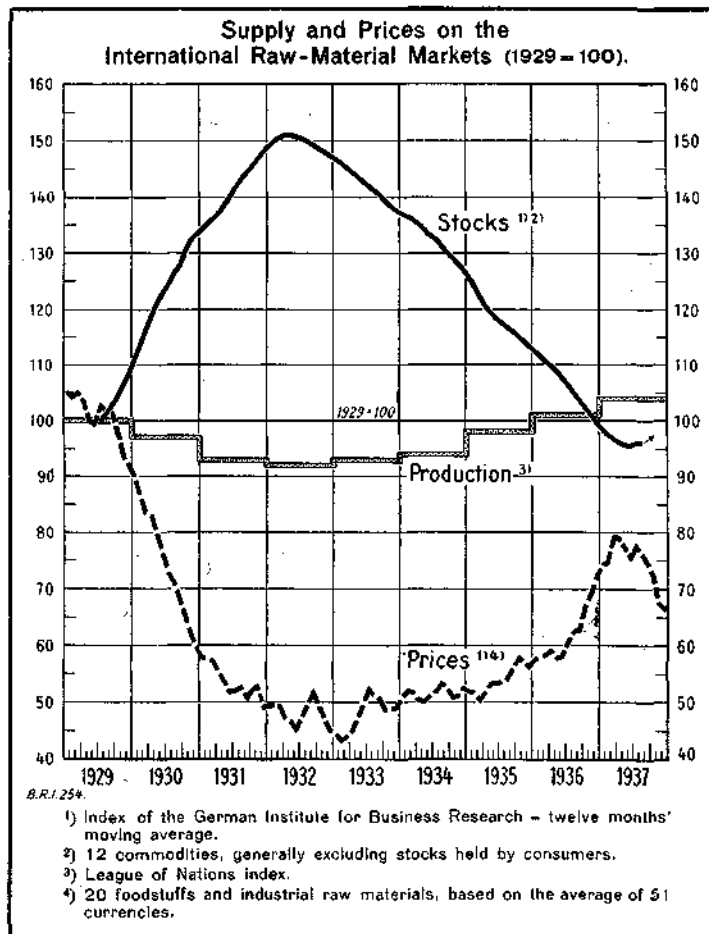
and from government orders for armament purposes. Industrial companies, anxious to cover themselves against the advances in the prices of their raw materials, bought more — in many cases much more — than their normal needs would justify. There was thus a general accumulation of inventories and a depletion of visible stocks, accompanied not unnaturally by purely speculative buying.

(ii) This movement was followed by an equally sharp fall in the second quarter, reflecting a general change of outlook and a liquidation of speculative transactions. The rapidity with which prices of some commodities had risen far beyond the actual cost of production at a time of great opportunity for extended output was, in itself, sufficient to create hesitation as to the future.

Then, after (iii) a period of relative stability of prices in the third quarter, (iv) a sharp decline set in in the last three months of the year when the arrival on the market of more abundant supplies coincided — as is often the case when business reaches a turning-point — with a contraction of demand following the change in economic outlook.

In response to the rise in prices at the end of 1936 and the beginning of 1937 and under the influence of favourable weather conditions, world production of primary commodities expanded considerably and reached record dimensions. Producers of internationally-controlled commodities, such as rubber and tin, decided upon a further increase of output and export quotas. These increased supplies became available on the markets mostly in the latter half of the year. When, however, prices turned and visible stocks began to accumulate, producers became apprehensive and production and export quotas were again reduced. There was, thus, a complete reversal, within the space of twelve months, of the previous line of production policy.

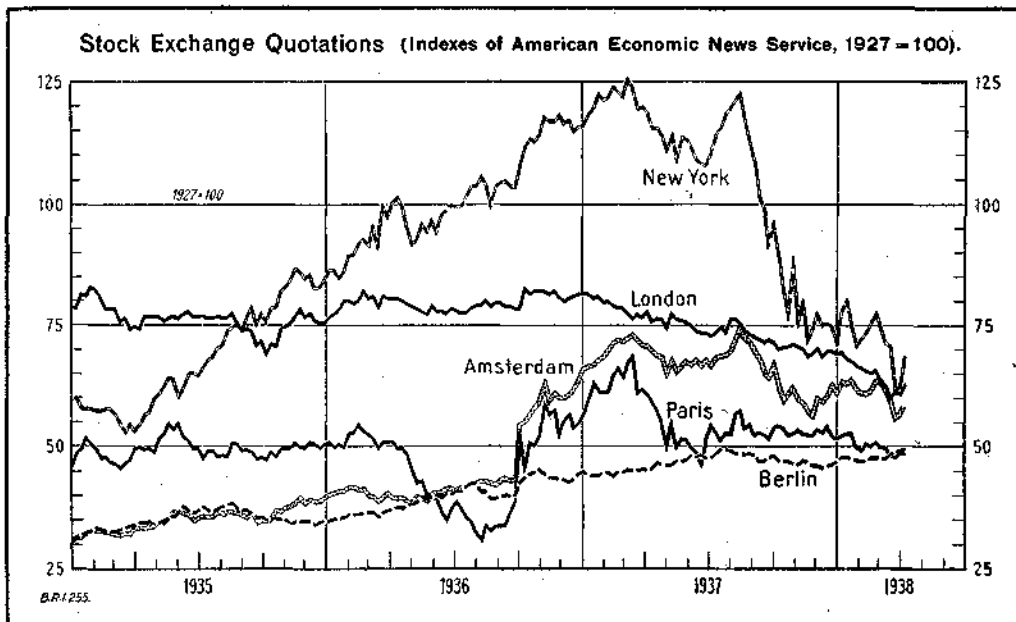
The following graph shows for the whole period from 1929 to 1937 the changes that have occurred in the production of the most important primary commodities, in visible stocks and in prices.



That the production index in the year 1932 shows so relatively slight a decline is due to the inclusion of agricultural production, which never varied very much. In 1937 production was higher and stocks lower than in 1929. As a result of the rise in the first quarter of 1937, prices came to a peak about 20 per cent. below 1929, but the subsequent declines brought them at the end of 1937 to about the same position as in the early autumn of 1936, i. e. about halfway between 1929 and the lowest point reached at the depth of the depression in 1932.

The different phases of the year are also reflected in the movements of stock exchange quotations, which in most centres rose in the first quarter of 1937, declined in the second, recovered in the third and slumped in the fourth.

These movements, giving an indication of the outlook of investors and speculators, undoubtedly have a great influence on the volume of business in general, both psychologically and through the effect which windfall profits and losses have on the spending habits of the public. This influence has certainly not decreased in recent times. In many countries it probably outweighs the influence of government investment orders; this is all the more remarkable if it be considered how much more important a part investment by official and semi-official bodies now plays in the whole of economic life. The public is rather more than less "stock exchange minded" in the greater part of the world, and the New York Stock Exchange still has a leading influence on the attitude of several important bourses outside the United States. This further increases the influence which the rhythm of economic life in that country exercises on developments in the rest of the world, particularly as movements of stock exchange quotations are liable to affect the volume of new issues on the different markets.



In the latter half of 1937 apprehensions regarding future developments began to weigh heavily on the minds of business men and security holders: fears of serious political disturbances, fears of renewed monetary troubles and fears of another depression. And it was perhaps natural, though unfortunate, that the dreaded depression should be thought of in terms of the sinister experiences of 1929-32.

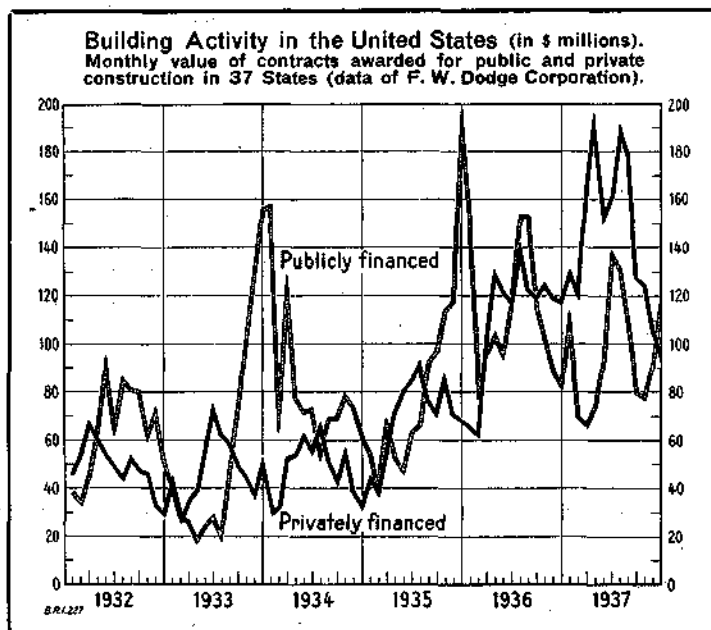
Both the depression of 1929-32 and the subsequent recovery bear the marks of the exceptional circumstances in which they developed. These circumstances obscure the normal characteristics of the so-called trade cycle. There is even a tendency — psychologically understandable owing to a natural disinclination to accept the inevitability of upswings and downswings in the world's material welfare — to ascribe the whole of prosperity to wisdom of policy and the whole of a setback to abnormal non-economic factors. Never have there been such far-reaching attempts to influence economic development by governmental action; never before have hopes been so great that an active economic policy could influence, if not master, the cyclical movements of the world's economic activity — at least within the national limits. The curse of unemployment, with its economic, social and political consequences, has never lain so heavily on the minds of statesmen, making an active economic and monetary policy almost a political necessity. But the impediments in the way of a normal development of business have never been so numerous. Government action, though creating work on the one hand, has on the other hand created, in many cases, an atmosphere of uncertainty hampering to private enterprise. Economic nationalism, though fostering certain branches of internal activity in all countries and the whole of economic life in the countries with a controlled economic system, has often unintentionally stood in the way of the development of foreign trade. This has led to a shrinkage of what is called the world market for many important products and thereby increased the

sensitiveness of their so-called world prices. The desire for independence from fixed exchange parities, often considered a necessary instrument in an active economic policy, though not on the surface leading to great exchange fluctuations has prevented the return of a really well-established monetary stability and thereby left a feeling of uncertainty that incidentally plays an important part in the "hot money" problem. Last but not least, political disturbances, with the actual outbreak of hostilities in some parts of the world and the fear of more disastrous possibilities, have prevented the development of much new enterprise, checked the natural optimism inherent in times of expansion and led to flight of capital and liquidation of investment.

It is generally admitted that the tendencies of the trade cycle are reinforced by the cumulative effect of price movements; and the enormous influence of psychological factors in stimulating this cumulative process cannot be denied. Even to those who do not believe in the possibility of completely ironing out or even of mastering the trade cycle the necessity of mitigating these cumulative effects is apparent. The events of the past years, by increasing the elements of uncertainty, have, however, increased the state of indecision in the business world, and this, in turn, may frustrate the beneficial action of government policy, even in those cases where action of this nature does not in itself increase the feeling of uncertainty. Little result can be expected from a policy that seeks to diminish the cumulative effects of the trend of business if it is of a nature to increase sensitiveness to those factors that inevitably remain. This simple truth puts certain limits to the possibilities of following a purely national economic policy on the one hand, without accepting the ultimate consequence of economic isolation on the other.

Summing up the whole picture of the recovery from the severe depression of 1929-32, it may be said that the world economy fought its way back to recovery in abnormally adverse circumstances, and that the natural forces of recovery were partly strengthened, partly hampered, by the action of governments. In Europe, where the adverse elements were strongest, recovery was showing signs of stability by 1936, though, of course, many abnormal factors were still at work. The setback experienced in the world in the following year originated in the United States, and in this respect the developments in that country are of particular importance. In no country, except those in which the government practically controls the whole of economic life, has administrative action been so strong and widely spread. No country is so naturally independent of other countries and so well protected against international political troubles. Nowhere, however, has the reaction been so violent. It has proved to be infinitely more difficult to direct the trend of economic life by government action, even in a country with a very large home market and an organised banking system, than the weight of well-studied experience and the attentive survey of economic developments encouraged many to believe.

If governments are to succeed in influencing the trade cycle they must not only counteract the periodic downward swing, but also be prepared to check an excessive upward tendency. When activity begins to slacken, a stimulus may be given until private business recovers its own impetus, but



official influence must be exerted in the opposite direction as soon as signs appear of a too rapid rise in the rate of investment. One of the most remarkable features of the recent phase was that when business activity was high and government action slackened there appeared to be insufficient impetus in ordinary private activity to carry on the forward movement; business receded im-

mediately the stimulating effect of government action slowed down. In the United States, for example, the government is now confronted with the problem of counteracting a decline in business activity before conditions had been such that it had entirely reversed its previous policy of expansionist measures.

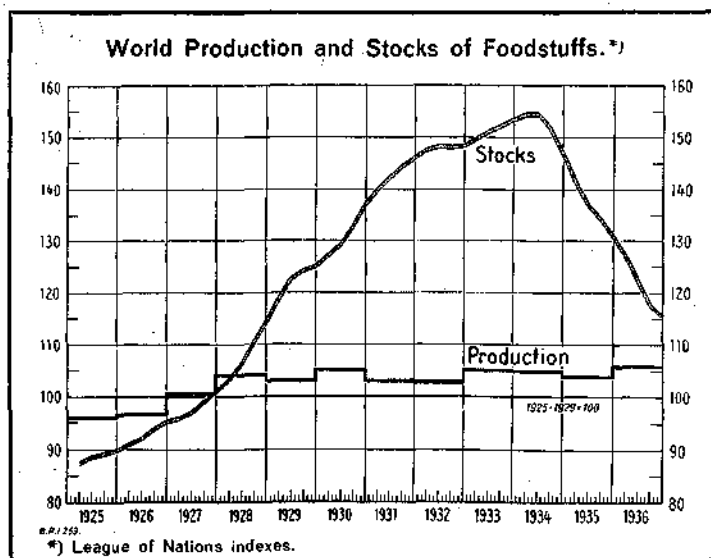
The recovery in the past few years in the United States was not in fact marked by a large development of new investment in capital equipment. There was a better use of productive capacity already existing but no widespread increase of capacity. This seems to prove the correctness of the assumption that only a rise in the rate of new investment can provide a more durable basis for an upswing in business activity. The mere stimulation of consumption by government expenditure or — as in France — by suddenly improving labour conditions does not provide business activity with this basis. It may stimulate when it is introduced, but it does not awaken the more normal and permanent motive forces, and if it puts too heavy a burden upon production the ultimate effect may even be the reverse of that intended.

The events of 1929 taught us that the absence of any rise in prices did not prove that no crisis was pending. 1937 has taught us that an abundant supply of gold and a cheap money policy do not prevent prices from falling — at least, temporarily and sharply. The past years have taught us too that, owing to differences of monetary policy and of economic structure, one country may show an entirely different rhythm in the cyclical movement of its economy from that seen in other countries. But the hope cherished in certain circles that a country could liberate itself from the influence of developments in other countries by following a national economic policy has proved to be vain. On the contrary it may be that one of the consequences of the fact that cyclical movements in different countries no longer coincide is that the turn of the cycle in one country may arrest the upward trend in others long before it comes to its normal maximum. Except in cases of complete isolation — which few believe

to be the ideal — the interdependence of modern countries is so great that, though economic nationalism and freedom to change monetary parities may allow them to walk out of step (and this is claimed to be one of the main advantages of breaking with an automatic international monetary standard), it does not make them free to move independently of each other. At a certain distance the movements of the more important countries must be followed. It might have been hoped that the difference in the rhythm and the pace of economic development in the world would have a stabilising effect on the trade cycle for the world as a whole, the prosperity in one country offsetting and checking the decline in another. But at the moment experience rather proves that the chief effect of this walking out of step is a greater disorder in the general economic development of the world and a psychosis in which the feeling of living in a depression never leaves the world because it is always justified in one country or another.

There are now so many disturbing factors at work both in the political and economic fields that one is apt to forget that there are undoubtedly certain happier elements in the situation and that in certain important respects the actual position compares not unfavourably with that of 1929.

1937 was a year of comparative exchange stability, only the French franc being subject to any important downward movement. The fluctuations between the pound and the dollar were kept within limits narrower by a third than those of the previous year. International trade continued to expand, the physical volume of goods exchanged being brought back practically to the 1929 figures. This recovery helped many debtor countries to make larger provisions for foreign debt service and established a basis propitious to the conclusion of debt arrangements. In two respects the situation in 1929 was exceptionally dangerous. There was the coincidence of an agricultural depression with an industrial setback coming after some years of rapid expansion, and the crisis was followed and prolonged by a general financial débâcle, profoundly affecting the world's whole monetary system.



Experience proves that there is no necessary connection between even a severe industrial decline and an agricultural depression. There was no fall in the prices of agricultural products in the depressions which started in 1900 and 1907. And at present the agricultural outlook appears at least in some respects brighter than it was in the 'twenties.

The above graph sets out the movements of world production and stocks of important foodstuffs, including wheat, sugar, meat, milk, coffee and tea etc., in recent years, in so far as statistics are available. Production rose very steeply in the years 1925-28, with the result that a disequilibrium between production and consumption caused a great increase in stocks and a sharp fall in prices. In 1936 there was again an increase in production, but the level then attained was only slightly above that of 1928-29, while world population has been rising by perhaps one per cent. per annum. Special importance attaches to the wheat situation; the following table gives the development of the wheat acreage since 1910-14.

World Wheat Acreage.

In million acres (yearly averages)	1910 - 14	1918 - 19	1926 - 27	1931 - 32	1936
United States of America . .	54.1	72.4	63.2	66.0	73.6
Argentina	16.2	17.2	20.0	18.5	17.5
Canada	10.5	18.3	22.7	26.7	25.3
Australia.	8.2	7.2	12.0	15.3	12.3
Four chief exporters	89.0	115.1	117.8	126.5	128.7
European importing countries .	35.4	29.1	32.5	33.7	34.6
European exporting countries .	24.3	18.4	25.0	27.7	29.3
Other countries*	53.6	55.4	59.1	63.8	65.7
World total*	202.3	218.0	234.4	251.7	258.3
Total production* (in million tons)	80.7	77.1	94.2	100.3	89.7

* without Russia.

During the world war wheat acreage was reduced in European importing and exporting countries but greatly increased in the four chief exporting countries; the world supply of wheat was thus fairly well sustained in spite of the virtual disappearance of Russian exports. When, however, after the war, European production was restored, largely with the aid of protection, and overseas production continued undiminished, a few large harvests in succession were sufficient to bring the wheat market into disequilibrium; and after some years of artificial intervention, the price of wheat fell to such a low point that it was profitably used in the United States as cattle feed. In spite of low prices, the area under wheat was actually increased, farmers having no alternative way of using their productive power. The improvement in the wheat position that set in from 1934 onwards was due neither to a reduction in acreage nor to an increased demand from the importing countries, but to a succession of very poor crops in Canada and the United States. The danger now is that, given the present acreage, the appearance of a few large or even normal crops may endanger the stability of the market; certain factors, however, tend to make this danger less formidable than it would appear to be at first sight.

Most important are the developments in the United States and Canada, the two largest wheat-producing countries. Since 1929 the area sown in the United States has increased considerably, but not so the area harvested.

Area under Wheat in U. S. A.

For harvest in	Sown			Harvested			Difference between area harvested and area sown
	Winter	Spring	Total	Winter	Spring	Total	
	in million acres						
1925	40.9	20.8	61.7	32.0	20.5	52.5	— 9.2
1929	43.9	22.9	66.8	41.2	22.1	63.3	— 3.5
1932	42.3	22.6	64.9	35.2	21.9	57.1	— 7.8
1933	42.7	24.3	67.0	28.5	19.4	47.9	— 19.1
1934	41.9	18.5	60.4	33.0	9.3	42.3	— 18.1
1935	44.5	22.3	66.8	31.0	18.8	49.8	— 17.0
1936	49.8	23.9	73.7	37.7	11.2	48.9	— 24.8
1937	57.6	21.1	78.7	46.9	17.5	64.4	— 14.3

According to the U. S. Department of Agriculture, the acreage of the principal crops planted and subsequently abandoned in 1937 appears to have been about 24½ million, including about 14 million sown with wheat. Three-quarters of the lost acreage was in the States west of the Mississippi and largely in the "dust bowl" area of western Oklahoma, northern Texas and north-eastern New Mexico. The year 1937 is the fifth successive year of heavy drought losses and much of the drought area is still unfavourably dry. The question arises whether these misfortunes are simply to be regarded as temporary occurrences of dry seasons or whether more permanent factors are operative.

The extension of wheat production which took place during and after the war was mainly the result of virgin land being brought under the plough, a development similar to the great pre-war cultivation of new tracts of land. It would seem, however, that not only has this process reached its limit, no more really suitable land being available, but also the margin of cultivation in the United States and to some extent in Canada has been pushed too far, land being worked that could only by way of exception be expected to yield a normal return to the producer. The U. S. Government has begun buying back land in an effort to save the "dust bowl" from becoming a desert. More than 5 million acres have already been purchased and an expanded programme under the Bankhead-Jones Farmer Tenant Act calls for the buying of another 5 million acres during the next two years. Such land as is withdrawn from wheat production will be used for forests, recreation areas, wild-life refuges and controlled ranges and other purposes for which it is best suited.

It is too early to make any definite pronouncement on the wheat situation in the light of these developments, especially as even a temporary reappear-

ance of favourable weather conditions in the United States and Canada may lead to the accumulation of large exportable surpluses. In a world of still growing population, the possible decline in wheat acreage should, however, tend to give a greater steadiness to the wheat markets. An improvement in the standard of living might mean a certain shifting of consumption from bread to a more varied diet, but such an improvement would, without a doubt, also increase the aggregate demand for all foodstuffs. In any case, the accumulated stocks of agricultural products are now smaller than when the depression began in 1929.

As to the other aggravating element in the world depression — the widespread international liquidity crisis — the situation may be said to be fraught with less danger. Great was the havoc wrought in 1931 by bank failures, depreciating currencies, moratoria and exchange restrictions, and the disequilibria produced by the monetary and other changes have had lasting effects on the whole subsequent developments. Still, in the last few years great adjustments and consolidations have been carried out and the situation now obtaining is in practically every material respect less vulnerable. In commercial banking the disappearance of the weakest banks, the consolidation of others, the more general observance of stricter liquidity principles and other measures of adjustment have strengthened the banking position all over the world. The large holdings of government securities by commercial banks might constitute a source of danger if there should be a marked decline in the market value of these securities; but, on the other hand, the reserves of the banks have, as a rule, been increased by allocation of profits and recovery of amounts previously written off, and their liquid resources are relatively higher.

Furthermore, the international debt position has been greatly alleviated. Long-term foreign debts have been reduced by redemptions and repatriations or the service lightened by conversions. In other cases temporary arrangements have been made to cover the transitional period until a permanent scheme can be agreed upon between debtor and creditor. Old short-term foreign debts have also been greatly reduced. In some cases arrangements for gradual repayments over a protracted period have been agreed upon; and, wherever the withdrawal of the remaining nominally short-term liabilities might constitute a danger for the position, they are kept under control by various restrictions, which of course are undesirable in themselves but at least afford protection against any breakdown as a result of a massive outward movement.

The position of those creditor markets in which large short-term funds are held by owners domiciled abroad has also been greatly strengthened. The accumulation of substantial gold reserves provides, as far as can be seen, a backing sufficient to meet possible contingencies; and the methods employed to prevent movements of short-term balances from exerting an undesirable effect on the internal credit position have been improved at least in some markets.

The difference in the financial position as compared with the situation of 1929-31 may prove to be of importance as regards the length of time which the world will take to recover from the present economic setback. It is,

of course, a truism that the downward movement of the cycle must naturally find its turning-point. But nothing so greatly retards the moment when economic activity starts to increase again as a disorderly financial situation. Formerly it was thought that in a crisis one of the gravest dangers was the financing of new investment in fixed capital by banking credits, because of the inevitability of bankruptcies and forced liquidation of industrial enterprises which had to repay their banking credits. In the financially stronger countries, therefore, after the lessons of the crisis of 1921, enterprises avoided this method of financing their new investments and banks also pursued a more prudent course. The practice of issuing shares well in advance of outlay came into favour and it was one of the features of the 1929 crisis that relatively few industrial enterprises broke down. Concurrently, industrial enterprises were building up large reserves out of profits, in order to be able to finance extension without having recourse either to the banks or to the public. The application of this method appears to have been one of the main fillips to the stock-exchange boom of the year 1929, because it led the public to base their valuation of equities on what was called "intrinsic value" instead of on expected returns, the theory being that returns only represented a part of what was actually earned. Intrinsic value, however, is too vague a notion to set a limit to exaggerated hopes. Bank credit to finance new investment then slipped in by the back door, that is, by financing the holding of shares by the public. In two respects this proved to be more harmful than direct bank credits. First, there is always a limit to financing by bank credit, since a moment comes when apprehensions begin to be felt by the banks, whilst the expectations of a speculating public (much more than those of the professional speculators who incur so much censure) are, during a boom, practically without limits, especially if they have lost their connection with expected returns. Secondly, though it is true that bankruptcies and forced liquidations have an aggravating effect on a crisis, they tend to bring it to an end, whereas the liquidation of private debtors may take an interminable time, because there is always hope that some day they may be able to pay. The effect is to prolong the crisis; for, when business begins to improve, purchasing power is withheld because old debts have to be repaid and this forced saving prevents recuperating business from having the normal cumulative effect on purchases by consumers. This tendency is reinforced when instalment selling is widespread and debts under this heading have to be gradually repaid. The crisis of 1929 was already burdened by the bias towards slow liquidation inherent in the particular financial structure of the stronger countries. This tendency was multiplied by the special features of the international financial crisis of 1931. The rapid liquidation of international indebtedness being impossible because of the extension of the disaster that would have followed, it became habitual to freeze existing positions by general laws or agreements. This, combined with a general feeling that weak debtors must be protected, prevented any quick clearing away of the bad debts. The body was to be cured, not by surgical operation but by the gradual improvement of its state of health under financial shelter. It is impossible to say whether any other solution would have been materially or politically possible. To some

extent the system was as necessary for helping creditors as for protecting debtors. But old debts contracted for the purchase of assets that have lost their value can be repaid out of new profits only after a complete turn of the trade cycle; the existence of these debts, however, tends to hinder the trade cycle from taking its natural turn. There is thus no doubt that a financial crisis of the scope of that of 1929-31 is a tremendous obstacle in the way of recovery.

The present situation, from a financial point of view, though not entirely satisfactory, does not appear to contain those deterrents to recovery that were characteristic of the crisis of 1929-31, or, at any rate, not to anything like the same extent. It is to be hoped, therefore, that this time a quicker and more general recovery will be made. Two factors, it is clear, play a large part in the present world situation: the organisation of production by means of so-called restriction schemes on the one hand, and government action on the other.

Though no-one can overlook the fact that the working of restriction schemes is anything but simple, and that even in their most concentrated form they are not yet able to follow, much less lead, the market as efficiently as might be wished, they no doubt prevent production from continuing to outstrip requirements as it is apt to do when no organisation of producers exists, but, of course, they contain no element of stimulation.

As to government action, it is to be hoped that the fact will not be overlooked that the main incentive to recovery over wide areas of the world is still the expectation of a sufficient margin of profit during a sufficiently long period. Investment in new capital is not only the more durable basis of an economic activity that makes the factors of production, including labour, employable at a satisfactory level — a basis which, as experience has proved, can be neither replaced nor built up by simply stimulating consumption — it is also the only way of improving the general welfare of the world. The immediate necessity of fighting unemployment may induce governments to ignore the fact that, though it may be better to extend employment, even without increasing the production of wealth, rather than doom a major part of the population to the curse of idleness, the ultimate aim must be to employ the factors of production for the improvement of the economic situation of the world at large. In this respect the slogan of national monetary independence, by which is meant freedom to alter exchange parities, may prove dangerous. The freedom it seems to give is often fallacious. It cannot break the inevitable interdependence of modern countries. And the instability it creates may frustrate the effects of the best-planned government action by preventing available capital from looking for investment in new productive enterprise. It is human to look backwards at past disasters in the hope of avoiding them in future. But it might prove as dangerous to be led by fear of a deflation that may not come as it has been dangerous, in some cases, to be led by fear of an inflation that was not imminent. And, if the fear of deflation be identified with a fear for international monetary stability, this may so hinder economic recovery as to force deflation on a world gorged with gold. If history repeats itself, it never repeats itself in happenings identical with those we

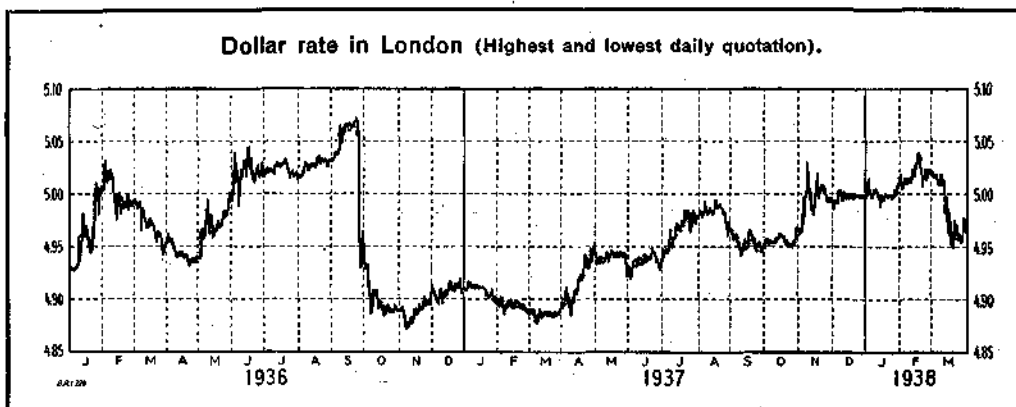
know from the past. In its causes and effects the crisis of today and the recovery of tomorrow will have their own features and their own, partly new, problems. Central banks will have to face these problems both as regulators of the money markets and as advisers of their respective governments. In the Bank for International Settlements they find their centre of consultation at a time when active economic policy makes co-operation of monetary authorities even more necessary than under an automatic system. It may be mentioned that, in this past year as in previous years, representatives of central banks have availed themselves regularly of the opportunities afforded by the meetings in Basle to consult one another and to take stock of the general trend of events influencing their policy.

II. EXCHANGE RATES, PRICE MOVEMENTS AND FOREIGN TRADE.

1. EXCHANGE RATES.

Notwithstanding the many disturbances both political and economic that occurred in 1937, exchange stability was maintained remarkably well, in fact better than in any year since 1931, for, although the external value of the French franc was reduced and certain South American currencies also showed a decline, the exchange movements in the rest of the world remained within very narrow limits. This is the more remarkable as the year witnessed a succession of scares regarding the value of leading currencies and the price of gold, large movements of funds from one market to another, sharp fluctuations in prices and grave political conflicts. The greater stability of exchange rates is to be seen in connection with the increase in the volume of international trade, which enabled central banks and other monetary authorities in a large number of countries to strengthen their monetary reserves.

The movements of the sterling-dollar rate set out in the graph were kept within somewhat narrower limits in 1937 than in 1936, the year of smallest range since the depreciation of the pound in 1931:



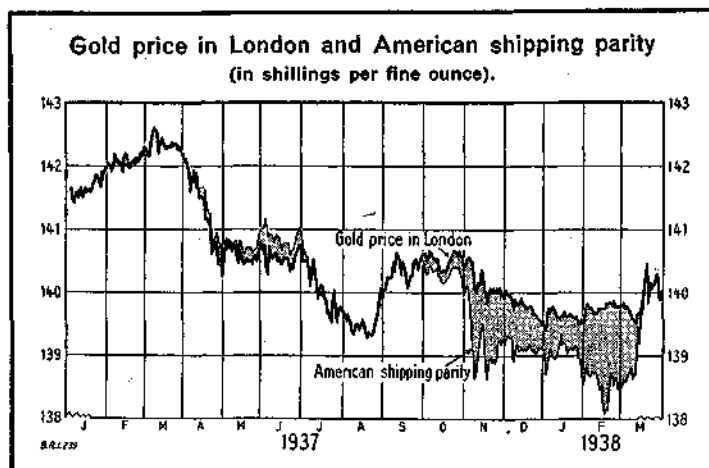
The first effect of the devaluation by the gold bloc at the end of September 1936 was a reflux of funds from the London market to France, the Netherlands and Switzerland. The movement towards France, however, was reversed after about two months, while it continued in the direction of the Dutch and Swiss markets. In the last quarter of 1936 and the first quarter of 1937, moreover, there was a flow of funds from London to the United States, sustained by large shipments of gold. Against the dollar the low point of \$4.88 to the pound was reached at the beginning of March 1937.

In the following months, from mid-April to the end of June, when it was thought there might be a cut in the price of gold in the United States (followed perhaps in other centres), the markets came under the influence of the "gold scare". The demand for dollars was intensified and a wave of gold selling occurred, more than £60 million being dehoarded on the London market alone, a fact not unconnected with the appearance of a "discount"

on the price of gold in London as compared with New York. During these months the price of gold was kept fairly stable at 140s. 6d. in London so that the discount on the gold price showed itself in the sterling-dollar rate. The funds moving to New York were used to build up bank balances rather than to purchase securities. This tendency to purchase dollars continued throughout the summer but was offset to a large extent by the influx to London of French funds particularly in May and June, and later, in September.

In the second half of the year, when stock prices fell on Wall Street and a recession in American business set in, the trend turned against the dollar. In November this tendency was sharply intensified by the "dollar scare" when it was feared in some quarters that there might be a further devaluation of that currency. Although this scare passed, the dollar rate in London remained around \$5 to the pound in the following months. In the second half of 1937 a strong export surplus developed in the United States, while in the United Kingdom the balance of trade became increasingly adverse. The remarkable strength which sterling developed in the autumn shows the decisive effects at present produced on exchange rates by capital movements as compared with demands relating to merchandise imports and the settlement of other current items in the balance of payments.

The different trends of the year are closely reflected in the following graph, which shows the gold price as established on the official market in London and the so-called American shipping parity.



The "American shipping parity" is the price for gold on the London market at which it would be profitable to ship gold to New York taking into account the ruling sterling-dollar rate. During the period of the gold scare from April to June 1937 the gold price in London fell below this parity; in the parlance of the

market there developed a "discount", an altogether abnormal situation. This was due to the fact that the American banks which usually made arbitrage purchases were reluctant to work under conditions that might have led to a considerable loss if the price of gold had been reduced in the United States, and thus gold in transit could be sold only at a price lower than \$35 per fine ounce. As soon as these fears subsided the "discount" disappeared; gold then moved to the United States at the shipping parity, showing that arbitrage was again working effectively. From the end of September the gold price in London rose above the American shipping parity, and gold could therefore no

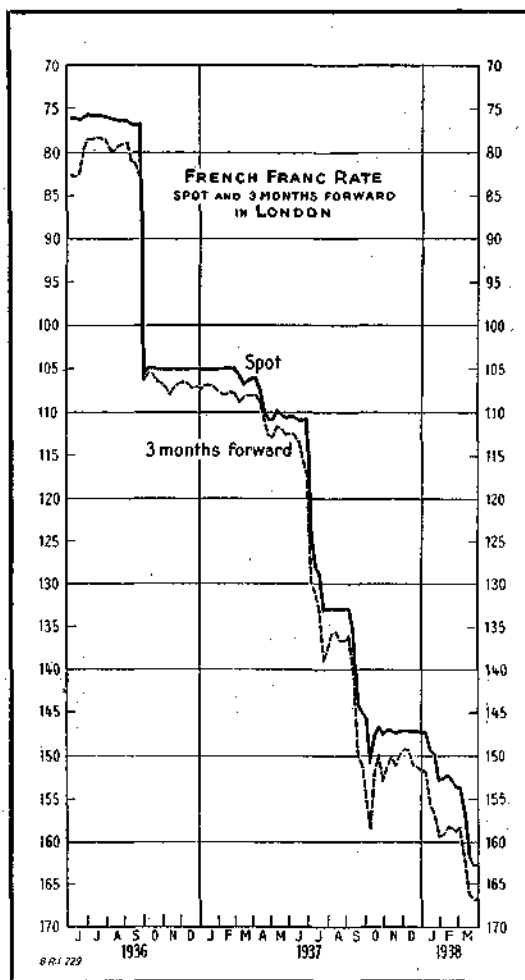
longer be profitably shipped from London to the United States. On the other hand, the gold price in London only on one day rose sufficiently in relation to the sterling-dollar rate to cover the costs (including interest charges) for the shipment of gold from New York to London. The point at which such shipments could take place may be compared to the "gold import point" for sterling, just as the American shipping parity is similar to the "gold export point" under the old gold-standard system. The distance between these two points represents the natural margin for the fluctuations of the gold price in relation to the sterling-dollar rate of the day. By a false analogy it has become customary to quote as a "premium" the amount in pence by which the market price of gold exceeds the American shipping parity. Obviously this "premium" may rise to the whole width of the margin between the "gold points", which, with the pound equivalent to around \$5, is generally considered to be about 22 pence. While, however, the American shipping parity should be a more or less automatic gold point since gold may be shipped by private arbitrage to New York, the lower gold point for the dollar is by no means automatic, for shipments cannot be made from the United States by private persons but only by recognised exchange funds and other authorities. The effectiveness of this rate therefore depends essentially on the willingness of these authorities to make shipments.

It was general in gold-standard days for the gold points between London and continental centres to be narrower than between London and New York, transport costs being obviously less in the former case. At the present time this disparity is particularly remarkable as the "gold points" vis-à-vis New York have become wider. This margin of 22 pence represents about 1.3 per cent. compared with about 0.5 per cent. before 1931. The greater part of the difference is caused by the so-called "handling" charge in the United States, this being, in fact, a tax of 0.25 per cent. on the value of gold bought or sold by the U.S. Treasury, which thus contributes 0.5 per cent. to the total margin between the gold points.

As regards the European currencies that have been linked to sterling, the following developments are of interest. A decree of 18th October 1937 abolished all restrictions imposed in Portugal since 1922 on dealings in foreign exchange and the free circulation of funds. In Denmark the monetary position improved sufficiently to allow the Government to free certain categories of commodities from import restrictions so that at the beginning of 1938 more than a third of all imports were exempt from official control. In the early months of 1937 the question arose whether an adjustment should be made in the rate of the Swedish exchange in order to mitigate, as far as the domestic market was concerned, the sharp rise in prices on the world markets. Since the middle of 1933 the Swedish crown has been pegged to sterling at the rate of S.Kr. 19.40, involving a depreciation of about $6\frac{1}{2}$ per cent. in terms of sterling, and it was thought that the rate might be brought back to the neighbourhood of the old parity of S.Kr. 18.16. It was decided, however, to make no change for the time being, and, as a result of the subsequent fall in prices, the question was naturally dropped. While the uncertainty lasted

forward operations were undertaken by traders and others to secure the rates applicable to individual transactions; the Riksbank estimates that in February 1937 the total involved in these operations amounted to S.Kr. 260 million, of which S.Kr. 200 million were undertaken for Swedish account and the remaining S.Kr. 60 million for foreign account. To secure the rates Swedish banks and industrialists borrowed foreign currencies, principally sterling, and the sale of these amounts on the spot market increased the Riksbank's holdings of gold and foreign exchange.

The fluctuations in the value of the French franc may be seen in the accompanying graph, which gives the spot and three months' forward quotations in London.



After the devaluation in the autumn of 1936, the spot rate was held for a period of five months at Fr.fcs 105 to the pound, but the forward rate soon went to a considerable discount, indicating uneasiness on the market as to the permanency of the rate adopted. A more flexible method of intervention on the exchange market was considered advisable and in the early spring of 1937 the rate moved to about Fr.fcs 110. After the legal limits, equivalent to 49 and 43 milligrams of gold nine-tenths fine, had been abolished, the rate reached a new low level of Fr.fcs 133 (on 22nd July) and remained at that level for about a month and a half. There was a further decline in September and on 5th October the quotation reached Fr.fcs 151. After a new period of stability between Fr.fcs 145 and 150, the rate rose above Fr.fcs 160 in March.

The intense demand for foreign currencies on the French market has been due partly to the increased import surplus of commodities (which rose from Fr.fcs 9,900 million in 1936

to Fr.fcs 18,400 million in 1937) and partly to the export of capital at different periods of the year. The deeper causes are to be found in the uncertainties of the internal and external political position, the large volume of government borrowing (met to the extent of Fr.fcs 14,200 million by advances from the Bank of France), the relative increase in internal costs and prices and

the restricted level of domestic production. All these various factors reacted upon one another and it is therefore difficult to assess the weight to be attached to each in the prevailing situation.

In 1937 some strain was felt on the Belgian exchange market from movements of funds and an increased import surplus. As the belga is linked to gold, however, the equilibrium of the market was maintained through the mechanism of the gold standard, the gold reserves of the central bank being reduced from B.fcs 18,640 million to B.fcs 17,623 million in the course of the year. Large movements of funds to the Dutch and Swiss markets did not greatly affect the exchange rates, but resulted in substantial additions to the gold reserves of these countries. The President of the Nederlandsche Bank explained in a speech on 8th February 1938 that so long as the demand for florins exceeded the supply the authorities were obliged to choose between two alternatives: either to allow the florin to appreciate in relation to other currencies, or to continue gold purchases by the equalisation fund assisted by the Nederlandsche Bank. The President underlined the importance of exchange stability and expressed the opinion that the useful effect of the Tripartite Agreement of September 1936 resulted from its link with gold.

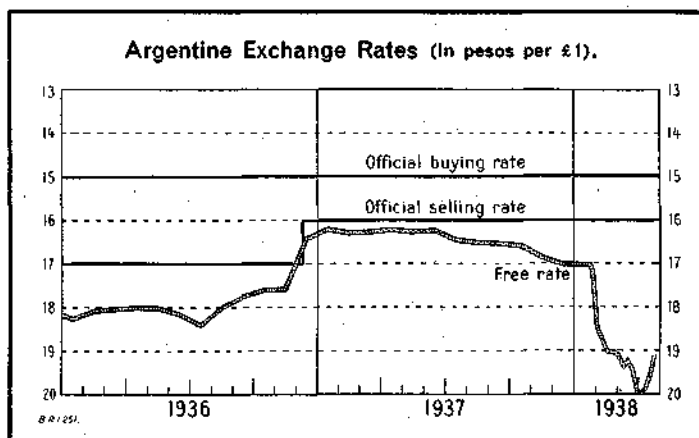
Those European countries that have introduced exchange control maintained their rates of exchange in accordance with the regulations prevailing on their markets and in many cases increased their reserves of gold and free foreign exchange, thanks to the improvement in their foreign trade. Of great importance has been the general reduction of arrears on clearing and similar accounts, which as long as they remained at high figures interfered with the settlement of current business. Germany's clearing debts were reduced during the year by about RM 150 million to RM 313 million at the end of 1937. During the same period the Reichsbank's holdings of gold and foreign exchange showed an increase from RM 178 million to RM 261 million.

Outside Europe, the conflict in the Far East had less effect on the exchange position than might have been expected, both the Japanese and Chinese rates remaining unchanged throughout 1937. The stability of the yen was maintained partly with the support of gold exports and partly by the introduction of import control and exchange restrictions. As regards China, the sales of silver made abroad to secure foreign currencies were complemented by an internal banking restriction so that the expansion in the note circulation was limited, the total issue rising only from 1,390 million to 1,760 million Chinese dollars in the twelve months to January 1938. In March 1938, however, the Chinese authorities found it necessary to introduce exchange restrictions; by the end of the month the foreign banks had withdrawn from the Gentlemen's Agreement entered into in 1935, under which they had agreed not to quote a rate lower than $1s.2\frac{1}{16}d.$ for the Chinese dollar. The dollar then declined to 11d. but has since recovered to a level showing a relatively small discount on the previous rate.

Nowhere have the fluctuations in commodity prices and world trade had a more immediate effect on the volume of purchasing power and the exchange

position than in the various South American countries. As a source of primary products, these countries depend for their prosperity on the demand for foodstuffs and raw materials in the United States and the industrial centres of Europe. The rising prices during the latter half of 1936 and the beginning of 1937 brought great profits to South American exporters and, as the import trade lagged behind, monetary reserves were generally strengthened, debts repaid and exchange restrictions made less stringent, while the market value of several South American currencies showed a distinct tendency to appreciate. Soon, however, the improved internal position led to the placing of orders abroad chiefly for machinery and ready-made articles of consumption; when suddenly raw material prices turned downward and the supply of foreign exchange shrank, the increase in the demand for foreign exchange to pay for the goods ordered created a rather stringent position on the exchange markets of practically all these countries.

In the Argentine the good harvest of 1936-37 sold at high prices and gave the Republic a year of almost unprecedented prosperity. From 10th December 1936 the official selling rate was lowered to 16 owing to the strength of the rate in the free market, as can be seen from the graph. Foreign



exchange at the official rate is available for payment of the greater part of the country's import trade (about 80 per cent. of the total), for public debt service and remittances on private investments, while marginal transactions such as payment for a part of the import trade, foreign investments and

movements of floating funds are settled over the free market. A slight complication arises from the fact that a surcharge is levied, under certain conditions, on purchases of foreign exchange in the free market. Up to January 1938 this surcharge amounted to 20 per cent. of the official rate, which meant that those who had to buy exchange in the free market had to pay a minimum of \$19.20 (the official rate of \$16 plus 20 per cent.), and the difference between this rate and the free peso rate represented a tax on foreign exchange transactions in the free market. In the middle of January 1938 the surcharge was lowered to 10 per cent. and the minimum rate thus reduced to \$17.60 (the official rate of \$16 plus 10 per cent.). As, however, the free market rate moved above \$17.60, this minimum rate ceased to be operative. It was hoped that the reduction of the surcharge would prove to be a step towards the gradual re-establishment of normal currency conditions. This reduction, however, coincided with the sale of a rather poor harvest at falling prices on the world market and the withdrawal of foreign-

owned funds which had previously been placed on the Argentine market. The resulting tension in the exchange position found expression in the weakening of the free peso, but no change has been made in the official buying and selling rates.

In Brazil the official rate has been maintained unchanged, but the free market rate has been subject to fluctuations. It improved in the first half of the year and then declined rather sharply in the second, the net loss over the year being about 12 per cent. In the autumn Brazil relaxed her coffee regulation policy, the price of coffee being allowed to fall in order to enable the country to compete more effectively with other centres of production. The export surplus, however, failed to re-establish itself, and the control of imports and exchange was tightened considerably towards the end of the year. Although no decline occurred in the Peruvian sol and the Chilean peso, both the countries concerned tightened their exchange restrictions in the latter half of 1937. The Bolivian currency (the boliviano), on the other hand, depreciated by about 19 per cent. in the summer of 1937 and the Ecuador sucre by as much as 25 per cent. The exchange position in Venezuela is in a class of its own. The strong position of this country is due, on the one hand, to its rich natural resources, especially oil, and, on the other, to the absence of foreign debts. The Exchange Centralisation Office buys exchange derived from petroleum drafts and drafts covering the export of subsidised agricultural products at the fixed rate of 3.09 bolivares to the U.S. dollar, i. e. at the present-day dollar equivalent of the old gold rate fixed in 1910 when Venezuela adopted the gold standard. Normally the Office withholds enough exchange to cover the requirements of the government and sells the remainder to the banks at 3.17, to meet the demands of trade. This exchange is used to pay for the great bulk of imported merchandise; there is an unofficial (but entirely legal) exchange market available for other purposes, but its quotations averaged 3.30 to 3.40 between May and September and reached 3.50 in December 1937. The pressure on the exchange market noticeable in other South American countries thus affected Venezuela also.

The decline in South American exchange values in the latter half of 1937, though noteworthy, should not be exaggerated. In comparison with the depressed conditions of the years 1932-35, an improvement is to be found everywhere. The sudden break in the prices of primary products during 1937 took these countries by surprise, and the impact of the falling prices was felt all the more keenly since payments had to be made for imports previously contracted at higher prices. It is evident that the reduction in purchasing power to which these countries have been subjected will react upon their imports by reducing their demand for industrial articles from abroad.

2. PRICE MOVEMENTS.

The most significant change in world economic conditions is found in the fluctuations of prices of primary products — the strong upward movement in the autumn of 1936 and first quarter of 1937, the reversal of the trend

in the second quarter of the year, the comparative steadiness in the third quarter and the renewed decline in the fourth, which continued into the present year.

The factors that were responsible for the rise in the autumn of 1936 and early months of 1937 were partly technical and partly psychological. The recovery which took place in business generally after the long years of depression, and which made itself felt more strongly in the former gold-bloc countries after the devaluations in September 1936, provoked an increase in the demand for raw materials of all kinds; a succession of poor harvests had, moreover, brought down the accumulated stocks of foodstuffs. The graph on page 8 shows the marked reduction in the visible stocks of primary products from their peak in 1932 to a level as low as that obtaining before the depression.

In the winter of 1936-37 came the almost universal increase in budget allocations for armament purposes, which would affect the markets for metals and several other staple commodities. In the situation that thus arose, purchasers found a certain difficulty in obtaining prompt delivery, and fears began to be felt concerning a possible future scarcity of supplies. In order to safeguard themselves, many industrial and commercial firms placed large orders for forward delivery and some speculation in commodities set in. Prices soared; at the beginning of 1937 the American and British price indexes for primary products had advanced to a point 30 per cent. above the level obtaining in the first half of 1936.

Great concern began to be felt in official and other circles about this rapid rise of prices, not only because of the resulting increase in the cost of armaments, but also because of the unsound position that was being created by an advance in prices to levels which in all likelihood could not be permanently sustained. By the beginning of April 1937 the prices of many primary products far exceeded the cost of production. Rubber producers are generally thought to be satisfied with a price of 9d. and in April 1937 the price reached 13d. For tin, £200 per ton is usually regarded as a fair price, but in the spring of 1937 it went above £300. It is believed that in Rhodesia, where conditions of copper production are most favourable, a profit can be made on copper at a price of £30 to £35 a ton, and the market price went up to £80. As compared with the 9-cents-a-pound loan on cotton which had been granted in the United States, the market price touched 15 cents in March 1937. And these examples could be multiplied many times. To bring a certain corrective into the situation which had developed some influence was exerted by the authorities in different countries. In the United States President Roosevelt uttered a warning that prices were too high; and the decisions taken at the end of the previous year to reduce excess reserves of the member banks were expected to and gradually did exert a certain restrictive influence on the credit policy of these banks. In some other centres influence was exerted on commercial banks to limit the amount of credit granted to finance the holding of stocks of commodities. At the same time the nervousness of the market was increased by the "gold scare", it being feared that a reduction in the gold value of the dollar, and perhaps other currencies also, might have a deflationary effect on commodity prices generally. Moreover, it began

to be realised that the output of many of the products for which the demand was most intense was rising with unexpected rapidity and that no fear of a scarcity need be entertained.

The rapid expansion which took place in the output of primary products has been one of the most interesting experiences of the year, for it has shown how great are the possibilities of extended production over a wide range of commodities. The larger supplies of foodstuffs and agricultural raw materials were, it is true, primarily the result of favourable harvest conditions. In 1937 the cotton crop of the United States was the largest on record, being estimated at 19 million bales from 34 million acres; in the previous record year, 1926, 18 million bales were harvested from 45 million acres. More significant in this connection is the fact that for those commodities which are internationally controlled an expansion of production proved possible immediately the quotas/agreed upon were increased. For rubber the export quotas were raised from 60 per cent. at the beginning of 1936 to 90 per cent. in the second half of 1937, and for tin from 85 per cent. at the beginning of 1936 to 110 per cent. from April 1937. The bulk of the world's copper production outside the United States is controlled and was allowed to rise. The following table shows the extent to which output in 1937 was greater than in the previous years.

World Production of Primary Commodities.

Year	Tin	Copper	Lead	Zinc	Rubber
	in thousand tons				
1929	192	1,915	1,725	1,450	868
1932	99	886	1,162	778	709
1936	179	1,684	1,469	1,473	862
1937 ⁽¹⁾	199	2,141	1,642	1,620	1,140

Year	Cotton (⁽²⁾)	Wool (⁽³⁾)	Wheat	Tea	Sugar (⁽⁴⁾)
	in million lbs		million bushels	million lbs	1000 tons
1929	12,700	3,915	3,566	968	27,340
1932	11,400	3,857	3,812	932	24,130
1936	15,000	3,713	3,491	844	28,670
1937 ⁽¹⁾	18,500	3,880	3,751	850	30,960

(⁽¹⁾) provisional figures.

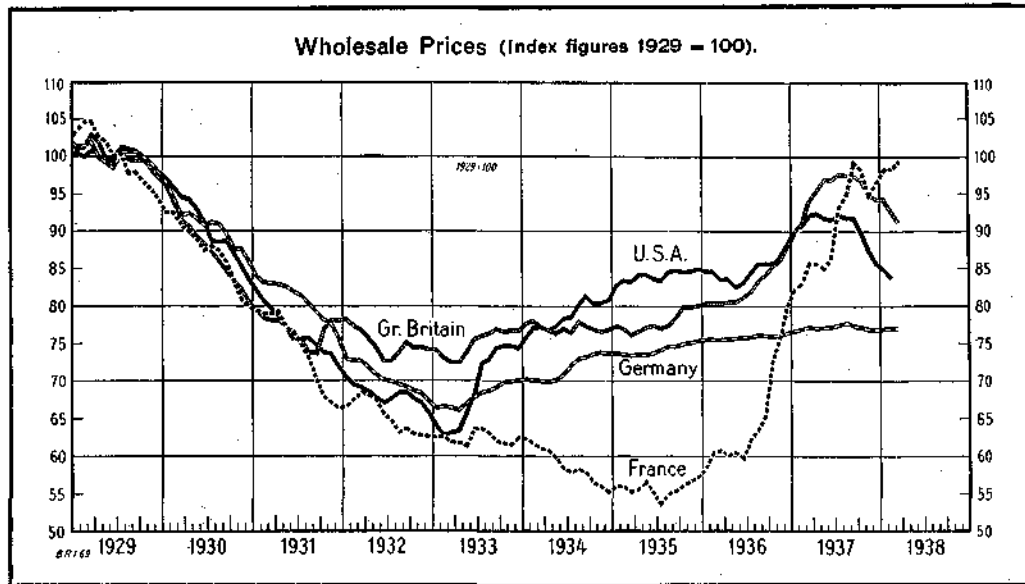
(⁽²⁾) year beginning 1st August.

(⁽³⁾) year ending 30th June.

(⁽⁴⁾) aggregate for crop years ended at various dates.

It was particularly in the second half of 1937 that the greater supplies from increased production affected the markets. The decline in prices, which then set in, was intensified by the fact that manufacturers were overstocked after their heavy purchases in the spring, while a further major factor appeared in the situation — the serious business recession which developed in the United States. Visible stocks of primary products began to rise, and

steps were taken to curtail output by a reduction in the export and production quotas of internationally controlled commodities. Thus, reductions in the export quotas for rubber were announced in December 1937 and again in January 1938, being fixed at 60 per cent. from April 1938; quotas for tin were reduced to 70 per cent. from 1st January 1938. Unfortunately few statistics are available concerning stocks in the hands of manufacturers (i.e. other than visible stocks), but it is believed that manufacturers' inventories vary



a great deal, and more in the case of raw materials than of foodstuffs. According to an investigation made by the Cleveland Trust Company in the United States, stocks of raw materials held by 51 large industrial companies were about 50 per cent. higher at the end of September 1937 than they had been at the corresponding date in 1929. No figures are available for the

last quarter of 1937, but it is reported that a certain reduction occurred.

Wholesale Price Indexes.

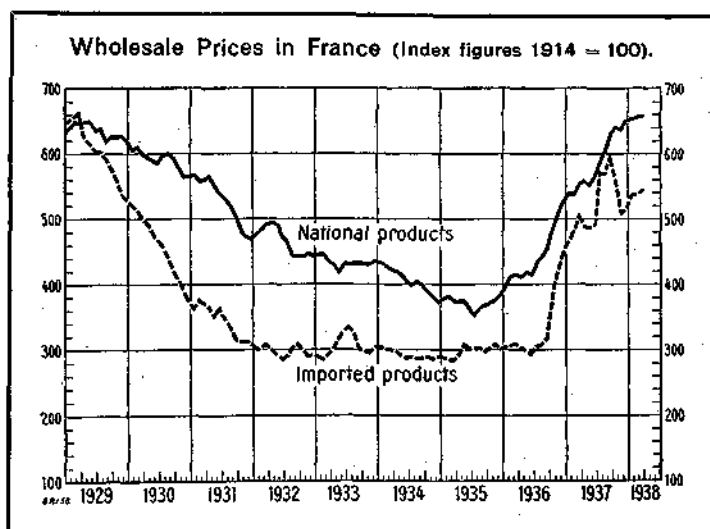
1929 = 100	1936	1937	Per- centage change	1938		
	Dec.	Dec.		Jan.	Feb.	March
Danzig	107	102	- 4.9	101	.	.
U. S. A.	88	86	- 3.1	85	84	84
Austria	86	85	- 0.7	86	85	85
Czechoslovakia . .	81	80	- 0.5	80	80	80
Germany	77	77	+ 0.5	77	77	77
Poland	59	60	+ 2.0	60	60	.
Switzerland	76	78	+ 2.6	78	77	77
Belgium	75	77	+ 3.3	78	77	76
Hungary	76	79	+ 3.3	78	77	76
Canada	83	87	+ 3.7	88	87	.
Estonia	81	86	+ 6.3	87	87	.
Albania	63	67	+ 6.4	66	.	.
Netherlands	71	76	+ 6.5	75	74	73
United Kingdom . .	88	94	+ 6.7	94	93	91
Finland	97	104	+ 7.4	104	103	.
Sweden	90	97	+ 7.9	96	96	94
Denmark	103	111	+ 8.1	110	108	107
Greece	117	126	+ 8.1	126	126	.
Roumania	73	79	+ 8.4	.	.	.
Portugal	94	103	+ 9.8	.	.	.
Bulgaria	61	68	+ 10.5	63	60	.
Latvia	87	96	+ 10.6	96	95	.
Yugoslavia	71	79	+ 12.1	80	79	78
Japan	98	110	+ 12.2	112	113	.
Norway	94	107	+ 13.5	106	105	104
France	83	101	+ 21.5	101	101	101
Italy	83	101	+ 22.0	100	98	98

The price movements of articles other than primary products have as a rule been much less pronounced, and for that reason such general indexes of wholesale prices as include quotations of many semi-manufactured and finished articles show only moderate changes, except in a few countries where, from national causes, special movements have occurred.

In only a few countries were wholesale prices lower at the end of 1937 than they had been at the end of the previous year. That the downward

movement of prices that began in 1937 originated in the United States is a conclusion that may be drawn from the tendencies shown by closely comparable price indexes for the United States and the United Kingdom*. While the general price movements in the two countries, as indicated by the total for all articles, followed each other closely up to April 1937, American prices began to fall sooner than British and by the end of 1937 were fully 10 per cent. below the level of the United Kingdom. The disparity is found in practically every category of commodities but is especially pronounced with regard to coal, iron and steel, and foodstuffs. The price of coal, in fact, rose in both countries up to the end of the year, but more in the United Kingdom than in the United States. And while American steel and iron prices remained relatively stable from April 1937 to the end of the year, British prices rose by more than 8 per cent. in the same period.

The wide fluctuations in the United States index for food and tobacco, which contrast with the steady advance in prices in the United Kingdom, are mainly connected with American harvest conditions. In 1936 crops in the United States were very poor, especially those of cereals, and maize and many other foodstuffs had to be imported to an extent never experienced before. For this reason American protection of agricultural products could become effective, and domestic prices rose more than prices abroad. In the following year the crops were fully up to average and part of the production was exported as usual, with the result that American prices again became largely dependent on conditions in the export markets.



The rise in the French price level that occurred in 1937 was to a certain extent due to the decline in the exchange value of the franc, which increased the prices of imported raw materials and other goods, but mainly to internal causes, such as the increase in the cost of production (by the successive augmentations of wages and the introduction

of the forty-hour week) and the upward adjustment of prices of agricultural products, which even at the current rate of exchange are above world market prices. Since September 1937 the price level in France has remained comparatively steady, the moderate depreciation of the franc after that date being partly offset

* The Board of Trade index for the United Kingdom and, for the United States, the continuation of an index compiled by Sir A. W. Flux — see figures and graphs in March 1938 number of the Statistical Summary of the Bank of England.

by the simultaneous world decline in prices of imported raw materials. From the beginning of 1938 a tendency to a greater price stability is also found in other countries; notwithstanding a continued decline in the world market prices of some important commodities such as wheat, rubber and certain non-ferrous metals.

In order to make even a rough comparison between the price levels in different countries, it is necessary to recalculate the national indexes on a common gold basis, as has been done in the following table, with a pre-war year as the base.

Wholesale Price Gold Indexes.

1913 or 1914 = 100	1935	1936	1937
	December		
United States	69	71	69
United Kingdom	66	72	78
France	72	74	66*
Netherlands	78	74	78
Switzerland	92	75	78
Italy	85	61	76
Germany	103	105	106
Poland	59	63	65
Sweden	66	70	77
Belgium	60	66	68
Czechoslovakia	87	75	75
Japan	52	58	66

* March 1938 = 89.

If the position in the United States and the United Kingdom is taken as indicative of the level of world prices in gold, it will be seen that this level is still 20 to 30 per cent. lower than before the war. In so far as past experience of price movements is still applicable, the prospects, in view of the increased output of gold, are that the long-term trend of world prices will be in an upward direction.

Domestic prices in Japan rose considerably during 1937, but on a gold basis they were still among the lowest in the world at the end of the year; the depreciation of the

yen by 72 per cent. had not yet had its full effect on the domestic price structure. In France also the recent depreciation of the franc has brought the level of French prices, on a gold basis, somewhat below that obtaining in the United States and the United Kingdom. As a result of the rise that occurred in 1937, Italian gold prices, on the other hand, appear to have been brought up to the level of British prices.

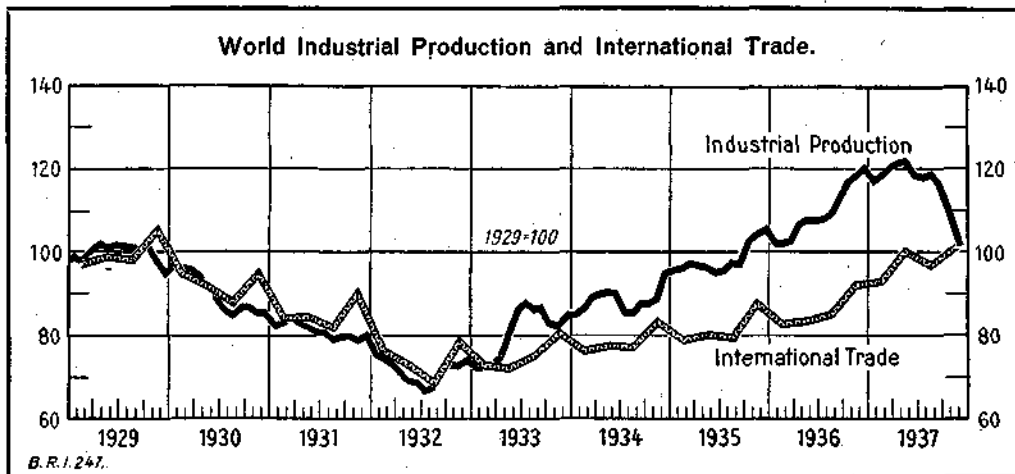
Wholesale prices in Germany are still considerably higher in terms of gold than the corresponding prices in other countries, although the difference has been somewhat reduced during the past two years by the rise in prices abroad, especially within the sterling area. The Reichskommissar für Preisbildung has repeatedly laid considerable emphasis on the fact that German prices have for many years been much higher than prices in the other important trading countries of the world, and that this difference has considerably weakened Germany's competitive power in the world markets. At the same time he indicated that one of the most urgent tasks ahead was to eliminate the disparity between Germany and the most important foreign countries in this respect. The President of the Reichsbank in his speech at the annual general meeting of the Bank on 11th March 1938 also laid great stress on the principle of stable prices and wages as a necessary condition for the success of the financial measures that had been taken in Germany in recent years; he likewise referred to the problem of a suitable

level of exchange in relation to the most important currencies of the world, indicating that foreign exchange control had temporarily solved this problem by protecting German currency against external influences.

As can be seen from the above table, the spread between gold prices in the different currencies narrowed somewhat in the two years from the end of 1935 to the end of 1937. This is evidence of a return to a better international equilibrium in monetary matters, for, even if no hard and fast conclusions can be drawn from the calculation of "economic parities" on the basis of wholesale price levels when conditions have often changed materially in comparison with those obtaining in the base years, it remains true that too large a disparity will not allow normal currency relations to be maintained. It is indeed a primary condition for the sound working of any international monetary system that there should be no serious overvaluation or undervaluation of individual currencies.

3. FOREIGN TRADE.

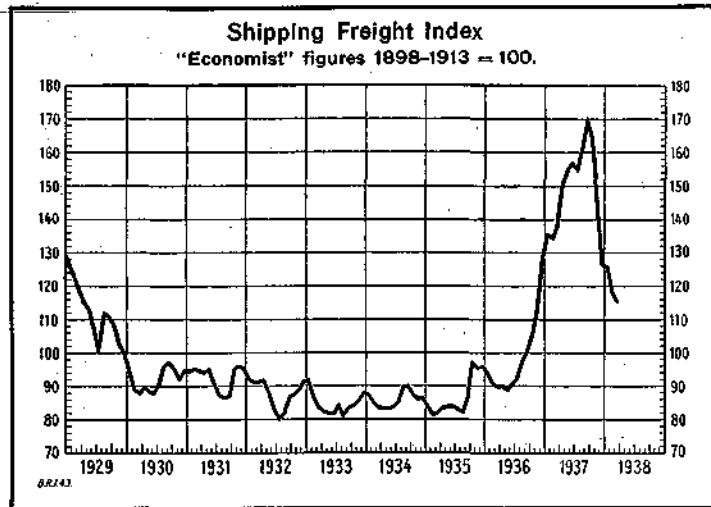
During 1937 there was a marked improvement in international trade, the physical volume of goods exchanged rising by $13\frac{1}{2}$ per cent. in comparison with 1936 and reaching the level attained in the previous peak year 1929.



As British wholesale prices in 1937 were still some 5-10 per cent. lower than in 1929, it may be concluded that in terms of sterling the value of world trade was perhaps 10 per cent. less than it was in 1929.

Some slackening in trade was noticeable towards the end of the year, but the setback was moderate, as is shown inter alia by the fairly good employment of shipping services. At the beginning of 1938 freight rates, according to the index of the London "Economist", had receded by some 30 per cent. from the high peak attained in September 1937, but were still slightly above the average of 1929.

For the first time since the turn of the trend in 1932, the increase in world trade was more pronounced than the increase in world production. In



the early phases of the recovery the improvement of business in the vast majority of countries was in the nature of a domestic recovery, foreign trade lagging behind. Government spending on public works, the fostering of home industries by increased protection, and the pursuit of a cheap money policy without international lending

were measures that tended to give a special impetus to the domestic side of economic activity; and some of the measures taken were directly prejudicial to a revival of foreign trade.

Import restrictions, with which must be included exchange restrictions, added to the difficulties, and over-pessimistic opinions were formed as to the declining importance of international trade for the future. The revival that has taken place is thus all the more significant as it indicates that with prosperity comes an increased need for foreign goods. Indeed, notwithstanding the policy of greater national self-sufficiency pursued in a large part of the world, official declarations almost without exception lay stress on the necessity of maintaining a high level of foreign trade.

Some reduction in trade barriers has been achieved by the suppression of quotas and other import restrictions, but progress in this field has not been very impressive. More important have been the reductions resulting from the trade agreements that the U. S. Government has concluded with seventeen other governments; negotiations are now in progress with four more countries including the United Kingdom and Canada. Other factors helpful to trade are the maintenance of greater exchange stability (which in turn is facilitated by the increased volume of trade), the gradual adjustment of exchange values to the cost and price levels ruling in the different countries, the abundant gold production, to some extent also the heavy outlay for armaments, and, last but not least, the increased consumption of a variety of goods in countries with a rising standard of living.

Some noteworthy changes have occurred in the composition of world trade. While in the early years of recovery trade in primary products showed the greater increase, the upswing of trade in 1937 affected both finished goods and primary products. This was due in part to the improved position of the primary producing countries, which were enabled to import finished goods in larger quantities, in part to increased purchases for armament purposes (particularly in the case of steel products), and in part also to the higher income of wide classes

of the population in many industrial countries, leading to an increased demand for goods not readily met from purely domestic sources. Among finished products the increase was more pronounced, however, in capital than in consumption goods. The Reichs-Kredit-Gesellschaft A. G., Berlin, in its report on Germany's economic situation at the turn of the year 1937-38 showed that for the first eleven months of 1937, as compared with the same months in 1936, German exports of production goods (including engineering products) increased in value by 26 per cent., while exports of typical consumption goods (textiles, certain chemical products etc.) increased by only 14 per cent. The same tendency is found in other countries. It is natural in recovery that the demand for

Changes from 1936 to 1937 in the foreign trade of different countries.*

Imports				Exports			
in millions of national currencies							
Country	1936	1937	% changes	Country	1936	1937	% changes
Italy	6,039	13,837	+129.1	Latvia	138	261	+ 89.1
Latvia	122	231	+ 89.3	Italy	5,547	10,429	+ 88.0
Netherlands Indies	287	490	+ 70.7	Netherlands Indies	539	938	+ 74.0
France	25,414	42,316	+ 66.5	Chile	549	933	+ 69.9
Indo-China	975	1,579	+ 61.9	Switzerland	441	683	+ 54.9
Syria	2,883	4,600	+ 59.6	France	15,492	23,935	+ 54.5
Bulgaria	3,181	4,926	+ 54.9	Netherlands	746	1,148	+ 53.9
Morocco	1,151	1,766	+ 53.4	Indo-China	1,708	2,590	+ 51.6
Danzig	93	142	+ 52.7	Palestine	4	6	+ 50.0
Netherlands	1,017	1,551	+ 52.5	Czechoslovakia	7,997	11,953	+ 49.5
Finland	6,203	9,123	+ 47.1	Morocco	782	1,144	+ 46.3
Iran	878	1,259	+ 43.4	Yugoslavia	4,376	6,272	+ 43.3
Switzerland	1,263	1,797	+ 42.3	British Malaya	629	899	+ 42.9
Roumania	12,638	17,897	+ 41.6	Roumania	21,703	30,965	+ 42.7
Argentina	1,117	1,558	+ 39.5	Argentina	1,656	2,308	+ 39.4
Norway	916	1,273	+ 39.0	Syria	1,650	2,300	+ 39.4
Czechoslovakia	7,894	10,965	+ 38.9	U. S. A.	2,419	3,295	+ 36.2
Lithuania	154	212	+ 37.7	Iran	1,960	2,582	+ 31.7
Colombia	120	164	+ 36.7	Sweden	1,514	1,994	+ 31.7
British Malaya	508	686	+ 35.0	Belgium-Luxemburg	19,526	25,394	+ 30.1
Japan	2,928	3,955	+ 35.1	Finland	7,222	9,368	+ 29.7
India	1,223	1,593	+ 30.3	Greece	7,379	9,555	+ 29.5
Germany	4,218	5,468	+ 29.6	Bulgaria	3,910	5,019	+ 28.4
Mexico	464	600	+ 29.3	Austria	952	1,217	+ 27.8
Sweden	1,633	2,111	+ 29.3	Estonia	83	106	+ 27.7
Tunis	1,014	1,310	+ 29.2	U. S. S. R.	1,359	1,729	+ 27.2
Yugoslavia	3,984	5,148	+ 29.2	Ceylon	244	310	+ 27.0
Belgium-Luxemburg	21,299	27,257	+ 28.0	Germany	4,768	5,911	+ 24.0
Estonia	87	111	+ 27.6	Philippines	273	331	+ 21.2
Canada	635	809	+ 27.4	Norway	674	811	+ 20.3
New Zealand	44	56	+ 27.3	Australia	124	148	+ 19.4
Greece	11,963	15,204	+ 27.1	China	707	839	+ 18.7
Poland	1,003	1,254	+ 25.0	Japan	2,798	3,319	+ 18.6
U. S. A.	2,424	3,012	+ 24.3	Portugal	1,026	1,216	+ 18.5
Turkey	92	114	+ 23.9	United Kingdom	441	522	+ 18.4
Chile	347	429	+ 23.6	New Zealand	55	65	+ 18.2
Egypt	30	37	+ 23.3	Hungary	504	589	+ 16.9
Brazil	4,268	5,186	+ 21.5	Turkey	118	138	+ 16.9
United Kingdom	787	954	+ 21.2	Poland	1,026	1,196	+ 16.6
Uruguay	66	80	+ 21.2	Denmark	1,327	1,541	+ 16.1
Union of South Africa	84	101	+ 20.2	Egypt	33	38	+ 15.2
Manchukuo	644	770	+ 19.6	Mexico	775	891	+ 15.0
Denmark	1,442	1,697	+ 17.7	Colombia	158	181	+ 14.6
Haiti	40	47	+ 17.5	Tunis	841	950	+ 13.0
Peru	200	235	+ 17.5	India	1,806	2,024	+ 12.1
Portugal	1,994	2,339	+ 17.3	Peru	332	366	+ 10.2
Austria	1,249	1,454	+ 16.4	Canada	1,021	1,124	+ 10.1
Ceylon	190	221	+ 16.3	Uruguay	90	99	+ 10.0
Australia	87	100	+ 14.9	Danzig	325	357	+ 9.8
Palestine	14	16	+ 14.3	Union of South Africa	112	123	+ 9.8
Eire	39	44	+ 12.8	Manchukuo	474	520	+ 9.7
Hungary	437	475	+ 8.7	Lithuania	190	208	+ 9.5
Philippines	202	216	+ 6.9	Siam	165	176	+ 6.7
Siam	105	110	+ 4.8	Brazil	4,900	5,095	+ 4.0
China	942	953	+ 1.2	Eire	22	22	0
U. S. S. R.	1,353	1,341	- 0.9	Haiti	49	42	- 14.3
Algeria	3,234	2,544	- 21.3	Algeria	3,469	2,230	- 35.7

* partly provisional figures.

capital goods should show the most rapid increase, but, in the present situation, some special factors operate in the same direction. Firstly, the more intense demand for commodities for armament purposes has in many cases led to the increased purchase abroad of machinery, tools, etc. Secondly, the character of the protection measures at present applied in many countries is such as to discriminate against trade in consumption goods: protection granted is designed chiefly to promote the home manufacture of ordinary consumption articles (textiles etc.), and has far less effect upon the import of raw materials (which, up to a point, must be obtained from abroad) and of specialised articles such as machinery, mechanical implements, dyes and paints, etc. The last-mentioned articles fall largely within the category of production goods. It is typical that in two countries, Finland and Sweden, in which the export trade had already expanded considerably in the years 1933-36, exports comprise hardly any ordinary consumption goods but consist primarily of raw materials and, in the case of Sweden, also of some highly specialised articles (high-grade steel, ball-bearings, telephones, separators, etc.).

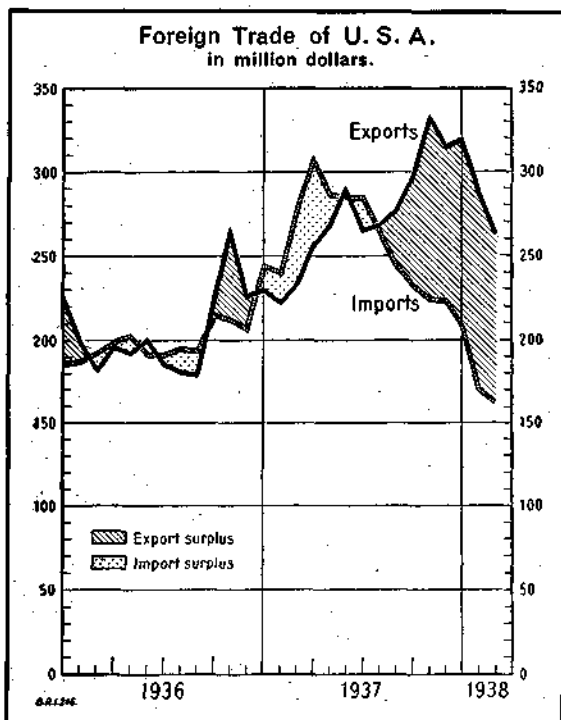
An important feature of commercial developments in recent years has been the increase in the aggregate import surplus of the eight creditor countries of the world, viz. Belgium, Eire, France, Holland, Sweden, Switzerland, the United Kingdom and the United States.

Merchandise Trade(*) (in millions of dollars)	1934	1935	1936	1937
Eight creditor countries:				
Imports	8,990	9,109	10,226	12,373
Exports	7,130	7,091	7,443	9,236
Balance	- 1,860	- 2,018	- 2,783	- 3,137
All other countries:				
Imports	11,293	11,593	12,030	15,023
Exports	12,008	12,472	13,851	16,698
Balance	+ 715	+ 879	+ 1,821	+ 1,675
Total world imports	20,283	20,702	22,256	27,396
" " exports	19,138	19,563	21,294	25,934

(*) League of Nations figures.

It has often been pointed out that the richer countries have to take the initiative in the revival of international trade so as to enable the debtor countries to acquire the funds which they need to meet their current debt service, to reduce their foreign liabilities and gradually to increase their purchases abroad. The aggregate import surplus of the creditor countries increased every year from 1934 to 1937 and, although part of this increase was offset by the higher income from shipping and foreign investments, there can be no doubt that a greater net balance accrued to the debtor countries as a whole. It will be seen, however, that the export surplus of the "other countries" in the above table was slightly reduced from 1936 to 1937, this decline being due on the one hand to the fall in the prices of primary products that occurred in the autumn of the latter year and on the other hand to the rise in imports into these countries as the result of orders placed in the prosperous first half of 1937.

Only one among the eight creditor countries, the United States, had an export surplus during each of the four years under review. It is estimated, however, that for 1936 there was (for the first time since before the world war) a deficit on the current account of the American balance of payments amounting to \$153 million. It is of interest to follow the development of the American balance of trade during the past two years:



Imports exceeded exports from December 1936 to April 1937, i.e. during the short period of the pronounced business boom. A decline in imports, however, began already in the second quarter of the year and the fall became more and more marked every month up to the end of December 1937. Exports, on the other hand, advanced up to the month of October and showed only a slight decline for the remainder of the year. By February 1938 imports had fallen to little more than half the figure of March 1937 while exports, although falling, were still above the figures of the previous year — an indication of the setback in the United States as compared with the rest of the world.

Among the other creditor countries the United Kingdom had an import surplus of merchandise which rose from £346 million in 1936 to £432 million in 1937 and in the latter year was the highest since 1926. This rise was only partly offset by an increase in the net income from shipping, foreign investments and other invisible items, with the result that the current account of the balance of payments showed an adverse balance of £52 million compared with £18 million the previous year. It is of interest to note that differential price changes for imports and exports were a principal cause of the increase in the excess of imports. Over the two years 1936-37 the rise in import prices was double that in the prices of exports, the increase being considerably greater in 1937 than in 1936. If price changes between the two years are eliminated (i.e. if imports and exports in 1937 are valued at the average prices for similar products in 1936) it is found that the increase of £85.9 in the passive trade balance in 1937 is reduced to £8.3 million. In France the import surplus attained a record figure, amounting in 1937 to Fr.fcs 18,400 million as against Fr.fcs 9,900 million in 1936. The higher imports were due partly to the increased requirements of raw materials for French industry, partly to higher imports of foodstuffs, the harvest having been below average, and partly to increased imports of certain

commodities such as coal, the domestic production of which showed a decline connected with the reduction in working hours in the mines. Poor harvests were also responsible for higher imports of foodstuffs into Italy and Germany. German imports rose from RM 4,218 million in 1936 to RM 5,468 million in 1937 but, thanks to a simultaneous rise in exports, largely of manufactured articles, from RM 4,768 million in 1936 to RM 5,911 million in 1937, the export surplus only slightly declined, from RM 550 million in 1936 to RM 443 million in 1937. The increase in Germany's export trade in recent years has been in about the same proportion as the rise in world trade. The import surplus of Italy rose from Lit. 492 million in 1936 to Lit. 3,408 million in 1937. Higher income from tourists and shipping partly offset this increase in the adverse balance, which, however, was sufficiently marked to necessitate an increasingly strict control of imports.

Important developments occurred in the trade of Japan: the import surplus rose to Yen 636 million, which is the highest on record (excluding the abnormal year 1924), and in the autumn exchange control, as well as supervision of foreign trade, was imposed in connection with the conflict with China. An important change has occurred in the direction of the Japanese export trade during the past decade, the percentage of Japanese exports taken by the United States falling from 43 in 1927 to 20 in 1937, while the percentage taken by Asia rose from 42 to 52. China, followed by India, had become the most important customer for Japanese goods while the United States was gradually changing from an export to an import market for Japan.

Among the Central European countries there was a noticeable tendency to divert exports from "clearing" countries to free markets in order to obtain a surplus of free "Devisen". In general, trade balances were exceptionally good for agricultural countries, whether in Europe or other continents, as well as for gold-producing countries. The most remarkable instance in the latter group was the strong position of South Africa, which has been for the past two years the foremost customer of the United Kingdom, the place previously held by British India and, before the world war, by Germany.

Simultaneously with the recovery in world trade there was some increase in the volume of international financing. Even when the financing is carried on under a régime of clearings and payments agreements, exporters, especially of industrial goods, find it necessary to extend credits to their customers in order to sustain the volume of business. This financing, however, is chiefly of a relatively short-term character and rarely extends beyond six months or a year. There was very little new long-term lending in 1937. Countries like the United Kingdom and Germany, whose exports both before the war and in the post-war decade were largely dependent on a regular flow of funds from the main creditor markets to the financially weaker countries, are naturally most affected by the virtual cessation of long-term international financing. It is true that enterprises that would normally cater for large investment works financed by loans to overseas countries are now as a rule fully occupied by armament works, but, as and when armaments slow down, recovery in international lending for the equipment of undeveloped countries may possibly be helpful in filling the gap.

III. FROM DEHOARDING TO RENEWED HOARDING OF GOLD.

World production of gold increased by 5 per cent. in 1937, i.e. at a lower rate than in previous years. The slowing-up of the increase has been due almost wholly to a decline in the absolute amount of U.S.S.R. production from 1936 to 1937. Shipments from the East have lost their importance as far as dehoarded gold from China and India is concerned, but exports of gold from Japan to cover commercial and other needs attained almost \$250 million. In western countries the dehoarding movement that began in the last quarter of 1936 continued during the first half of 1937, reaching in nine months nearly \$1,000 million; gold hoards located in London were reduced by more than half.

In this, as in other fields, the change in the situation in the last half of the year was sudden and unexpected; under the influence of falling commodity prices, a setback in industrial production, especially in the United States, and rumours of a further devaluation of the dollar, apprehensive holders of currencies again turned to gold as a refuge. Some \$150 to \$200 million gold was reabsorbed into private hoards, while the monetary authorities in a number of countries, from which gold had flowed in the spring, made substantial purchases. In November and December 1937 there was a net export of gold from the United States; and in the autumn the British Exchange Equalisation Account supplied some of the gold needed on the market out of its own accumulated holdings. Even so the gold reserves of the United States and the United Kingdom were greatly increased over the year; and this is true also of the Netherlands. The total gold acquisitions of these three countries in 1937 were nearly twice as high as the current gold production, now running at a rate of \$1,220 million a year.

1. THE SUPPLY OF GOLD.

In 1937 the world output of gold continued to increase, as can be seen from the following table:

Year	South Africa	U.S.S.R. (¹)	U. S. A. (²)	Canada	Other producing countries	World Production (¹)	
	In thousands of fine ounces						million dollars (³)
1930	10,716	1,501	2,286	2,102	4,318	20,923	732
1931	10,878	1,656	2,396	2,694	4,702	22,326	781
1932	11,559	1,938	2,449	3,044	5,264	24,254	849
1933	11,014	2,700	2,537	2,949	6,378	25,578	895
1934	10,480	3,858	2,916	2,972	7,070	27,296	955
1935	10,774	4,784	3,619	3,285	7,570	30,032	1,051
1936	11,336	5,173	4,296	3,735	8,616	33,156	1,160
1937	11,733	5,000	4,753	4,091	9,254	34,831	1,219

(¹) Revised figures.

(²) Including Philippines.

(³) Figures are given in dollars of present day value of \$35 per ounce of fine gold instead of in Swiss gold francs as in earlier Reports. The main reason for this change is that figures in an existing currency are more easily comprehensible, and the dollar has been chosen because its value is fixed in relation to gold. To convert the dollar figures approximately into Swiss gold francs and into sterling respectively, it is sufficient, in the first case, to multiply by three (exact multiplier 3.061), and, in the second case, as long as the gold price in London stands at around 140 shillings an ounce, to divide by five.

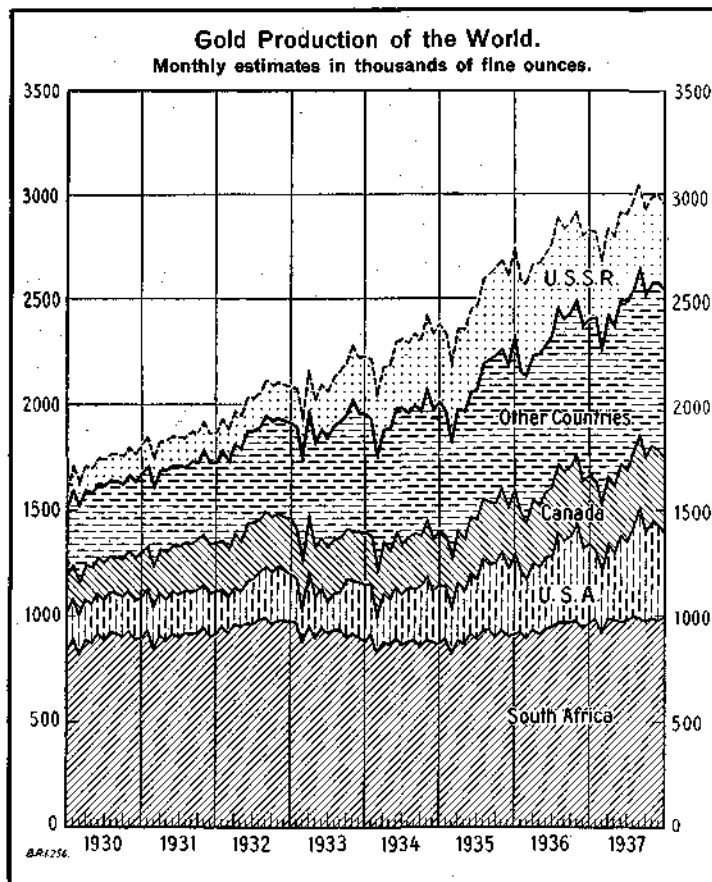
If the gold production of 1930, for example, were given in dollars of the weight then applicable, the equivalent of \$ 20.67 per fine ounce, it would amount to \$432 million.

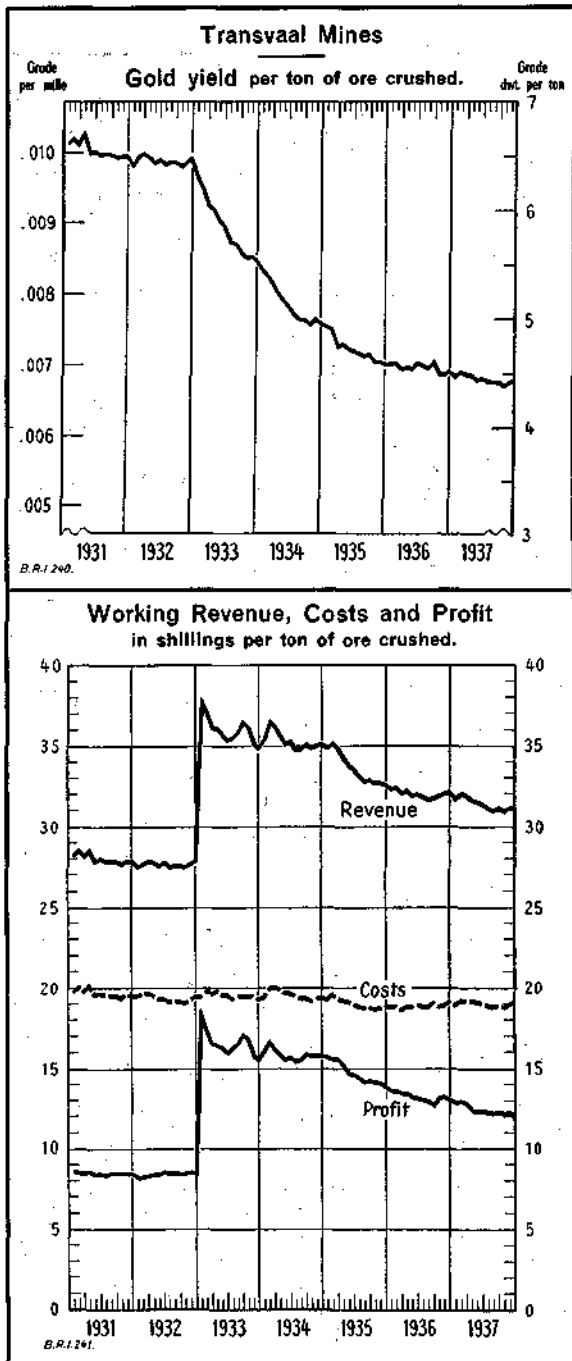
The figures given in last year's Annual Report for the gold production of the U.S.S.R. in the years 1930 to 1936 have been revised in the light of more recent information and, for the period 1934-36, appreciably reduced. As no official statistics regarding the absolute amounts of gold production are issued by the Soviet authorities, estimates have to be based on scattered information from various sources. In a Soviet publication "U.S.S.R. in Construction" certain percentage increases in the gold output are given for the years 1930, 1932, 1934 and 1936, but no basic figure is indicated and it is not made clear whether the increases refer to actual results or to expectations in accordance with such plans as have been drawn up. As a rule each new estimate that becomes available in Soviet publications is lower than the one it supersedes and it is therefore desirable to exercise caution in the appraisal of the various estimates available. Nevertheless, it cannot be doubted that great efforts have been made, through the extension of plant and attraction of labour, to further the output of gold in the country. The latest information available, however, indicates a decline in production since 1936, the total for 1937 being estimated at not more than five million ounces, equivalent to \$175 million, which compares with Russian exports to London of about \$200 million during the year.

South African gold production increased by nearly 400,000 ounces from

1936 to 1937, but two-thirds of this increase was derived from a company that produced gold for the first time in 1937 and from the higher output of two companies that recently started producing; the old companies showed hardly any increase of output, but followed the policy adopted since 1932 of exploiting the lower grades of ore.

When the South African pound left the gold standard at the end of 1932, the price of gold in South Africa increased from 85 shillings to 120 shillings an ounce, and the working revenue per ton of ore crushed in the Transvaal jumped





in nearly the same proportion, from $27\frac{1}{2}$ shillings to 36 shillings. As working costs remained roughly stable at around 19 shillings, the working profit per ton rose suddenly from about $8\frac{1}{2}$ shillings to $16\frac{1}{2}$ shillings. This higher price for gold made it profitable to work lower-grade ores, which meant that, while more ore was crushed and more labour employed, the total gold output of the mines was kept more or less stable. This policy was favoured by the fact that working costs per ton of ore crushed decreased slightly as, for example, certain economies were effected by working the mills at crushing capacity. Costs per ounce of gold won naturally rose with the increase in the tonnage crushed.

The volume of ore crushed in the Transvaal increased from 35 million tons in 1932 to 51 million tons in 1937, while the average gold content was reduced from $6\frac{1}{2}$ to $4\frac{1}{2}$ dwts. per ton (i.e. 0.00990 to 0.00683 per mille), the amount of gold produced remaining roughly unchanged. Thus the further increase in the price of gold from 120 to around 140 shillings an ounce has not led to a corresponding rise in the working revenue and profit per ton of ore crushed.

The capital expenditure out of profits made by the South African mines, which was over

£3 million in each of the years 1934 and 1935, fell below £2 million in 1936. So far, the extension of plant would appear, in general, to have been based on a minimum gold price in the neighbourhood of 120 shillings per ounce; further extensions of crushing capacity necessary to exploit ore of still lower grades would imply faith in the continuance of a gold price substantially higher than 120 shillings. As shown in the graph, the rate of reduction in the grade

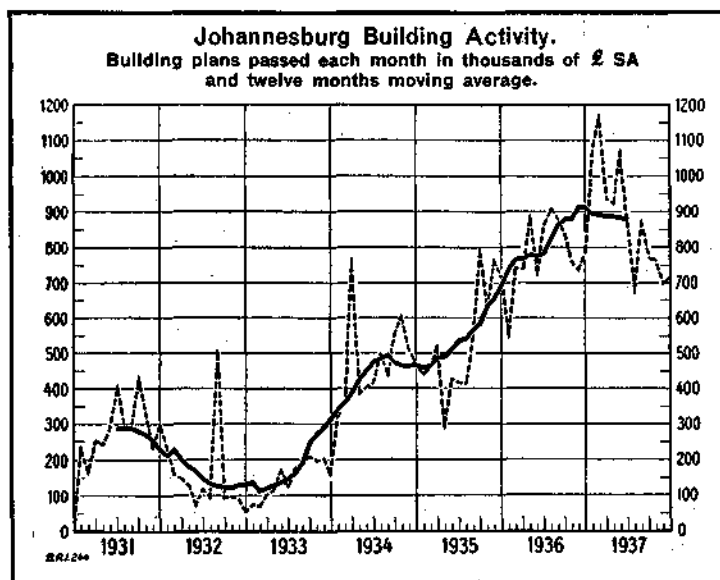
Transvaal Gold Mines.

Year	Crushing Policy			Financial Results					
	Million tons crushed	Grade dwts. per ton	Grade per mille	Working revenue		Working costs		Profit	
				per ton of ore crushed					
				s.	d.	s.	d.	s.	d.
1932	35.2	6.47	0.00990	27	7	19	3	8	4
1933	37.2	5.84	0.00894	35	11	19	5	16	6
1934	40.1	5.15	0.00788	35	3	19	6	15	9
1935	44.6	4.73	0.00724	33	6	18	11	14	7
1936	48.6	4.57	0.00699	32	0	18	10	13	2
1937	51.1	4.46	0.00683	31	4	18	11	12	5

of ore crushed has greatly diminished since 1935, indicating that there are certain limits to this policy.

The scarcity of native labour must also be taken into account with regard to the policy of exploiting ores of lower grades. At the present rate of crushing of some 50 million tons a year, a native labour force of approximately 310,000 is required and it is estimated that by the end of 1938 (with new mines coming into production) requirements will be over 350,000. As a matter of fact, from about 310,000 in the early part of 1937 the labour force employed fell to 283,000 at the end of the year. An increase in the labour force appears possible only if the South African Government permits the enrolment of natives north of a certain latitude, i.e. what is in fact tropical labour. The problem of the labour force, though it does not appear insoluble, has naturally led to certain preoccupations.

Though South African gold mines are largely owned by foreign interests, as shown by the fact that 70 per cent. of the dividends is estimated to



find its way abroad, the increased activity has naturally brought great prosperity to the country, which is reflected in the expansion of building, especially in Johannesburg.

In the United States gold production continued to increase, chiefly as a result of the greater activity in the mining of certain basic metals, such as copper, gold being obtained

as a by-product. The output of 4,750,000 ounces in 1937 was 10.6 per cent. higher than in 1936 and nearly as high as in the previous record year 1915, when 4,888,000 ounces were produced. A somewhat similar increase (9.5 per cent.) occurred in the gold production of Canada, where not only have the older mines almost without exception increased their output, but a number of new mines are entering the production stage; further, in the near future fresh mines will be opened up provided with the most modern technical equipment. In comparison with pre-war figures, Canadian production has quadrupled.

The four main producing centres, namely, South Africa, U.S.S.R., the United States and Canada, are responsible for about three-quarters of the total world production of gold, but the output of the remaining countries is not negligible and is increasing. In some of these countries production has made a very rapid advance in recent years. In Western Australia the output in 1937 was twice as high as in 1929 and, for the first time since 1915, exceeded one million ounces; a further rise may be expected in the next few years as some important new mines are coming into operation. In a number of countries gold producers have been granted special facilities by the State since the gold obtained helps to strengthen monetary reserves (as, for instance, in Roumania and Yugoslavia) or to cover a deficit in the balance of payments (as in Japan and Manchukuo).

As a result of sustained efforts in a large number of countries, all factors point to a further increase in the already high level of the world's gold production during the next few years. The following table shows for the principal countries the output of gold in 1936 and 1937 and the percentage increase from year to year.

Gold production in the principal countries	1936	1937	Percentage Increase
	In thousands of fine ounces		
South Africa	11,336	11,733	+ 3.5
U.S.S.R.	5,173	5,000	— 3.3
U. S. A. (*)	4,296	4,753	+ 10.6
Canada	3,735	4,091	+ 9.5
Australia	1,160	1,422	+ 22.6
Mexico	754	846	+ 12.2
Rhodesia	802	809	+ 0.9
Japan	678	717	+ 5.8
Other countries	5,222	5,460	+ 4.6
Total	33,156	34,831	+ 5.1

(*) including the Philippines.

(When comparisons are made with figures in earlier Annual Reports, account must be taken of the downward adjustment of the estimates regarding U.S.S.R. gold production.)

In spite of the rise in the Canadian figures the British Empire's share of the world's production remained at about 56 per cent. of the total.

The important additions to the current supply of gold, which were obtained for a number of years after the depreciation of sterling from dehoarding in eastern countries (mainly India and China), have now lost their importance, as can be seen from the following table.

Gold from the East	India(*)	China	Hong Kong	Total
	in million dollars (at \$ 35 per fine ounce)			
1931	208	18	20	246
1932	320	39	19	378
1933	202	24	33	259
1934	220	18	22	260
1935	150	14	11	175
1936	110	12	10	132
1937	50	17	1	68
Total	1,260	142	116	1,518

(*) private holdings only.

The amount of \$68 million (1,914,000 ounces) for 1937 is about half that obtained from the same sources in the previous year and around a sixth of the amount shipped in 1932. Moreover, purchases of gold coins for Indian account have recommenced on the London market and, although the amounts exported from England to India are still comparatively small, the rising tendency is noticeable:

1935 £ 21,500
1936 £193,369
1937 £472,725

An increasing demand for gold coins during the year was also reported from the Netherlands Indies, reflecting the greater prosperity of the native population. On the other hand, the absorption of silver in the East seems to have declined, even apart from the exports of China. Thus the absorption of silver in British India in 1937 is estimated at only 58 million ounces, an amount considerably below the 1936 figure of 100 million ounces, but substantially larger than the annual absorption of the preceding four years, which varies between 5 and 15 million ounces. The decrease from 1936 to 1937 is attributed mainly to two factors: (i) the increase from 2 to 3 annas an ounce in the import duty, which resulted in a higher domestic price for the metal, and (ii) the heavy slump in prices of primary products, especially cotton.

Against the new gold that has become available during the year must be set whatever amount has been required for use in the arts and in industry. It has been a peculiar feature of the period since 1931 that industrial consumption of gold has been very largely, perhaps even fully, met by the return of old gold. In the Federal Reserve Bulletin of August 1937, the reported consumption of gold from 1931 to September 1936 is given as \$502 million while the return of scrap is shown as \$733 million. The information regarding industrial consumption, however, is necessarily incomplete and the actual amount consumed is probably somewhat higher than the reported figure. Moreover, consumption has been rising with the return of prosperity as can be seen from the following table, which gives the value of gold used by U. S. Government institutions and private refineries as well as the return of old gold.

Gold furnished in the United States for use in manufactures and the arts.

Year	Total issues	Old material returned from manufactures and the arts	New material		
			Net	United States coin	Domestic and foreign bullion and foreign coins
in million dollars (at \$ 35 per fine ounce)					
1930	72.3	46.6	25.7	1.7	24.0
1931	49.4	39.3	10.0	1.7	8.3
1932	34.0	45.0	— 11.0	1.7	— 12.7
1933	28.8	38.6	— 9.8	0.2	— 10.0
1934	14.2	75.9	— 61.7	—	— 61.7
1935	25.9	58.4	— 32.5	—	— 32.5
1936	33.0	35.9	— 2.9	—	— 2.9

Judging from the tendency revealed by these figures, it seems likely that a certain amount of the 1937 production was absorbed for industrial uses, but a deduction of 5 per cent. from the total production would seem to be sufficient provision for this factor.

	\$ millions
To sum up, the amount of gold available in 1937 from new production	1,219
increased by shipments from the East of	68
but reduced by the amount absorbed in the arts and industry, namely . .	61
thus amounted to	<u>1,226</u>

The net industrial absorption of gold in 1937 appears to have been of about the same amount as the gold obtained from the East. Thus, the current production of gold, amounting to approximately \$1,220 million, was available for monetary purposes. The disposal of this gold naturally constituted the main business of the gold market. Other important movements occurred, however, during the year, reflecting, on the one hand, fluctuations of hoarding and dehoarding and, on the other, transfers of balances from one market to another.

It is not difficult to account for the disposal of the current production of \$1,220 million, for the net increase in the reported gold reserves of banks of issue and governments (excluding the reserves of the U.S.S.R. and Spain) amounted to about \$1,350 million. These reserves thus absorbed \$130 million more than the amount of newly produced gold. As far as the U.S.S.R. is concerned, gold exports during 1937 exceeded the estimated domestic production by \$25 million. An amount of gold of at least \$200 million would seem to have come out of the reserves of the Bank of Spain during the year. Account being taken of these additions, there remains about \$100 million constituting part of the gold that went to increase unreported reserves of exchange funds and other monetary authorities. The main increase in these reserves was derived from another source, namely the net dehoarding of gold which occurred during the year.

2. GOLD IN PRIVATE HOARDS AND EXCHANGE FUNDS.

Changes in unreported holdings of exchange funds and erratic movements of gold into and out of private hoards have made it difficult in recent years to obtain a complete picture of the gold situation. Some progress was made during 1937, however, in making information available to the public, the most important step being the publication, after an interval of three months, of the holdings of the British Exchange Equalisation Account as at the end of March and September. But difficulties remain in estimating the amounts which at various periods of the year came out of or returned to private hoards.

Dehoarding of gold had already begun in the autumn of 1936 after the devaluation of the former gold-bloc currencies. Apart from the surrender of gold in France, which was made obligatory by the Monetary Law of 1st October 1936, the movement was caused chiefly by a desire to realise profits and to obtain funds for the purchase of securities on the rising markets of the world stock exchanges. The increased need for working capital at a time of rising prices and extended activity may also have led business firms to convert into current balances gold which they had previously acquired. A feeling of increased monetary security went together with a belief in wider opportunities of employing capital profitably in security investments and in active business. In last year's Annual Report, it was estimated that an amount equivalent to at least 1,000 million Swiss gold francs (say, \$330 million) was disgorged in Europe during 1936. In fact the amount dehoarded in the last quarter of that year was perhaps as high as \$500 million.

Dehoarding continued in the opening months of 1937, especially on Dutch account, for reasons similar to those obtaining in the autumn of 1936. Gradually, however, a distinct change occurred in the attitude of the public towards the holding of gold as an asset providing unquestionable security. The steep rise in the prices of primary products in the first quarter of 1937 aroused fears as to an excessive rise in prices of commodities generally; and the opinion was expressed that a brake, in the form of an increase in the gold values of important currencies, might be applied. Moreover, the United States continued to receive very large shipments of gold, amounting to more than the current gold production, and the question was raised whether receipts at this high rate would be welcomed by the authorities, especially as the incoming gold was sterilised in the inactive fund and thus added to the burden of public financing. A gold scare began to grip the markets; and the gold price in London fell to a discount on the American shipping parity, owing to the fact (as explained on p. 20 above) that private arbitrage was reluctant to work under conditions that might have led to considerable losses if the price of gold had been reduced. The existence of the discount in itself increased the fears, and reports concerning the sale of Soviet gold (although the amounts sold were hardly more than the volume of the current production) added a further unsettling effect on the gold market. While the interest aroused in the gold question served to attract attention to the fundamental problems of the world supply of, and demand for, monetary gold, the situation on the gold market

in the spring of 1937 was largely dominated by the temporary but spectacular effects of the sudden disgorging of gold from hoards.

It has been estimated that in London alone gold to the value of more than \$300 million was dehoarded during the spring, and it is likely that some dehoarding occurred also in other centres. It may perhaps be assumed that in all some \$450 million were dehoarded during the first half of 1937; the aggregate dehoarding during the nine months following the devaluation of the currencies of the former gold-bloc countries would thus be of the magnitude of nearly \$1,000 million. This estimate may be compared with the results of calculations published in the Federal Reserve Bulletin for August 1937, the main elements of which are set out below:

Sources and Uses of Gold, January 1931 to June 1937.

In million dollars (at \$35 per fine ounce)	January 1931 to September 1936							Oct. 1936 to June 1937*	Total*
	1931	1932	1933	1934	1935	1936 Jan.- Sept.	Total		
Sources of gold:									
Mine output (excl. U.S.S.R.)	722	776	794	823	883	715	4,713	748	5,460
Receipts from:									
Indian private holdings	129	355	234	206	163	88	1,176	49	1,224
U. S. S. R.	100	82	68	86	25	11	373	149	522
China, Straits Settlements, and Egypt	73	114	68	52	29	18	355	12	367
Return of coin	—	65	98	51	35	1	250	—	250
Return of scrap	105	162	146	144	110	66	733	66	799
Total	1,129	1,554	1,409	1,362	1,245	899	7,599	1,023	8,622
Reported uses of gold:									
Increase in central gold reserves (excl. U.S.S.R.)	500	964	— 19	1,532	532	136	3,645	2,177	5,822
Industrial consumption . .	132	87	76	66	78	63	502	63	566
Total	633	1,051	57	1,598	610	199	4,147	2,240	6,387
Indicated increase in un- reported official hold- ings and private hoards in western countries .	496	504	1,352	- 236	635	701	3,452	- 1,217	2,235

* preliminary figures.

The difference between the total of current gold production and shipments from the East etc., on the one hand, and the amount taken into the reported central gold reserves or used for industrial consumption, on the other, must be gold that has entered private hoards in western countries or been incorporated in the holdings of official exchange funds. This is the gold which has "disappeared" from published returns since the beginning of 1931; by the end of September 1936 it amounted to \$3,452 million, of which some \$1,700 million were believed to have been the unreported holdings of governments and central banks; the remainder, some \$1,500 to 2,000 million, represented the private gold hoards in Europe, and of this gold perhaps two-thirds (i.e. around \$1,000 to 1,350 million) was held in the London market.

The Federal Reserve Bulletin further estimated that for the period October 1936 to the end of June 1937, gold to a value of more than \$1,000 million came out of private hoards, a figure only slightly higher than the estimate given in the previous paragraph.

The dehoarding of gold in the last quarter of 1936 and the first half of 1937 reduced the amount held in private hoards on the London market by more than half. In itself the very strength of the movement was apt to bring it to a fairly rapid close. Of great psychological importance was the announcement by the Chancellor of the Exchequer on 28th June 1937, of an increase of £200 million in the resources of the Exchange Equalisation Account, which would thus be raised to £575 million. The Chancellor said that, so long as large-scale capital movements to London were taking place, the Account must be prepared to add to its holdings of gold, and he also recalled that under the Tripartite Agreement one constant object of policy was to maintain the greatest possible equilibrium in the system of international exchanges and to avoid to the utmost extent the creation of any disturbance in that system by British monetary action. This was taken as official confirmation of the fact that the British authorities were prepared to support the market and if necessary to absorb increased amounts of gold.

In the following months the gold and exchange markets assumed a calmer aspect although fairly large amounts were dealt in and substantial movements occurred, connected with an outflow of funds from France and continued acquisitions of dollar balances in preference to gold by certain central banks which had already participated in the spring movement of balances to the United States. From the beginning of July, however, signs began to appear of intermittent weakness of the dollar. In the first half of 1937 net imports of gold to the United States amounted to \$1,029 million, and to a large extent the dollars obtained against this gold were not invested in securities but held idle on deposit with American banks. The rest of the world thus became long in dollars and was able to meet its commercial requirements in the autumn with great ease. Some influence was also exerted by Japanese shipments of gold to the United States at the rate of about \$40 million a month in July, August and September, as these shipments led to sales of dollars against sterling. The exchange value of the dollar was thus already affected by a certain weakness, when at the beginning of the last quarter of the year there came the sudden fall in industrial production in the United States, the break on the New York stock market and the sharp decline in the prices of primary products.

This turn of events, for which the public was largely unprepared, had a pronounced effect on the monetary outlook. Large sums were withdrawn from the American market, and this movement grew in strength when it was rumoured that in order to counteract the fall in commodity prices the gold value of the dollar might be reduced. A "dollar scare" developed, comparable in intensity with the "gold scare" in the spring, but of course with the opposite effects on the gold market. The nervousness of the public led to purchases of gold by private persons, and at the same time foreign exchange was largely converted into gold in the reserves of a number of monetary authorities. It seems probable that gold to a value of perhaps \$150 million found its way again

into private hoards on the London market, i.e. the hoarding in the autumn brought back nearly half of the amount dehoarded in the spring. Some hoarding of gold also occurred on the Continent of Europe (that is, in addition to the purchases on continental account retained in London). At certain times gold coins commanded a premium of 4 per cent. and more compared with gold bullion.

Figures relating to the hoarding and dehoarding of gold are necessarily approximations, but even so they serve to illustrate the proportions of the movements that occurred. By and large, in 1937 there was a net dehoarding of gold (outside the East) which is estimated at \$250 to 300 million. This amount all went into unreported holdings of exchange funds and other monetary authorities, which also absorbed some \$100 million out of the gold obtained from the U.S.S.R. and Spain, indicated on page 43 above. The total net amount absorbed by the unreported holdings of exchange funds and other monetary authorities in the course of the year was thus probably some \$350 to 400 million.

The gold holdings of the British Exchange Equalisation Account, in fact, rose by more than this amount from the end of March to the end of September 1937, as shown by the following figures from the official statements which have been issued:

British Exchange Equalisation Account	In ounces	In £ millions at 140 shillings per fine ounce
31st March 1937	26,674,000	186.7
30th September 1937	39,854,000	279.0
Increase	13,180,000	92.3

These six months included the period of the gold scare when the acquisitions of the Account were extraordinarily heavy. The amount of £21 million (at the current price), transferred from the Account to the Bank of England in the same period, is included in the figures of reported reserves.

For the year as a whole the increase in the holdings of the Account was almost certainly less than £92 million (\$460 million). During the first quarter of the year sterling remained comparatively weak on the exchange markets owing to the strong movement of funds to the United States on the one hand, and to Switzerland and the Netherlands on the other, only partially offset by an inflow of funds to London from France. In the circumstances, it is unlikely that the Account acquired any considerable amount of gold in that quarter, and there may, indeed, have been a decrease in its holdings. As regards the last quarter of the year, the demand for gold for hoarding purposes, as a counterpart to a certain repatriation of funds to France, and the demand by various central banks, was so strong that the Account had to supply the market with fairly substantial amounts of gold. For these purposes very little gold was available from current production. If the Russian figures be excluded from the calculations, as no Soviet shipments occurred that quarter, it is found that all but \$40 million of the current production was absorbed by the reported reserves of the central banks and governments. Some addition to

this figure may have to be made on account of gold from Spain and other unreported sources, but even so the amounts available were clearly insufficient to meet the extra demand which set in during the last quarter of the year.

Thus, if the increase in the holdings of the Exchange Equalisation Account was substantially less than \$460 million, some of the gold available from current production and net dehoarding must have gone to increase the amount held in the unreported reserves of other exchange funds and monetary authorities. In fact the French exchange fund held a larger amount of gold at the end of 1937 than at the beginning. The resources of this fund had run very low during the last months of 1936, necessitating the repurchase of gold by the fund from the Bank of France in December 1936 and January 1937. During the last few months of 1937, on the other hand, the fund added to its gold resources and was also able to transfer gold back to the Bank of France.

The amount of gold held for the account of the Dutch exchange fund at the end of 1937 did not, however, vary greatly from that held at the end of the previous year. With regard to the Swiss exchange fund, it is explained in the last annual report of the Swiss National Bank that at the end of 1937 the greater part of the assets of the fund consisted of gold. Since at the end of the previous year practically the whole of the fund, the total of which has remained the same, was held in gold, it may be concluded that as a net result of the transactions of the year gold had to some extent been replaced by other assets.

But some increase appears to have occurred in the amount of gold held by certain central banks as part of their foreign exchange resources, especially when the gold was set aside for special purposes. As already mentioned, the Federal Reserve Bulletin estimates unreported holdings of exchange funds and other monetary authorities at \$1,700 million at the end of September 1936. Since that date new funds have been established (in France, the Netherlands and Switzerland) and some important changes have also occurred in the resources allotted to the various funds as well as in the particular assets held by them. Nevertheless, at the end of 1937 the total unreported gold holdings of the exchange funds and other monetary authorities amounted to nearly the same figure of \$1,700 million as at the end of September 1936. Such additions to their gold holdings as occurred during this period would seem to have been largely offset by the transfer in December 1936 and again in May and June 1937 of an aggregate of £128 million gold (at the current price), equivalent to \$640 million, from the British Exchange Equalisation Account to the Bank of England.

3. MOVEMENT OF GOLD TO MONETARY RESERVES.

While unreported stocks of gold in exchange funds and held by other monetary authorities at the end of 1937 had a value which may be estimated at about \$1,700 million, the reported reserves of central banks and governments (excluding the U.S.S.R. and Spain) at the same date amounted to \$23,250 million. In the table these published reserves are given for each country separately at the end of 1935, 1936 and 1937 respectively, the countries being divided into three groups: countries in which the published

reserves increased in 1937 (group 1); those where there was practically no change in the magnitude of the reserves (group 2); and those in which a decline occurred (group 3).

Reported gold reserves of banks of issue and governments	End of 1935	End of 1936	Loss (—) or Gain (+) during 1936	End of 1937	Loss (—) or Gain (+) during 1937
in million dollars (at \$ 35 per fine ounce)					
Group 1: U. S. A.	10,125	11,258	+ 1,133	12,760	+ 1,502
Netherlands	438	490	+ 52	930	+ 440
United Kingdom	1,648	2,584	+ 936	2,689 ⁽¹⁾	+ 105
Java	54	60	+ 6	79	+ 19
Poland	84	75	— 9	83	+ 8
China	10	8	— 2	16	+ 8
Roumania	109	114	+ 5	120	+ 6
Brazil	17	25	+ 8	31	+ 6
Sweden	185	240	+ 55	244	+ 4
Yugoslavia	43	48	+ 5	51	+ 3
Turkey	24	26	+ 2	29	+ 3
Bulgaria	19	20	+ 1	23	+ 3
Italy	270	208	— 62	210	— 2
Peru	20	20	0	22	+ 2
Portugal	68	68	0	69	+ 1
Lithuania	6	12	+ 6	13	+ 1
Germany	63	46	— 17	47	— 1
Czechoslovakia	112	91	— 21	92	+ 1
Chile	29	29	0	30	+ 1
Total	13,324	15,422	+ 2,098	17,538	+ 2,116
Group 2: Algeria	14	14	0	14	0
Austria	46	46	0	46	0
British India	274	274	0	274	0
Egypt	55	55	0	55	0
Estonia	13	13	0	13	0
Latvia	15	15	0	15	0
New Zealand	23	23	0	23	0
Hungary	23	25	+ 2	25	0
Total	463	465	+ 2	465	0
Group 3: Denmark	54	54	0	53	— 1
Danzig	4	6	+ 2	5	— 1
Greece	34	26	— 8	24	— 2
Morocco	7	8	+ 1	5	— 3
Uruguay	74	69	— 5	68	— 3
Columbia	16	19	+ 3	16	— 3
Canada	189	188	— 1	184	— 4
Switzerland	454	655	+ 201	648	— 7
Finland	20	35	+ 15	27	— 8
South Africa	212	203	— 9	189	— 14
Mexico	44	46	+ 2	31	— 15
Norway	84	98	+ 14	82	— 16
Argentina	444	501	+ 57	469	— 32
Belgium	607	632	+ 25	597	— 35
Japan	425	463	+ 38	261	— 202
France	4,396	2,995	— 1,401	2,566	— 429
Total	7,064	5,998	— 1,066	5,223	— 775
Grand total ⁽²⁾ . .	20,900	21,900	+ 1,000	23,250 ⁽²⁾	+ 1,350

⁽¹⁾ Not including Exchange Equalisation Account: 30th Sept., \$ 1,395 million.

⁽²⁾ Partly estimated and including also other countries (except U.S.S.R. and Spain).

⁽³⁾ If estimated reserves of U.S.S.R. and Spain be included, as well as the unreported holdings of exchange funds and other monetary authorities, the world grand total would be about \$ 26,500 million.

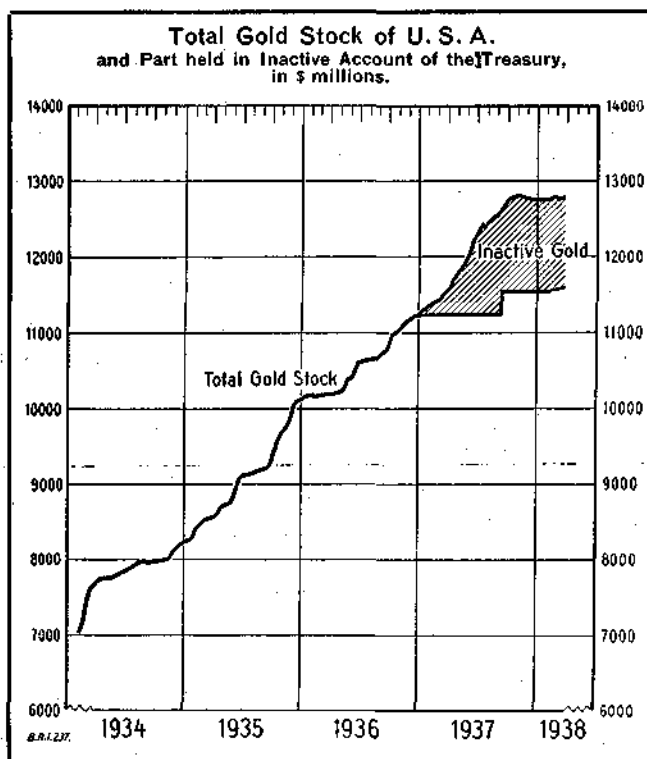
Three countries, namely the United States, the Netherlands and the United Kingdom, between them accounted for practically the whole increase in the reported monetary reserves. Together they absorbed \$2,047 million, and an even higher amount if account be taken of the net acquisitions of the British Exchange Equalisation Account. The amount of gold that has gone to increase their reserves is thus not far from twice the current annual production of gold running at the rate of \$1,220 million a year; and the

amount absorbed above the current supply of newly-mined gold was derived from net dehoarding of \$250 to \$300 million, from France to the extent of perhaps \$350 million, Spain at least \$200 million, Japan \$200 million (in addition to current production) and from the reserves of other countries a net amount of about \$100 million.

The United States alone has absorbed \$1,502 million, which is 23 per cent. more than the world's current gold production. Apart from certain minor movements, \$143 million were received from production within the country, \$1,585 million constituted net imports, while \$200 million were earmarked on balance for foreign account, the net receipts from foreign sources thus being \$1,385 million. The preliminary estimates of the United States balance of payments for 1937 give a passive balance on current account of \$49 million compared with \$160 million in the previous year. The most important change in individual current items was the increase in the export surplus on merchandise trade from \$33 million in 1936 to \$261 million in 1937. Thus the gold imports resulted, as in preceding years, from the vast imports of capital. It is of interest to compare, for the different quarters of the year, the receipts of gold from abroad with the estimates of capital movements to and from the American market.

Net movements of gold and capital to the United States in millions of dollars	Net receipts of gold from abroad: (net imports adjusted for changes in earmarked gold)	Net balance of capital movements to (+) and from (—) the United States
1937, First quarter	+ 339	+ 323
Second „	+ 651	+ 631
Third „	+ 394	+ 350
Fourth „	+ 1	— 502
Total	+ 1,385	+ 802

For the first three quarters of the year there is a natural concurrence between the gold received from abroad and the inflow of capital. In the last quarter the picture changes; a total of \$502 million is reported to have left the country but no corresponding export of gold occurred. There was, however, an export surplus of merchandise trade, amounting to \$310 million, in the last quarter against an export surplus of only \$97 million in the third quarter and an import surplus of \$148 million during the first half of the year. Purchases of dollars for commercial account in the last quarter doubtless helped to offset the sales of dollars resulting from the withdrawal of funds from the American market. It is of some interest to note that, precisely in the period of the year when a substantial export surplus of merchandise was realised and also American commodity prices fell more steeply than in other countries (see p. 29 above), the dollar was under pressure and not only was no gold received but in November and December even some net export occurred. The decisive factor was thus the outflow of balances; according to the annual report of the Board of Governors of the Federal Reserve System for



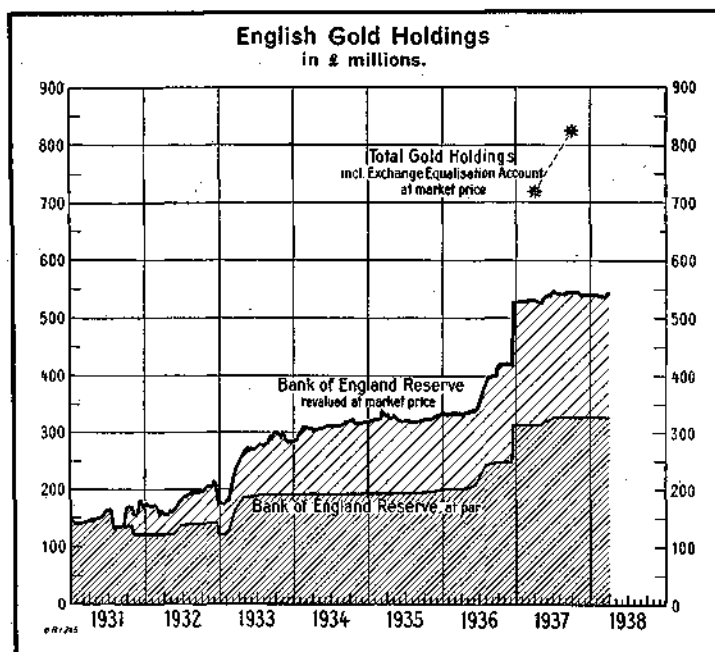
1937 "not only was the outflow of balances in the autumn nearly as great as the inflow in the spring but it was divided in about the same way between central banks and private interests and to a considerable degree it returned to the same countries from which it had come".

The increase of \$440 million (about Fl. 800 million at current rates) in the gold reserves of the Nederlandsche Bank was in the main also a result of capital movements. A certain surplus was probably achieved on the current account of the balance of payments, the increase in the country's import

surplus of merchandise from Fl. 270 to 403 million being offset by larger income from shipping and foreign investments, especially from those in the Netherlands Indies, whose export surplus rose from Fl. 252 million in 1936 to Fl. 448 million in 1937. The inflow of funds to the Dutch market would appear to have been caused chiefly by the repatriation of Dutch capital and the funds of large international companies with their head-offices in Holland, and only to a minor extent by the transfer of foreign-owned funds. The intensity of the movements that occurred may be judged, however, from the fact that during 1937 the Netherlands, a country of 8 million inhabitants, absorbed into its monetary reserves a little more than a third of the world's current gold production.

The increase during 1937 in the gold holdings of the Bank of England amounted to £21 million at the current price, £12.7 million at the old statutory price of 84s.11½d. having been transferred from the Exchange Equalisation Account to the Bank. At the end of March and September 1937 the holdings of the Account and of the Bank were of the following magnitude:

English Gold Holdings	31st March 1937	30th Sept. 1937	Percentage on 30th Sept. 1937
	in million ounces		
Exchange Equalisation Account	26.7	39.9	34.2
Bank of England	73.8	76.8	65.8
Total.	100.5	116.7	100.—
	in millions		
Total value at 140 shillings an ounce	£703.6	£816.9	Increase in six months: £113.3 million



In the last quarter of the year the Account supplied gold to the market to meet the demand for hoarding and other purposes, so that the aggregate amount held at the end of 1937 was certainly below the £800 million mark. Even so, there was a substantial net addition to the total gold reserves over the year, in spite of an increase from £18 million in 1936 to £52 million in 1937 in the estimate of the passive balance on current account of the balance

of payments. It should be noted, however, that on capital account repayment in respect of overseas loans (sinking fund as well as repayments at maturity) exceeded the amount of new overseas issues. The final figures for 1937 are not yet available but, according to estimates made by Sir Robert Kindersley, repayments exceeded overseas loans by £30 million in 1935 and £46 million in 1936. The main causes of the addition to the British gold holdings have been the influx of foreign capital, not only flight capital but also funds for commercial and financial purposes, and the building-up of reserves by countries in the sterling area. In its commentary on the balance of payments for 1937, the Board of Trade draws attention to the large increase in the balances held in London for account of banks in the Dominions and other countries of the sterling bloc as compared with those held several years ago. On 28th June 1937, when the Chancellor of the Exchequer in the House of Commons moved the increase by £200 million of the resources of the Exchange Equalisation Account, he laid stress on the fact that many of the countries included in the sterling bloc kept very large sterling holdings in London as a part of their reserves, and he added that the conclusion to which the Treasury was disposed to come was that, when all considerations were weighed, the existing gold holdings were not considered excessive.

Compared with the increase in the gold reserves of the United States, the Netherlands and the United Kingdom, the net acquisitions of other countries were of only minor importance. The increase in the holdings of the Javasche Bank reflects the improved trade position of the Netherlands Indies during the year. In Poland, on the other hand, an increase in the gold reserves by Zl. 42 million and in the foreign exchange holdings by Zl. 6 million went together with the development of an adverse trade balance. For the first time since 1929 imports exceeded exports, the industrial recovery which became more

marked during the year necessitating higher imports of raw materials and machinery, while the export of cereals declined owing to a poor crop. The increase in imports was, in fact, compensated by a partial mobilisation of Polish claims frozen abroad and by foreign commercial credits granted in higher amounts and for longer maturities than in previous years. Moreover, the proceeds of the first tranche of the National Defence credits obtained from France in 1936, and sales of gold previously hoarded, contributed to the improvement of the position.

The gold holdings of the Riksbank in Sweden rose by only S. Kr. 17 million in 1937 (on the basis of the gold price at the end of the year), but its foreign exchange holdings increased by S. Kr. 290 million (at current rates of exchange). An important source of foreign exchange was a surplus on the current account of the balance of payments, preliminarily estimated at about S. Kr. 180 million. Capital and credit transactions in relation to foreign markets attained an unusually high volume and included certain amounts of money placed by foreigners in Swedish balances in the expectation of a rise in the value of the Swedish krona.

The gold holdings of the Swiss National Bank decreased by Sw.fcs 30 million during the year, but at the same time the Bank's holdings of foreign exchange rose by no less than Sw.fcs 437 million. The resulting net increase in the total foreign resources was to some extent due to an improvement in the balance of payments, which is estimated to have given a surplus on current account in 1937. The main sources of the increase, however, were an influx of foreign flight money and large repatriations of funds by Swiss nationals. In Norway also a reduction in the gold reserves was more than counterbalanced by an increase in foreign exchange holdings, the combined resources of gold, foreign exchange and foreign securities in the hands of the Norges Bank having risen by N.Kr. 134 million at current rates. A most important factor was the larger income from shipping, which contributed a net surplus to the exchange market in spite of the fact that large amounts were used by shipowners to make repayments on debts incurred for the building of ships abroad.

The reduction in the gold reserves of the Bank of France amounted to the equivalent of \$430 million in 1937. During the first half of the year three transfers of gold were made from the Bank of France to the Exchange Fund, amounting in all to Fr. fcs 11,500 million at the accounting rate of 0.0441 gr. fine. At the end of July the gold holdings of the Bank were revalued, the accounting value of the franc being reduced by about 12 per cent.; and in November Fr.fcs 3,127 million were transferred from the Fund to the Bank. As a result of these various operations, the gold holdings as shown in the balance sheet of the Bank of France fell only from Fr. fcs 60,400 million at the beginning of the year to Fr. fcs 58,900 million at the end.

The losses of gold to which the French monetary reserves were exposed during 1937 were due as much to a deficit on the current account of the balance of payments as to the export of capital.

Japanese exports of gold to the United States, which began again in March 1937 and continued uninterruptedly to the end of the year, reached a total of \$247 million. As, however, the net gold production of Japan and Korea amounted to \$45 million the net reduction in the country's gold reserves was limited to \$202 million. Imports of merchandise exceeded exports by Yen 636 million for the whole year, but the excess of imports was reduced towards the end of the year by the application of increasingly stringent import and exchange restrictions.

As regards other countries, such declines as occurred in the gold holdings were of a limited character. The National Bank of Belgium lost gold to an amount of B.fcs 1017 million (\$35 million), the belga having been under pressure in the spring and again in the latter half of the year. Account must be taken, however, of the net repayments of long-term foreign indebtedness of public authorities and private companies, amounting to B.fcs 3,437 million, and thus to more than the decline in the gold reserves of the Bank. In the Argentine the gold holdings of the Central Bank rose in the spring but fell slightly in the autumn, partly as a result of capital movements and partly in response to changes in the trade balance. In other overseas countries the strain that developed in the autumn, when prices of primary products fell and imports contracted in the earlier, more prosperous period had to be paid for, was reflected in a decline in exchange holdings and in a tightening-up of exchange restrictions in some of the weaker markets.

The net effect of the year's gold movements was a further increase in the reserves of the creditor countries; and this increase was mainly due to capital movements. The world total of gold in monetary reserves, including the holdings of exchange funds, amounted to about \$26,500 million at the end of 1937, and of this aggregate seven creditor countries (the United States, the United Kingdom, France, the Netherlands, Switzerland, Belgium and Sweden) between them held about \$22,500 million, i.e. 85 per cent. In the absence of large-scale international lending, a better world distribution of gold can be obtained only from a surplus on the current account of the balance of payments of those countries whose present monetary reserves are clearly inadequate.

The advance in volume and in value of world trade from 1936 to 1937, and especially the increase in the imports of the richer countries in the winter of 1936-37, helped a large number of other countries to replenish their monetary reserves. As, however, most primary producing countries held their reserves predominantly in foreign exchange, they were not as a rule buyers of gold. This means that a considerable part of the gold which, for example, is held in London as a backing to foreign liabilities is really held for the account of monetary authorities in other countries. The maldistribution of monetary reserves in the world is, therefore, rather less acute than the distribution of gold holdings would suggest. The reserves of the primary producing countries, which expanded in the spring of 1937, were, however, somewhat reduced by the setback in economic conditions in the latter half of the year, and especially by the decline in the imports of the United States.

In analysing the changes that occurred in the reserves of the creditor countries themselves, the turn in the trend of world business during 1937 was a factor of the greatest importance. Annual figures, which apply to a division of time artificial as regards economic affairs, may obscure great variations within the year itself. It is difficult to imagine a more complete change than that which took place on the London gold market between the spring and late autumn. In the spring, when for some months large amounts of gold came out of hoards, the capacity for gold absorption by the few monetary authorities who acquired the gold was heavily taxed; and, although record shipments of gold were made from London to New York, the borrowing powers of the British Exchange Equalisation Account were increased by £200 million to provide, if necessary, the means for increased gold purchases. In the late autumn, on the other hand, notwithstanding the fact that gold ceased to flow to the United States, the demand for gold on the London market was so great that the Exchange Equalisation Account had to augment the supply side from its own accumulated holdings. Repatriation of funds to France, acquisitions by the Netherlands, Switzerland and several of the other smaller countries, and last but not least renewed hoarding, absorbed considerably more than the current flow from the gold producers.

The real significance of the changed position on the gold market is to be found in the preference which appeared in the attitude of the public and of financial institutions towards liquidity when the upward phase of the business cycle turned into recession. While business was rapidly expanding in the winter of 1936-37 there was an incentive to purchase equities and to employ funds directly in enterprise. Hoards of gold were dissolved and the proceeds invested. Apart from profit considerations, the movement was intensified by the belief that material assets and even currency balances provided greater security than gold. The sharp fall of stock exchange quotations in August and September came as the first shock to these expectations; the setback in business increased the uncertainty, and the renewed rumours of a possible reduction in the gold value of the dollar had a decisive influence on the markets. Once more there was a desire for greater liquidity, which, according to the mentality of the person or institution involved, found expression in the holding of larger bank balances, in the purchases of government securities, especially short-dated maturities, or in the acquisition of gold. The movement from gold and government securities into equities that had characterised the opening months of 1937 was thus reversed into a movement from equities into government securities and gold.

The shift towards gold naturally reflected a certain mistrust of currencies; there were signs of preference for gold even in relation to notes with more than 100 per cent. gold backing. Political fears played their rôle as an inducement to hoarding — the present generation is only too well aware of the damage to the monetary systems that comes in the wake of a war. It seems probable that the urge for liquidity and safety, which reappeared in the autumn of 1937, will make itself felt from time to time in the future and intermittently influence the demand for gold; and this is an element which cannot

be left entirely out of account in the consideration of the gold problem. A ready supply of gold, whenever required, from the large holdings of the exchange funds will no doubt help to ease the situation from a monetary point of view. As it happened, the renewed demand from the continent of Europe temporarily relieved the monetary authorities of the United Kingdom and the United States from the burden of adding further to their already vast holdings of gold, and even provided them with an opportunity of reducing their stocks.

In another respect also the gold problem changed its character in the autumn as a result of the turn in the business trend. Some apprehension had been felt in the early months of 1937 regarding an undesirably rapid rise in commodity prices, and it was discussed whether an increase in the gold value of individual currencies might provide a suitable means of checking this. In Sweden official consideration was given to the question whether *inter alia* an increase should be made in the exchange value, and thus also in the gold value, of the Swedish krona; and, although no such step was taken, great stress was laid on the desirability of preventing a sharp rise in prices. When, however, all over the world prices started to decline, the situation was materially changed. Faced with an abrupt fall in commodity prices and industrial production, the authorities in the United States decided to release gold previously absorbed into the "inactive fund" and to allow new gold to affect the credit system without offsetting. President Roosevelt explaining the Administration's price policy at a press conference on 18th February 1938 said, "The measures employed at any given time to further this policy must fit the needs of that time. A year ago there was ground for concern that a too rapid rise in the prices of some commodities was encouraging a speculative boom. During the past six months on the other hand the general price level and industrial activity has been declining. Government policy must be directed to reversing this deflationary trend."

The measures that have been taken in the United States during the past two and a half years to control the impact of gold movements on the credit system have not been related to the working of the American Exchange Stabilisation Fund. This Fund was formed in 1934 by the allocation of \$2,000 million in gold out of the "profits" from the revaluation of the country's gold stock. It has been held in its original form except for \$200 million placed with the Federal Reserve banks as a working balance. From time to time the Fund has engaged in exchange and gold operations; as, however, the dollar has been tied to gold, the need for such operations has not been as great as in those countries where no gold price has been fixed. By the nature of its resources the Fund could play no part in the gold sterilisation policy inaugurated at the end of 1936. To offset the expansion of the credit base that normally results from an influx of gold, sales of securities are necessary, but the American Fund, unlike the British Exchange Equalisation Account, had not been given borrowing powers, i.e. the right to acquire gold against sales of securities. The policy adopted during the period of business expansion to counteract an excessive increase in the cash reserves

of the banking system took two different forms: (i) sterilisation through the purchase of gold against sales of securities by the Treasury itself, this gold constituting the so-called "inactive fund", which rose to a maximum of \$1,400 million in the second week of September 1937; and (ii) an increase in the legal cash reserve requirements of the member banks. By these measures the excess reserves of the member banks of the Federal Reserve System were reduced from over \$3,000 million in the summer of 1936 to less than \$800 million in the summer of 1937.

In view of the strain that was experienced particularly by the New York banks, it was considered advisable to modify this policy in the autumn of 1937, and an expansion of excess reserves was brought about, firstly by the release of \$300 million from the inactive fund in September 1937, secondly by the purchase of securities by Federal Reserve banks to an amount of \$38 million in November 1937, and thirdly by the decision announced in February 1938 that "for the present, additions to the gold stock up to \$100 million in any one quarter of the year will not be placed in the inactive gold account". By these various measures the excess reserves of member banks were increased to about \$1,500 million by the end of March 1938. In the following month, however, as part of a general programme for the revival of business, the authorities reversed altogether their previous sterilisation policy. It was decided to desterilise all the gold placed in the inactive account, and to discontinue sterilisation for the future, this action being supplemented by a reduction in the required reserves of the member banks.

Through the various measures announced in April 1938 the credit base of the banking system will be greatly expanded. It is estimated that when the desterilisation has become fully effective member banks' reserve balances will amount to nearly \$9,000 million and excess reserves to about \$3,800 million. As total deposits of all kinds with member banks amounted to about \$40,000 million in February 1938, these deposits, even after the rise resulting from the desterilisation measures, will be covered on an average by reserve balances to the extent of more than 20 per cent.

In Switzerland the Exchange Equalisation Fund, which was established at the time of the devaluation in September 1936, was formed on the American model, revaluation "profits" of Sw.fcs 539 million being allocated to it. This Fund may exchange its holdings of gold for foreign exchange and vice versa, but it has not been provided with borrowing powers and has, therefore, in no way served to offset the expansive influence of the gold influx on the credit system. From the beginning of October 1936 to the end of December 1937 the Swiss National Bank increased its holdings of gold and foreign exchange by Sw.fcs 1,046 million, and during the same period the "other sight liabilities" of the Swiss National Bank, representing essentially the balances of Swiss banks with the National Bank, rose by Sw.fcs 750 million to a total of Sw.fcs 1,716 million. The liquidity of the commercial banks is very high. By the end of 1937 the notes, coin and cash balances of the seven largest banks amounted to Sw.fcs 977 million as compared with deposits of Sw.fcs 2,478 million, giving a relation of cash to deposits of about 40 per cent.

In the Netherlands the Exchange Fund of Fl. 300 million was formed in October 1936 on a mixture of the American and British models, i.e. the Fund was given Fl. 100 million in gold and the right to acquire Fl. 200 million gold and foreign exchange against the issue of government securities to that amount. These securities have all been issued and to that extent the influx of gold has been prevented from expanding the cash balances of the commercial banks. As, however, the increase in the gold holdings of the Nederlandsche Bank from the beginning of October 1936 to the end of December 1937 amounted to Fl. 800 million at the old statutory price, only a minor part of the effect of the incoming gold has been offset by the action of the Fund. In fact "balances on current account" in the return of the Nederlandsche Bank rose during the same period by about Fl. 650 million to a total of Fl. 755 million. This increase corresponds in the main to a rise in the cash balances of Dutch commercial banks, which would appear to have held at the end of 1937 on an average about 40 per cent. in notes, coin and cash balances against their total deposits.

In Switzerland and the Netherlands some concern has been felt about the great liquidity which the banking systems have thus acquired. It has, however, been found in practice that the commercial banks have not experienced a demand for increased advances to business sufficient to give employment to even a small proportion of their swollen balances with the central bank, and they have in fact abstained from the purchase of government securities. Moreover, there have been few opportunities for foreign lending. The banking situation in these countries is thus characterised by a high degree of caution observed by the commercial banks themselves.

Turning now to the United Kingdom, both the action of the Exchange Equalisation Account and the position of the commercial banks show a number of features different from those apparent in the countries just dealt with. The resources of the Exchange Equalisation Account were provided in the form of borrowing powers, i.e. a supply of Treasury bills available for sale. When there is an inflow of funds into the London market and the Account sees fit to intervene, Treasury bills are sold and the sterling thus obtained is used to buy, say, French francs, which the Account is able to convert into gold. Thus, through the double operation of selling Treasury bills and buying foreign exchange or gold, not only the foreign exchange position but also the volume of credit on the domestic market is affected. The sale of Treasury bills by the Account, in fact, acts as an offsetting open-market operation and prevents an inflow of gold to London from increasing the cash balances of the joint stock banks with the Bank of England. To provide for an increase in bankers' balances, for more notes in circulation, or a reduction in the fiduciary issue, the Bank of England may take over gold from the Exchange Equalisation Account without a counteracting sale of securities. From January 1933 to January 1938 £205 million gold at the official price was transferred to the Bank mainly to provide for an increase of £120 million in the note circulation and a reduction of £75 million in the fiduciary issue. Bankers' balances rose by only £10 million over the whole of this period. They had,

however, already been increased in 1932, when the policy of cheap and plentiful credit was inaugurated, by nearly £30 million — mainly through the purchase of securities by the Bank of England. The following table gives the relevant figures:

Bank of England (Last Wednesday in month)	Fiduciary issue covered by securities in Issue Dept.	Total securities in Banking Dept.	Gold holding at statutory price	Notes in circulation	Bankers' balances
	In millions sterling				
January 1932	275	95	121	346	74
January 1933	275	119	124	353	103
January 1938	200	128	326	473	113

The £113 million in bankers' balances represented only about 5 per cent. of the total outstanding deposits of the joint stock banks.* In order to maintain a relatively stable cash ratio of about 10 per cent. of cash against deposits, of which about half is in the form of notes and coins and the other half in the form of balances with the Bank of England, the Exchange Equalisation Account must by its absorption of gold prevent the emergence of excess reserves and, on the other hand, make provision for "cash" when it disposes of gold on the market. The sensitiveness of the British banking system is such that even a relatively small but persistent increase in bankers' cash (small in comparison with the variations found in other credit systems) is apt to cause an expansion of the credit extended throughout the country; the Exchange Equalisation Account thus acts as a "shock absorber" allowing the traditional policy based on fairly rigid ratios to be pursued.

At the end of 1937 "other sight liabilities" of the Swiss National Bank and the "balances on current account" with the Nederlandsche Bank had a value of £79 million and £84 million respectively, as compared with total deposits (bankers', public and other) with the Bank of England amounting to £172 million. In Switzerland and the Netherlands the gold reserves of the central banks are held largely as a counterpart to large balances of the commercial banks. In the United Kingdom, where the bankers' balances are not of the same relative magnitude, other methods of holding gold have to be found in order to provide the country with adequate reserves in relation to the foreign liabilities of the London market. This is one aspect of the accumulation of gold in the hands of the Exchange Equalisation Account.

The various exchange funds that have been established differ profoundly in size, in the composition of their resources and in their methods of working. The difference in technique, however, does not involve any marked difference in the main objectives of credit policy. In spite of the absorption of gold in

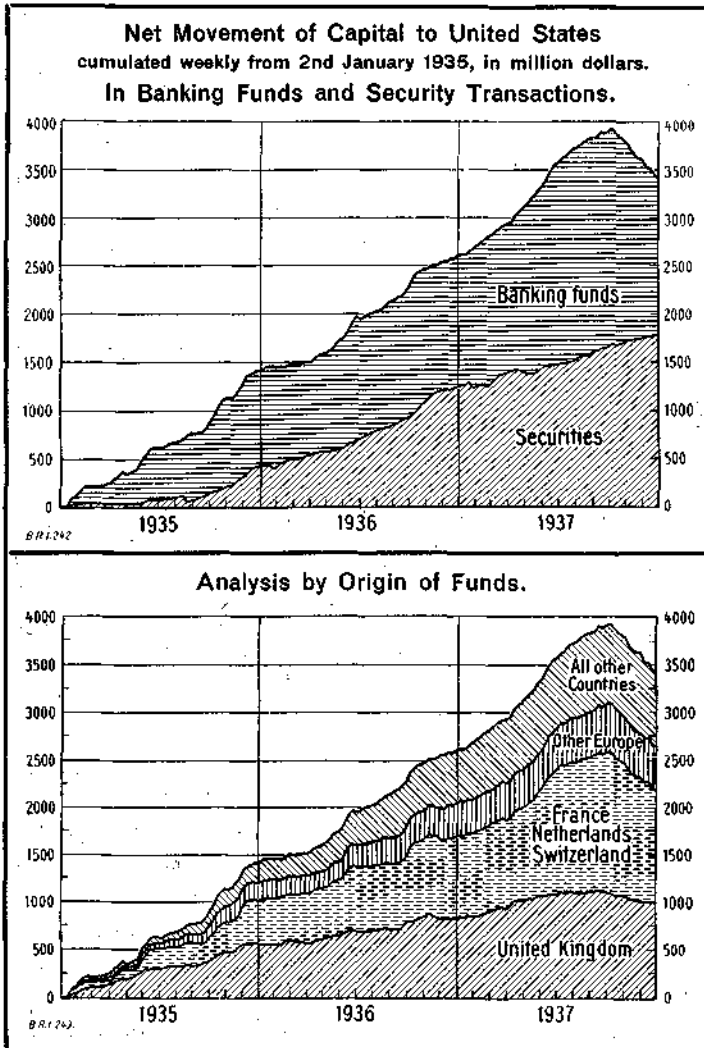
* It should be remembered that the joint stock banks besides their 10 per cent. of "cash" against deposits hold another 20 per cent. in other short-term assets: bills discounted and money at call and at short notice. See p. 77 below.

the British Exchange Equalisation Account since 1932 a sufficient volume of cash reserves has been left to the banks to make the cheap money policy effective, as is evidenced by the increase in their total deposits and the rise in the country's note circulation. The sterilisation of gold which has been undertaken by the purchases of the Exchange Equalisation Account is to be regarded as an attempt to cope with the problem of short-term balances moving from one market to another. In other countries too this problem has enlisted the attention of the authorities and must continue to do so as long as funds are driven by fears rather than attracted by opportunities for enterprise and investment. The measures that can be taken by the monetary authorities will naturally have to be adapted to the structure of each separate domestic market. Gold, whether held by exchange funds or central banks, remains the appropriate asset to meet the external claims to which the markets may be subject and thus affords a measure of protection from the continued monetary insecurity in the world.

IV. CAPITAL MOVEMENTS AND INTERNATIONAL INDEBTEDNESS.

Capital movements, affecting especially the markets of the creditor countries, continued on a considerable scale in 1937. To a large extent "hot money", volatile funds primarily in search of safety, is responsible for the abnormal volume of these movements. But other more normal elements, such as the accumulation of banking balances and other funds used in connection with ordinary foreign trade financing, have assumed increased importance with the higher volume of world trade and the replenishment of monetary reserves in a large number of countries. The change during 1937 in the trend of affairs and in the business outlook generally had an immediate influence on the direction in which capital moved. In fact, the tendencies in the latter part of the year were in many respects the opposite of those found in the early part of 1937 and in previous years.

The reversal of the current of capital was nowhere more marked than in relation to the United States, which during the first nine months of 1937



received \$1,300 million funds from abroad and in the last quarter sustained an outflow of \$500 million; the net influx over the year was thus \$800 million, compared with \$1,200 million in 1936 and \$1,400 million in 1935. In other words, the large stream of capital to the United States, which started after the devaluation of the dollar early in 1934, received its first check of importance in the last quarter of 1937. The graphs based on the weekly published figures of the U. S. Treasury illustrate these movements, which are further shown in the following table subdivided into classes of funds and chief countries of origin.

It is of interest to note that the outflow in the last quarter of

Net Capital Movement to U.S.A.

in million dollars	Grand total	Banking funds			Brokers' balances	Securities		
		Total	Foreign	U. S.		Total	U. S.	Foreign
1935, Jan.-March	259	212	(1) 58	(2) 154	21	26	6	32
April-June	357	314	156	158	9	34	22	12
July-Sept.	283	212	137	76	0	71	75	4
Oct.-Dec.	514	226	253	26	24	311	226	85
1936, Jan.-March	98	3	25	28	6	100	111	11
April-June	438	259	201	59	16	163	97	66
July-Sept.	334	126	120	7	7	201	109	92
Oct.-Dec.	327	9	32	23	10	328	284	44
1937, Jan.-March	323	171	191	21	9	161	158	3
April-June	631	546	491	55	14	70	6	76
July-Sept.	350	183	131	52	14	154	56	98
Oct.-Dec.	502	644	575	69	16	127	37	90
1935, Jan.-Dec.	1,412	965	603	361	6	442	317	125
1936, Jan.-Dec.	1,196	397	327	70	7	792	601	191
1937, Jan.-Dec.	802	256	238	18	35	512	245	267
Totals 1935 to 1937	3,410	1,618	1,169	449	48	1,745	1,162	583

In million dollars	Countries of origin							
	U. K.	France	Holland	Switzerland	Other Europe	Canada	Latin America	Far East
1935, Jan.-March	141	25	9	8	37	10	27	19
April-June	167	89	39	20	30	10	11	11
July-Sept.	72	14	34	42	58	2	27	61
Oct.-Dec.	175	110	32	61	66	22	7	38
1936, Jan.-March	6	12	10	43	6	2	32	2
April-June	122	18	73	75	33	28	40	43
July-Sept.	98	38	3	50	71	113	17	27
Oct.-Dec.	49	98	35	38	57	12	42	11
1937, Jan.-March	98	9	37	28	41	9	135	14
April-June	152	35	90	256	34	11	45	24
July-Sept.	27	5	34	118	78	45	26	27
Oct.-Dec.	112	56	79	130	52	70	3	3
1935, Jan.-Dec.	555	210	115	130	191	0	71	128
1936, Jan.-Dec.	274	89	115	205	167	150	130	56
1937, Jan.-Dec.	164	18	82	272	101	44	209	41
Totals 1935 to 1937	994	282	312	608	458	106	411	225

(1) increase of U. S. banks' liabilities to foreigners.

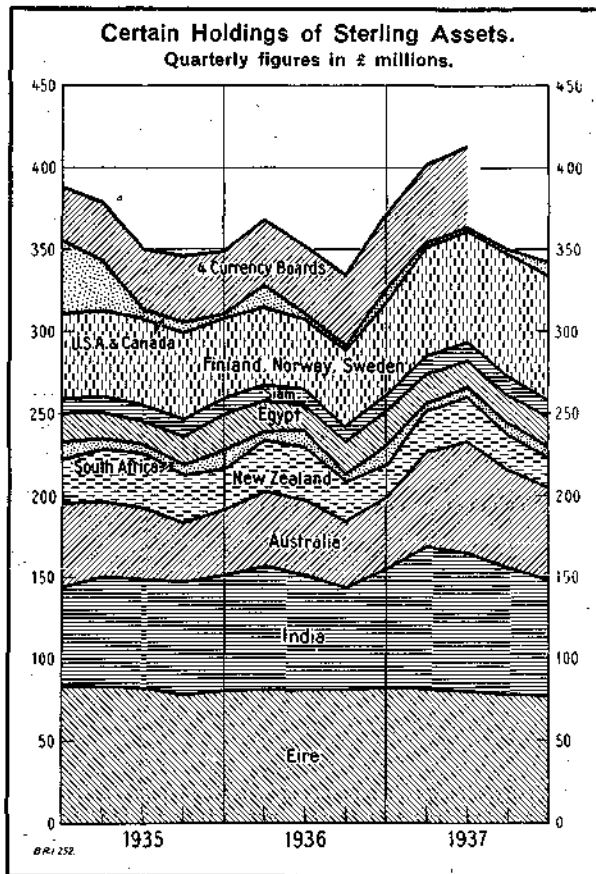
(2) decrease of U. S. banks' assets abroad.

1937 is wholly accounted for by the movements of banking funds, while foreign holdings of securities continued to increase. In fact, security investment has shown itself to be much less sensitive than funds held on deposit with banks. Of the reduction in foreign banking funds held in the United States, amounting to \$575 million in the last quarter, \$127 million was used to purchase securities and the balance was either sent abroad or utilised to cover the large foreign commodity purchases reflected in the American export surplus in the last half of the year. In addition, funds amounting to \$69 million net were lent abroad by American banks, mostly in England and Canada; this is a seasonal movement in the last quarter of the year, but larger than usual in 1937.

To some extent the increase of foreign banking funds in the United States in the first part of 1937 was a reflection of the favourable balances of payments of the Latin American countries, the dollar balances held by these countries increasing from \$260 million in December 1936 to \$500 million in May 1937. But the biggest influx was from Europe and particularly from Switzerland, representing to a large extent a change-over by private individuals and other institutions at the time of the "gold scare" from gold holdings

to dollar currency. Normally the United Kingdom takes first place in capital movements vis-à-vis the United States, partly because London acts as a conduit pipe for the funds of other countries; but in the second quarter of 1937 the influx of Swiss funds was \$250 million against \$150 million from England, and in the third quarter \$120 million came from Switzerland compared with \$30 million from England. In the third quarter the dollar balances held by the Latin American countries tended to decline as their main export season ended (and loans in dollars were redeemed). When the turn of the tide came in the last quarter of 1937 Switzerland again predominated, the efflux of funds to that country being \$130 million against \$110 million to England and \$80 million to the Netherlands. As indicated above net purchases of American and foreign securities by foreigners continued in the last quarter of the year when foreign capital was flowing out of the country. The total net purchases of American securities were, however, much less than in the previous year, amounting to only \$245 million in 1937 against \$600 million in 1936.

As usual the London exchange market was the most affected by the capital movements to the United States, some 60 per cent. of the purchases and sales of dollars by American banks being against sterling. Besides the capital movements to and from the United States, described above, London was affected by movements within the sterling area and also by an influx of funds from France and an efflux chiefly to the Netherlands and Switzerland.



The accompanying graph shows the sterling banking resources of the chief sterling-area countries plus Canada and the United States. These figures are net in all cases, i.e. they represent the excess of sterling assets over sterling liabilities, except for the New Zealand trading banks, whose sterling liabilities are, however, comparatively small. There is some difference in the nature of the funds shown — those of the banks of Eire being in the nature of accumulated savings and showing only small changes, while the London funds of the Australian banks, for instance, are subject to considerable fluctuations reflecting the balance of payments of the Dominion. For the three northern countries, Finland, Norway and Sweden, the graph includes the net sterling assets of the

commercial banks as well as the sterling holdings of the central banks. The four currency boards are those of West Africa, the Straits Settlements, Palestine and Iraq, the two former accounting for nearly £20 million each of the total of £50 million in the middle of 1937. The inclusion of the reserves of these currency boards, which only publish annual balance-sheets, necessitated some estimates based on the monthly figures of the notes in circulation (issued against sterling). Fourteen other currency boards and monetary authorities operating in the British Crown Colonies would add some £7 million to the total.

London, as the reserve centre of an area largely producing primary products, is directly affected by the balances of payments of those countries which benefited by the boom in their exports early in 1937. From the middle of 1936 to the middle of 1937 India added £15 million to her sterling resources, Australia £20 million to her London funds, and the four currency boards some £10 million to their reserves (West Africa's share being £6 million). For these countries the trend was reversed in the second half of the year. The three northern countries, however, continued to increase their sterling resources throughout the year, by some £20 million in all compared with £7 million in 1936. Denmark, which is not included in the graph, also improved its foreign position on the year, chiefly in the last four months, Danish export prices rising only when world market prices had passed their peak. Denmark (like Norway in a greater degree) owed part of its active balance to shipping earnings. The Argentine also, with its currency pegged to sterling, appreciably increased its pound as well as its dollar reserves in the first part of the year, with a decline after the end of the export season.

It is not, of course, the total of the foreign funds in London which is important from the point of view of the management of the sterling exchange, but their fluctuations. The reserves of primary producing countries naturally tend to move together in the same direction, but there is some compensatory effect since these sterling reserves increase at the time when the English current balance of payments is burdened with the higher cost of foodstuffs and raw materials (and vice versa). More important, because their behaviour is more erratic and also more violent, are the capital movements vis-à-vis countries other than those of the sterling area. Besides the United States, already mentioned, the chief countries concerned are France, the Netherlands and Switzerland.

Capital exports from France in 1937 were most pronounced in the first weeks of the year, in May and June, and later during September, in each case followed by some reflux which was particularly important in October and November. Fluctuations in the value of the French franc render it somewhat difficult to obtain a clear picture of the net changes which occurred during the year. While the balance sheet of the Bank of France registered a loss of gold equivalent to \$430 million on balance, the exchange fund would appear to have increased its holdings over the year so that the net loss was perhaps not more than \$350 million. The deficit in the current account of the balance of payments may have been in the neighbourhood of \$240 million, but nearly one-half of this deficit was covered by a net import

of capital in the form of credits, of which the largest were for the French railways. Taking account of sundry minor items, the efflux of capital over the year would thus be of the order of \$250 million. The amounts exported, i. e. used to buy foreign currencies, did not come from francs already in existence but from the creation of new francs by an extension of credit by the Bank of France. Out of the total increase of Fr.fcs 15,000 million in the credit items of the Bank of France in 1937, about Fr.fcs 14,000 million were for the account of the government. The funds exported went chiefly to the United States, England and Switzerland but also spread to other centres. Movements of capital of this nature and volume are of no advantage to the markets receiving the funds. Not only may they leave their refuge as quickly as they came, but they also add to the existing plethora of money, derived from an abundance of home funds, and exert an unnatural pressure on interest rates, diminishing the control of the central bank.

In Switzerland the influx of foreign funds, added to the repatriation of Swiss capital since September 1936, has enormously increased the amount of liquid money in the hands of credit institutions. The first half of 1937 was comparatively quiet; there was indeed an efflux of funds to Germany (on account of sales of Swiss securities by German holders), to France (for subscription to the National Defence Loan), and in the second quarter a much larger efflux, partly to England but chiefly to the United States. In the second half of the year, especially in the autumn, the tide turned and the National Bank had to buy some Sw.fcs 500 million (say, \$115 million) of exchange — Swiss funds returned from London and New York and to the influx of French capital were added some Belgian funds. In an attempt to combat the plethora the National Bank concluded a Gentlemen's Agreement with the commercial banks, which entered into force in November 1937, whereby no new foreign deposits would be accepted on sight account, old foreign sight accounts would be turned into fixed deposits as soon as possible, and all foreign deposits at less than six months would be subject to an annual commission of one per cent. In Switzerland some 15 per cent. of the deposits of the big banks are probably of foreign origin — but foreign funds have, of course, also found other employments.

A sudden influx of national funds raises similar problems to those arising from foreign "hot money" and to draw the line between them is of the greatest difficulty. This is true of Switzerland, but particularly of the Netherlands and Sweden. The gold holding of the Nederlandsche Bank has doubled since the devaluation in September 1936, the increase in 1937 being some Fl. 800 million in present-day guilders, say, \$450 million. The increased passivity of the trade balance has been offset particularly by the larger income from investments in the Netherlands Indies, while revenue from shipping and foreign investments has increased; but the predominating factor has been the influx of capital. Some of this was of a commercial nature, foreigners covering their needs in advance as the guilder tended to appreciate; part also may be attributed to foreigners seeking permanent investment and to the repayment of loans contracted before the guilder was devalued. But a large proportion consists of the abundant liquid funds of the big international concerns having

their head offices in the Netherlands, which are in the habit of keeping their funds to a great extent in the centre considered safest at the moment. How far such funds are to be considered Dutch and how far foreign is of minor importance, as the difficulties to which their presence, and that of other repatriated and foreign capital, gives rise are much the same.

The main source of the increase in recent years in the Sveriges Riksbank's holdings of gold and foreign exchange has been a surplus on the current account of the Swedish balance of payments; but some capital movements have occurred and these were of a more than usually pronounced character in 1937. To a certain extent these movements were connected with the rumours of a possible increase in the exchange value of the Swedish krona, which caused Swedish exporters to take up foreign credits secured by deposits in kronor in Swedish banks. Moreover, some foreign purchasers of Swedish exports invoiced in kronor acquired the necessary Swedish currency well in advance of the date for payment. Some speculation in Swedish kronor by foreign interests may also have taken place. Very little real flight money is, however, held in Swedish banks, but increased amounts in Swedish kronor are held by banks, business firms and private persons in neighbouring countries, which up to a point use Stockholm as a monetary centre; the amounts in question rose from about S.Kr. 50 million at the end of 1936 to S.Kr. 100 million at the end of the following year.

The Belgian situation has, on the other hand, been affected in recent years by movements of refugee funds. After the devaluation in the spring of 1935 there was a reflux of Belgian capital into the country, which became also a refuge for funds exported from the remaining gold-bloc countries. In the middle of 1935 foreign deposits were estimated at about B.fcs 4,000 million, say, \$135 million, of which three-quarters might be considered refugee funds. Some reflux occurred until the spring of 1936, but from then until the devaluation of the gold bloc in September funds again flowed in so that a higher level was reached than in 1935. Swiss and Dutch capital was then withdrawn but the greater part of the French funds remained and were in fact increased in volume in May and June 1937. The October return of funds to France affected Belgium also, and after a period of calm of about two months a rather violent efflux of funds reduced the gold reserve of the National Bank from mid-January to the end of March 1938 by B.fcs 2,000 million to the lowest figure since the 1935 devaluation. Foreign refugee money in Belgium must now be very small. The depreciation of the French franc was doubtless the main cause of the withdrawal of capital from Belgium. On the other hand, there was no loss arising from the current account of the balance of payments, which was active in 1937, exports having risen by 30 per cent. in comparison with the previous year.

Overseas countries most affected by capital movements of this nature during the year were probably Australia and the Argentine. In both countries foreign capital tends to be invested, in the hope of an appreciation of the exchange rate, when exports are active, and to be withdrawn when the tide turns. For example, a large amount of investment and speculative capital entered the Argentine in the last quarter of 1936 and the first half of 1937, causing a rapid appreciation of the "free" peso rate in spite of the purchase

by the Central Bank of Pesos 215 million on the free market; in the second half of 1937 these funds flowed out again and the Central Bank sold Pesos 193 million of foreign exchange to check the depreciation of the free rate. This in-and-out movement of some Pesos 200 million (say, \$60 million) in just over one year, a large amount in such circumstances, naturally aggravates the problems of the monetary authorities. In January 1938 the Central Bank sold a further Pesos 57 million of exchange on the free market, but the support was withdrawn in February when the rate was allowed to find its own level. Steps have recently been taken to make foreign deposits in the banks non-interest-bearing.

Spectacular international movements of short-term funds naturally attract great attention, but they must not be allowed to obscure the fact that in 1937 the increased turnover of international trade and the higher prices then ruling necessitated a correspondingly larger volume of financing, and that in connection therewith central banks and other financial institutions had to undertake a larger amount of exchange operations — partly to meet seasonal and other fluctuations. Trade financing is reaching normal proportions over a very large part of the world. Only in certain parts of Europe, some South American countries and latterly in the Far East are difficulties experienced. Clearings, of course, upset the legal relationships of importer and exporter and impair the normal financing mechanism. But serious efforts have been made during the past year to replace clearings by payments agreements, which, while regulating the volume of trade, restore direct relationships between traders and make more normal financing feasible.

In cases where difficulties still remain official help has been given to remove some of the uncertainties; the "Kurssicherung" of the Reichsbank is of long standing, but recently the Italian Government has given guarantees of exchange rates for transactions passing through the clearings: Germany, Czechoslovakia and other countries have given trade credits to the U.S.S.R. which assure the home exporter payment in his own currency. In some countries clearing debts have been taken over by the central bank and immediate payment made to exporters. The British Export Credits Guarantee Department of the Board of Trade (inaugurated already in 1926) increased its activities during the year, the value of guarantees which might be outstanding at any time being raised from £25 million to £50 million, while certain other restrictions were removed.

Year ended 31st March	Value of exports covered by guarantee £ millions
1933-34	7.5
1934-35	15.0
1935-36	20.6
1936-37	35.2
1937-38	43.0

If the outstanding volume of foreign trade acceptances in New York, London and Amsterdam remains at a low ebb, this is at least partly due to changes in the methods of trade financing and also to the fact that certain countries which used to borrow are now in a position to finance their own

trade. An effort to restore the foreign bill to its true function during the year was shown by the recommercialisation of part of Germany's standstill debt; although the amounts affected are comparatively small the change is a step in the direction of linking the credits up again to specific transactions.

The movement of other short-term international credits, not directly connected with trade, has generally been towards repayments of old credits by the debtors. New credits have been few and far between. A credit of £40 million granted by British banks to the French railway companies in February was repaid in December 1937 — while two advances of Sw. fcs 200 million and Fl. 100 million were obtained in Zurich and Amsterdam respectively in October and November 1937. In May 1937 a two-year credit of Sw. fcs 50 million was accorded by Swiss banks to the Czechoslovakian Post Office Savings Bank, the foreign exchange going to strengthen reserves of the National Bank of Czechoslovakia.

Repayments in general reflect the improved position of agricultural countries. The foreign short-term debts of the National Bank of Denmark were reduced from D. Kr. 70 million to D. Kr. 10 million during 1937 and the excess of indebtedness over foreign assets of D. Kr. 55 million in December 1936 gave way to a surplus of foreign assets of D. Kr. 62 million a year later — D. Kr. 31 million of the improvement being due, however, to the proceeds of a loan in London. In July 1937, the balance of Fr. fcs 39 million of the loan of Fr. fcs 250 million granted by the Bank of France to the Roumanian Government in 1932 was repaid and the gold pledged in Paris against the credit was repatriated to Roumania. In September 1937 an advance against gold previously granted by the Bank of France to another bank of issue, amounting to about Fr. fcs 1,000 million, was repaid and the corresponding item in the return of the Bank of France disappeared.

New foreign issues at long term remain generally at a low level although there has been a certain revival in Switzerland and the Netherlands. For facility of comparison the following table gives the foreign issues (converted

Foreign capital issues.

In U.S. \$ millions	U. S. A.	United Kingdom	Switzerland	Netherlands
New Issues				
1927	1,337	684	42	139
1928	1,251	720	18	121
1934	0	212	2	0
1935	48	104	0	0
1936	23	161	0	0
1937	4	164	44	16
Conversions				
1927	241	*	1	0
1928	238	*	0	0
1934	9	490	72	1
1935	26	351	0	0
1936	119	298	0	0
1937	159	274	16	44

* not available.

into U.S. dollars) in four of the creditor countries for the past four years, as well as for 1927 and 1928. The operation of the Johnson Act greatly restricts the possibility of new foreign issues in the United States. Conversion issues on foreign account were, however, the highest since 1930: as in 1936 the bulk of the conversion issues were for the Argentine and Canada.

In 1937 the London market remained subject to restriction with regard to new issues the proceeds of which would be remitted abroad. The effect of these restrictions may be appreciated from the official statement in June 1937 giving approximate figures of proposed new foreign issues coming before the Foreign Transactions Advisory Committee since its appointment in April 1936: the total approved was £37 million, of which it was proposed to remit about £10 million abroad, while issues for £31 million were refused, of which £29½ million would have gone abroad. New issues for British countries continued to be greatly in excess of foreign issues and in 1937 accounted for nearly 80 per cent. of the total given in the table. Empire and foreign conversion issues have declined somewhat from the high level of 1934 but remain substantial — in 1937 over 90 per cent. were for British countries. After the publication of the recommendations of the van Zeeland Report in March 1938, some relaxation was introduced into the regulations regarding new foreign issues.

Of the Sw.fcs 193 million new foreign issues in Switzerland, Sw.fcs 129 million were 2-year bills of the French railways (i.e. nearly \$30 million out of \$44 million), while a Belgian Government issue accounted for over 50 per cent. of the foreign conversions. Apart from the long-term foreign issues on the Dutch market, mention should be made of the credits granted by Dutch banks to the French railways for Fl. 150 million, of which two tranches of Fl. 50 million each were raised in 1937. In addition, issues for the Netherlands Indies are not included as foreign issues in the Dutch statistics. In September 1937 the Nederlandsche Bank lifted the embargo on foreign loans, but this ban was temporarily re-imposed as part of the preparation of the market for the big conversion operation of the government in January 1938.

Foreign issues for new money and conversion purposes have also been made in Sweden, mostly for neighbouring countries, but were insufficient to absorb the surplus on the Swedish current balance of payments. It may be mentioned that some issues considered as conversions by the borrower count as new money to the lender — as, for instance, the S.Kr. 18 million loan of the Oslo Gas and Electricity Works, made by a Norwegian municipality in Sweden to repay a \$4 million loan maturing in the United States.

Repayment of indebtedness to the principal creditor markets with the proceeds of loans raised in the internal market of the debtor, or from loans in the markets of the secondary creditor countries, has been a characteristic feature of recent years.

Repatriation of earlier foreign loans by the debtor countries either through private purchases or by the issue of an internal loan naturally weigh on their balances of payments and thus can only take place if a surplus is available. Reductions of foreign indebtedness of this nature have been carried out on a large scale by such countries as, inter alia, the Argentine, Belgium, Finland, Canada, India and South Africa. Where securities have already been repatriated in the past, advantage has been taken in some cases to make this reduction of foreign debt definitive by conversion into an internal issue. The Belgian conversion of 1935 and the Hungarian "nostrification" of 1936 are

examples, followed by Poland in 1937 with a $4\frac{1}{2}$ per cent. internal zloty loan covering about \$37 million of repatriated bonds, mostly bearing interest at 7 per cent.

In some other cases schemes for the alleviation of the burden of foreign indebtedness have been drawn up, often with the co-operation of some semi-official body in the creditor country. Of such a nature was the reduction of interest on Polish foreign loans in 1937, in general from 7 to $4\frac{1}{2}$ per cent., after negotiations with American, British and other creditors; in addition, the Swedish Match 1930 dollar loan was converted from a $6\frac{1}{2}$ to a $4\frac{1}{4}$ per cent. basis. Similarly a reduction was made in the interest of the two Danzig League Loans during the year from 7 to 5 per cent. and from $6\frac{1}{2}$ to $4\frac{1}{2}$ per cent. respectively, while the final maturity dates were deferred.

Further, a comprehensive plan covering the foreign indebtedness of Hungary was drawn up in 1937, superseding various earlier arrangements. A permanent settlement of the terms of the League $7\frac{1}{2}$ per cent. Reconstruction Loan, whereby interest was reduced to $4\frac{1}{2}$ per cent., further liability as regards the partly-paid coupons of the transition period was cancelled, and the maturity of the loan prolonged, was proposed by the debtor and supported by the League Loans Committee as "a serious offer from an honest debtor"; this offer was accepted by the great majority of bondholders. Other arrangements, mostly for a three-year period, were made as regards the remaining long and short-term indebtedness of the country in alleviation of the moratorium provisions hitherto in force. In each case the creditor was offered more than he had been receiving, but less than the original contractual rates. It is earnestly to be hoped that negotiations which have been in progress or are pending with other countries may lead to agreements which, while recognising the position of the debtor, may be accepted as just and equitable by the creditor.

The reductions of foreign indebtedness, whether through normal conversions and repatriations or through special arrangements, taken with the low level of new foreign issues in recent years, naturally result in a decline of the foreign investments held by the creditor countries. This is true particularly of England and the United States. The following table taken from the estimates of Sir Robert Kindersley illustrates the development as regards England:

£ millions	New* overseas issues	Foreign repayments and redemptions	Net foreign lending (+) or repayment (—)
1929	96	49	+ 47
1930	98	39	+ 59
1931	41	27	+ 14
1932	37	48	— 11
1933	83	67	+ 16
1934	63	42	+ 21
1935	51	81	— 30
1936	61	107	— 46

* These figures are specially compiled for the purposes of this table and differ somewhat from those given on page 68.

The rate at which repayments are out-distancing new issues has accelerated. Moreover, there has been over the period shown above a net movement of short-term capital towards England. The London funds of the sterling area countries shown in the graph on page 63 are now

some £100 million greater than in 1929. French holdings in London were high in 1929, but not higher than they are now. Meanwhile, England's short-term foreign assets are smaller — credits outstanding on account of foreign-trade financing are not as great as in 1929, while financial credits to central Europe and elsewhere are much lower. The tendency noticed already by the Macmillan Report in 1931 for London to "practice international deposit banking, as distinct from international acceptance business" and other commercial financing, has become more marked; the lending business is declining and the deposit business increasing, the resulting liabilities of the London market being largely short-term and covered by a high and sterile gold reserve.

The following table compiled from the statistics of the U.S. Department of Commerce shows a similar development for the United States:

\$ millions	New foreign issues	Foreign bond redemption and sinking fund	Net foreign lending (+) or repayment (—)
1929	631	199	+ 432
1930	822	173	+ 649
1931	212	207	+ 5
1932	27	122	— 95
1933	10	73	— 63
1934	0	89	— 89
1935	44	170	— 126
1936	20	166	— 146

Moreover, account has to be taken of the large influx of foreign capital into the United States in recent years and of a decline in the foreign short-term assets of American banks to less than half of the 1929 figures.

On the other hand, foreign securities held privately in some coun-

tries have been mobilised by the central authorities and sold from time to time to provide foreign exchange; and these sales have to a small extent counter-balanced the decline in the foreign investments of the creditor countries. The registration of all foreign values privately owned in Czechoslovakia was decreed in September 1934, followed by a conscription in favour of the State; sales of foreign bonds and shares have since been made from time to time, realising the equivalent of \$20 to 25 million. In Italy a mobilisation of foreign credits and securities and of Italian securities issued abroad was made by emergency decree in 1935; part of these securities has been realised but the amounts involved have not been published. Under the 1936 amnesty provisions in Germany foreign balances and securities amounting to the equivalent of several hundred million Reichsmarks, hitherto in the hands of German nationals, were handed over to the public authorities. Sales of securities on German account were made on foreign stock exchanges and shipments of gold into Germany for the three months ended February 1937 amounted to \$50 million. German imports of wheat were, however, exceptionally heavy in the spring and gold for about \$50 million was re-exported in the summer of 1937. German sales of American securities continued throughout the year 1937 but amounted to only \$10 million in all, while German balances with American banks, built up from a negligible amount to \$27 million in the first two months of 1937, declined later in the year.

Partly as a result of the difficulties of making statistical measurements of their volume, direct investments abroad do not receive the attention they deserve. Their importance, however, is beyond dispute. The carefully detailed estimates of Sir Robert Kindersley give a total of some £3,350 million as the amount of English foreign security investments, to which it has been suggested that at least £500 million should be added for direct investments, i. e. those which take place without the mediation of a security issue.

For the United States the figures are even more striking. Total foreign investments were estimated at around \$12,500 million at the end of 1936, of which \$4,750 million are in securities and \$7,750 million direct investments (book value). The investments in foreign securities are, however, largely offset by foreign holdings of American securities, while as regards the direct investments account has to be taken of only a small amount by foreign direct investments in the United States. The relative importance of the investments may perhaps best be judged by the income received from both classes: the U. S. Department of Commerce estimates the net receipt of income on "portfolio" account (i. e. deducting foreign income from American securities) at only \$24 million for 1936, compared with net income from direct investments amounting to \$295 million.

Direct investments are important not only for England and the United States but for many other countries also. As an example may be given Japan's recent investments in Manchukuo which averaged some Yen 250 million a year from 1932 to 1937 and have weighed heavily on the Japanese balance of payments.

The importance of direct investments in foreign countries has increased throughout the depression — in fact, the natural tendency has been somewhat accelerated as a result of trade and other restrictions. In many cases, where the import of certain goods has been prohibited or home industries given tariff protection, foreign concerns have directly, or through an affiliated company, built factories and provided the plant and equipment necessary to manufacture within the protected area. This type of investment gives direct employment in the country where it is made and arrangements have usually been concluded, where foreign exchange restrictions exist, for the transfer of a certain minimum amount of earnings. Surplus profits are re-invested and the investment grows by its own productivity.

Direct investments by foreigners and foreign holdings of shares — what may be called equity investments — have one great advantage over bonded investments in that they cause, as a rule, less strain on the balance of payments of the debtor country. In periods of depression, when the profits of industrial and other undertakings are shrinking, the amount to be transferred will decline and the balance of payments thus be almost automatically relieved. For example, the relative facility with which the balance of payments of the Netherlands Indies, a primary producing country, adapted itself in the depression of 1929-33 is undoubtedly connected with the fact that the foreign investments in this country were largely of an equity character.

In spite of all the difficulties which have beset international relations in recent years, there has been an increase in direct investments and in the volume of trade financing. Business is thus being extended abroad wherever opportunities present themselves. There is a curious contrast between the advance in international financing, which is predominantly of a private character, and internal financing in different countries, which is largely for the account of governments.

New foreign borrowing by public bodies is still conspicuous by its absence, although conversions have been carried out on a large scale. There has been some lifting of the obstacles that in recent years prevented foreign issues' being made in important creditor markets. Confidence has been shaken, however, by new defaults in 1937 in respect of debt agreements recently concluded (as in the case of Brazil) and by the decline in the quotations of the foreign bonds of countries in the Far East and in central Europe. These shocks naturally hamper any revival of foreign issuing activity. Such hopes of an improvement in the basic conditions of international financing as may be felt are intimately connected with a continued recovery in foreign trade.

V. TREND OF INTEREST RATES.

The general trend of short-term interest rates remains downwards. During the past year bank rates have been reduced in several countries and in others the rates remain very low. In some cases these exceptionally low rates have now been maintained for a very long time, in the case of England for six years. The stability of these low rates is the more remarkable when it is considered how greatly conditions have changed since they were first introduced. Only in France was bank rate a little higher on balance in 1937, and in no other country was bank rate changed more than once during the year.

In the first half of 1937 there was a check to the downward tendency of long-term rates in London and New York with, however, some improvement in the quotations of government securities during the latter half of the year. In the special conditions pertaining to France long-term interest rates still remain very high. Elsewhere long-term rates are generally steady at low levels or are still declining. Particularly in Switzerland and Holland, where there has been a large influx of capital, has the downward movement been very pronounced.

1. SHORT-TERM MARKETS.

The following table indicates the official discount rates of European central banks in force at the end of 1937 and of March 1938 compared with earlier years:

Discount rates of European central banks	Lowest 1925-1929	End 1935	End 1936	End 1937	Change in 1937	End March 1938 (d)
1. Rates reduced in 1937						
Danzig	5½	5	5	4	-1	—
Poland	8	5	5	4½	-½	—
Albania	9	7½	7	6	-1	—
Greece	7½	7	7	6	-1	—
2. Rates unchanged in 1937						
Switzerland	3½	2½	1½	1½	—	—
Belgium	4	2½	2	2	—	—
England	4	2½	2	2	—	—
Netherlands	3½	2½	2	2	—	—
Sweden	3½	2½ (a)	2½ (a)	2½ (a)	—	—
Czechoslovakia	5	3½	3	3	—	—
Austria	6	3½	3½	3½	—	(3½) (e)
Denmark	5	3½	4	4	—	4 (a)
Hungary	6	4	4	4	—	—
Finland	6	4	4	4	—	—
Germany	5	4	4	4	—	—
Norway	4½	3½	4	4	—	3½ (a)
Estonia	7½	4½ (b)	4½ (b)	4½ (b)	—	—
Italy	5½	5	4½	4½	—	—
Portugal	8	5	4½	4½ (a)	—	—
Roumania	6	4½	4½	4½	—	—
Latvia	6 (c)	5½ (c)	5 (c)	5 (c)	—	—
Spain	5	5	5	5	—	—
Yugoslavia	5½	5	5	5	—	—
Lithuania	7	6	5½	5½	—	—
Bulgaria	9	6	6	6	—	—
3. Rates increased in 1937						
France	3½	6	2	3	+1	—

(a) ½ per cent. lower for rediscounts of banks.
(c) ½ per cent. higher for private firms.
(e) last rate quoted by Austrian National Bank.

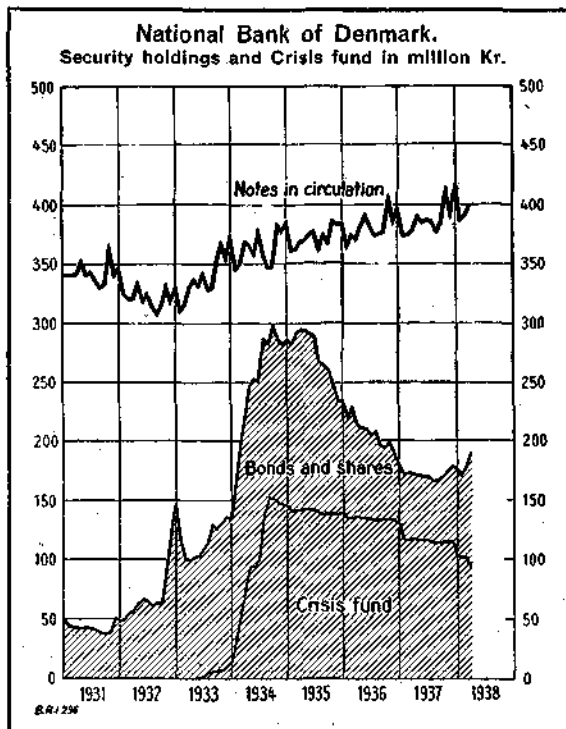
(b) ½ per cent. lower for bankers' acceptances.
(d) where changed since the end of 1937.

Of the twenty-six countries included in the table, twenty-one made no change in their official discount rates during the year, four made reductions and in only one, France, where special conditions obtained, was the discount rate increased on balance over the year. The reductions in official discount rates shown in the table for 1937 all related to rates previously over 4 per cent., and in general reflected the improved external position of the countries concerned. In Portugal a rediscount rate was quoted from August 1937 $\frac{1}{2}$ per cent. below the usual discount rate. In addition, mention should be made of the decrease by the National Bank of Roumania in the rate for loans against public securities from $5\frac{1}{2}$ to 5 per cent. while the official discount rate remained unchanged at $4\frac{1}{2}$ per cent. Furthermore, the central banks of Denmark and Norway, two countries which experienced a check to the downward trend of rates in 1936, benefited particularly from improved shipping earnings in 1937 and were able to lower the price for credit facilities on their respective markets in the first quarter of 1938.

Although in Norway deposits in the savings banks are diminishing or stagnating, the badly assessed tax on deposits still remaining in force, there was some increase on deposits with the commercial banks and the bond market was firmer. In these circumstances the official discount rate, which had been increased by $\frac{1}{2}$ per cent. to 4 per cent. in December 1936, was reduced by a similar amount in January 1938 to $3\frac{1}{2}$ per cent. In addition, the Norges Bank agreed to rediscount for the banks genuine commercial bills endorsed by them at $\frac{1}{2}$ per cent. below the usual discount rate (a facility similar to that which has been available in Sweden for some years past). The National Bank of Denmark, while maintaining a 4 per cent. official

bank rate, also introduced, from the beginning of March 1938, a rate $\frac{1}{2}$ per cent. below the usual discount rate for rediscounts by the banks. Already in 1937 the National Bank had been able to ease up its bond-selling policy of the past few years, as illustrated in the accompanying graph. As, however, discounts and advances were reduced, the total volume of central bank internal credit outstanding fell from D. Kr. 492 million at the end of 1936 to D. Kr. 449 million at the end of 1937.

The exception to the general tendency of interest rates found in France reflects the uncertainty on the French money and capital markets manifested in the frequent effluxes of capital at a time when heavy public borrowing for arma-

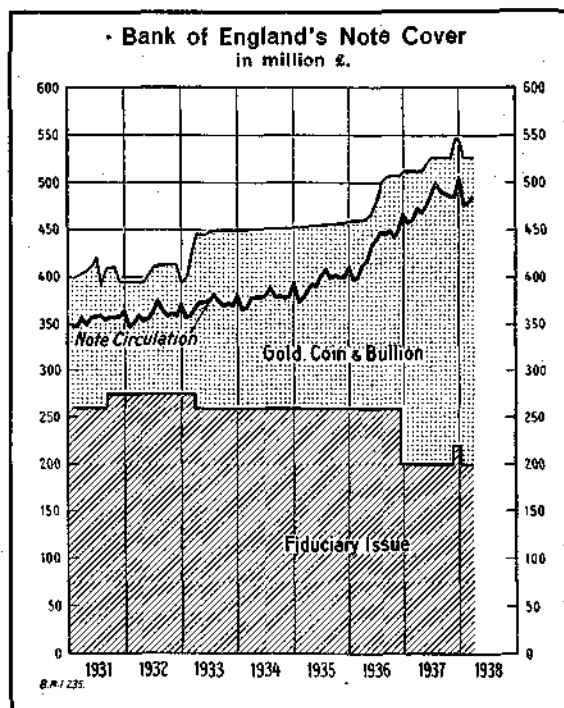


ment and other purposes is necessary. In the circumstances that prevailed the government was again forced to have recourse to the Bank of France, over Fr.fcs 14,000 million being obtained by advances from the Bank in 1937, a figure lower, however, than in 1936. In the first three months of 1938 a further Fr.fcs 6,500 million has been utilised. The liquidity of the market has not been increased by these advances, the new money created being offset by the outflow of funds and the resultant exports of gold. In spite of the considerable rise in prices in the country, the total credit items of the big Paris banks (bill portfolio, advances and overdrafts) increased only from Fr.fcs 26,250 million in December 1936 to Fr.fcs 27,150 million a year later; and an increase in the lending of the Bank of France to others than the government by about Fr.fcs 1,000 million over the year could do but little to relieve the penury of private credit.

In the other countries included in the table above no change was made in the rates for discounts and advances quoted by the central banks. This negative fact is in itself of some significance, considering the wide movements of prices and in economic activity which occurred during the year, and also the increased volume of government financing in most countries. But if rates have remained stable, other tendencies of considerable interest have made themselves felt in the credit conditions of the different markets.

The Bank of England's official discount rate has remained unchanged at 2 per cent. since June 1932. Market rates in 1937 continued at extremely low levels, the average tender rate for Treasury bills being 0.56 per cent. compared with 0.58 per cent. in the previous year. An interesting development in 1937 was revealed by the fact that bank rate did not become effective even at the half-yearly settlements. Such a thing has not happened since the early

'seventies except for the abnormal war years 1916-18. The principal reason why the market was not forced to borrow at the Bank was the perfected technique of tendering for Treasury bills payable at times when tightness would otherwise occur; in this way the burden was shifted on to the Treasury, which in June and December 1937 had to borrow some £50 million at the Bank of England owing to the running-off of maturing Treasury bills. The end of the year 1937 was also interesting as being the only occasion when the Bank of England's fiduciary issue has been raised temporarily to cover a seasonal movement of the note circulation: the total fiduciary issue



was increased on 17th November 1937 from £200 million to £220 million, reverting to £200 million on 19th January 1938.

The demand for short-term employments of funds has greatly increased in recent years. The deposits of ten London clearing banks, against which is maintained a backing of about 20 per cent. in short-term assets in addition to 10 per cent. in cash, have risen from £1,840 million in December 1929 to £2,270 million in December 1937. Moreover, the amount of "outside money", i. e. largely the liquid funds of foreign banks in London, has increased considerably over the past few years and is now at a very high level. Employment for short-term banking funds is found principally in Treasury bills and bankers' acceptances. The latter have declined, owing chiefly to changing methods of financing world trade; it is estimated that the total outstanding was reduced from over £300 million in 1929 to less than half that amount in 1937, and, although the total of all Treasury bills outstanding as given in the official returns has not varied considerably, an analysis of the component parts shows that a real contraction has taken place.

Analysis of Treasury bills outstanding.

At 31st December (in £ millions)	1929	1930	1931	1932	1933	1934	1935	1936	1937
Total Treasury bills	780	690	665	928	939	900	866	766	890
Deduct bills issued on account of:									
Current budget deficit*	170	181	204	205	98	110	114	139	173
Exchange Equalisation Account	—	—	—	150	350	350	350	350	550
Remains: other Treasury bills outstanding	610	509	461	573	491	440	402	277	167
Yearly increase (+) or decrease (—) in other Treasury bills outstanding .	-40	-101	-48	+112	-82	-51	-38	-125	-110

* including New Sinking Fund 1929—1932.

The issue of Treasury bills on account of the current budget deficit is due to the concentration of direct taxation receipts in the period January to March (the last three months of the budget year), which necessitates temporary borrowing in earlier months. If the bills covering the current deficit and those issued to the Exchange Equalisation Account be deducted from the total of outstanding Treasury bills, the amount remaining represents, apart from variations due to other forms of temporary borrowing such as "ways and means" advances and other minor factors, the unconsolidated residue from past budget deficits dating mostly from the war period. As a result of the steady compression shown in the table, the total of "other" Treasury bills outstanding fell by £443 million from 1929 to 1937. £235 million of this reduction was made in 1936 and 1937, chiefly as a result of the issue of

two government loans of £100 million each, the $2\frac{3}{4}$ per cent. Funding Loan in November 1936 and the $2\frac{1}{2}$ per cent. National Defence Bonds in April 1937. The first loan was a pure consolidation issue; the second was made for rearmament purposes in advance of this expenditure so that its first effect was a reduction of Treasury bills outstanding (while an inverse movement occurs as the money is gradually spent).

Thus in spite of the issue of £550 million to the Exchange Equalisation Account, the total of Treasury bills outstanding is only £110 million higher over the 8-year period. The increase of bills on the market is in fact not so great, as some of the bills of the Exchange Equalisation Account remain unissued in the Account. The total of outstanding Treasury bills issued "by tender" rose only from £573 million in December 1929 to £620 million in December 1937. As a rough approximation, the aggregate supply of bankers' acceptances and Treasury bills available for the market has been reduced from £900 million in 1929 to perhaps £750 million in 1937.

The dearth of short-term banking investments on the London market is due, therefore, to a curtailment of the supply of bills (the result chiefly of the scarcity of acceptances and the government's long-term policy of consolidating the floating debt), and an increase in the volume of funds available for this type of investment. These conditions have not been without their influence on the clearing banks as the following table, giving the movements of the chief items in their balance-sheets, shows:

London Clearing Banks - in £ millions.

Number of banks	End of year	Total deposits	Cash, at call and bills discounted	Advances	Investments
10	1935	+ 108	+ 60	+ 24	+ 18
10	1936	+ 150	+ 38	+ 72	+ 29
11	1937	+ 20	- 50	+ 95	- 24

In spite of the vigorous increase in advances (to the highest level since mid-1930) the long-term rise in the total deposits of the banks has been slowed up and investments show the first decrease on the year since 1931 (which may be, in part at least, due to a writing-down of values). Competition amongst the banks for deposits has become keener during the year and one of the "big five" accounts for over half of the increase shown for 1937 above (while four of the eleven clearing banks report decreases of deposits on the year). Early in 1938 the Bank of England expanded its holding of government securities. This, together with other factors, resulted in an increase of £20 million on the average of the first quarter of 1938 in the bankers' reserve balances with the Bank of England, compared with the corresponding period of 1937. In the absence of an expansion of the clearing banks' total assets this change was reflected merely by an increase in the cash ratio.

Apart from England, the European countries which have the lowest official and market rates of interest are Switzerland, with an official discount rate of $1\frac{1}{2}$ per cent., the Netherlands and Belgium with rates of 2 per cent., and Sweden with a discount rate of $2\frac{1}{2}$ per cent. and a rediscount rate for banks of only 2 per cent. In the Netherlands the market rate for three months' bankers' acceptances is down to $\frac{1}{8}$ – $\frac{1}{4}$ per cent., and in Switzerland to 1 per cent. In Belgium commercial paper of one to three months' currency was harder at 1.7 per cent. at the end of the year, after having been at 1 per cent. until September, the increase reflecting the tighter position on the market, which continued in the first quarter of 1938. End-of-year payments were, however, easily met owing to the return flow of capital brought about by maturing forward exchange contracts. In Sweden, where no money market exists outside the banks, the rate for three months' commercial paper is $2\frac{1}{2}$ per cent., but a few years ago, when special issues of Treasury bills were made, rates of less than $\frac{1}{2}$ per cent. were quoted.

The increased liquidity of the markets in the Netherlands and Switzerland has been the result primarily of a large inward movement of funds, partly home funds previously held abroad and partly capital owned by foreigners. On the other hand, very little foreign money would appear to be held in Belgium, such movements as have occurred in recent years having largely counterbalanced each other. In Sweden, finally, the increases in the gold and foreign exchange holdings of the central bank are mainly the result of a substantial surplus on the current account of the balance of payments. Some offsetting through the sale of government securities has been done by the exchange equalisation fund in the Netherlands, but it has affected only a minor part of the inflow of funds and in none of the other three countries is any offsetting mechanism in existence. In these circumstances the influx of funds goes directly to increase the deposits of the commercial banks and their cash reserves at the central bank, so that the latter is able to neutralise the influx only in so far as it can reduce its own internal credit outstanding. The table on the next page illustrates in comparison with 1929 the growth of note circulation and "other sight liabilities" as well as changes in internal credit granted in the four countries.

The bulk of the "other sight liabilities" in each case represents the cash reserves of the commercial banks; in Sweden and Switzerland the reduction of internal credit seems to be attaining the limits of compression; as regards the internal credit volume of the Nederlandsche Bank, the figures for 1935–37 are swollen by the inclusion of a loan to the Netherlands Indies (Fl. 66 million at the end of 1937) and of some other items not actually representing an extension of credit to the market.

In all four countries powers to undertake open-market operations are of little value for the time being as it is a reduction of central bank credit that is called for, and none of the central banks is in possession of large amounts of government securities available for sale on the markets. Increased powers of control have lately been given to the Sveriges Riksbank but have not yet been put to practical use. In the first place the Riksbank is permitted

Certain Items from Central Bank Returns.

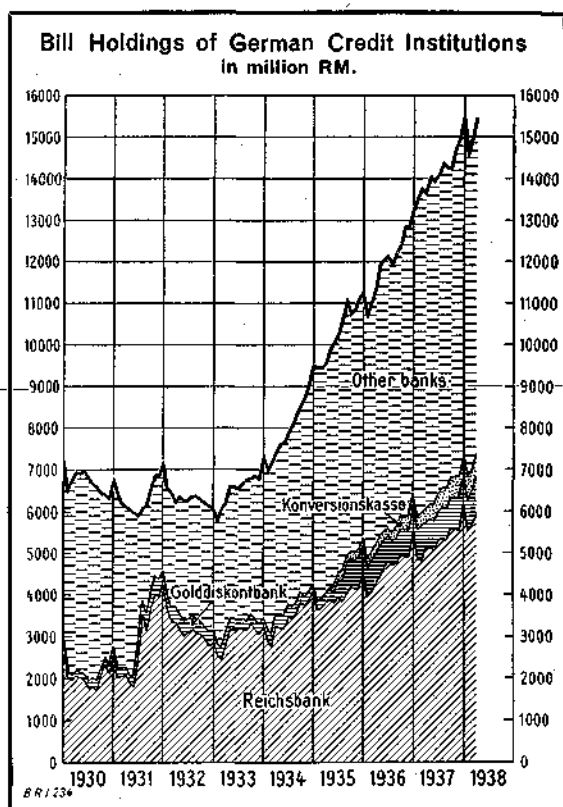
In millions of national currency	At end of year			
	1929	1935	1936	1937
Nederlandsche Bank				
notes	851	809	792	868
other sight liabilities	34	51	310	755
internal credit	208	212	383	258
Swiss National Bank				
notes	999	1,366	1,482	1,531
other sight liabilities	200	401	1,363	1,716
internal credit	270	452	125	96
Sveriges Riksbank				
notes	569	786	893	980
other sight liabilities	274	384	594	780
internal credit	434	83	83	59
National Bank of Belgium				
notes	13,437	20,637	22,452	21,460
other sight liabilities	1,075	4,897*	4,651	3,939
internal credit	**	**	3,331	3,279

* On 28th March 1935, i. e. just before the devaluation of the Belgian franc, total other sight liabilities amounted to only B.fcs 1,055 million, about the same figure as at the end of 1929.

** Comparable figures for 1929 and 1935 cannot be calculated from the published returns.

to pay interest on all deposits (instead of on time deposits only, as previously); this power might be used to draw money into the central bank from the market. In addition, the Riksbank may prescribe for the commercial banks a cash reserve up to 25 per cent. against sight commitments. In each of the four countries the commercial banks have comparatively little opportunity for the time being of extending their credit, as the demand for industrial and commercial advances is lacking, and the banks show great hesitation in adding to their other investments. The large balances they have accumulated at the central banks thus remain almost wholly unused.

While in Germany bank rate has been maintained unchanged at 4 per cent. since the decrease in September 1932, the market rate for daily money has declined, the average rate in 1936 being 3 per cent. and in 1937 slightly over $2\frac{3}{4}$ per cent.; in April 1937 the rate fell temporarily to below 2 per cent., the lowest level since 1914. The aggregate bill portfolio of the Reichsbank and its affiliates increased from RM 3,000 million early in 1933 to around RM 7,500 million at the end of 1937, while rediscounts as shown by the endorsement liabilities of the commercial banks have greatly declined. As during the same period the total amount of bills held in the banking system rose from RM 6,000 million to over RM 15,000 million, the share of the Reichsbank and its affiliates in the total thus remained around 50 per cent. In these statistics as well as in the graph the Solawechsel issued by the



Golddiskontbank have been deducted from the amount of bills held by this bank, in order to avoid double counting. These one-name bills are issued by the Golddiskontbank chiefly to the commercial banks, in order to mop up their liquid funds, and the proceeds are utilised to take bills over from the Reichsbank's portfolio, thus utilising to the greatest possible extent the available resources of the market.

The Golddiskontbank undertakes in this way an indirect form of open market policy for the Reichsbank and the amount of the Solawechsel in circulation is the best barometer of market conditions in Berlin.

The volume of Solawechsel outstanding increases with the liquidity of the market; decreases are intimately connected with issues of Reich consolidation loans, which in the past three years have amounted to some RM 9,500 million.

There have been some fundamental changes in the structure of the Berlin money market, especially since 1933, short-term bills having become more and more the characteristic type of credit, while bank loans and advances have decreased sharply. This is illustrated by the movement of the principal items from the published returns of the large Berlin banks. (See table on the next page.)

German Golddiskontbank Solawechsel	1935	1936	1937	1938
	in million RM			
January	-	629	700	498
February	-	716	1,185	561
March	-	750	1,082	767
April	-	862	1,240	
May	202	655	1,141	
June	358	716	993	
July	546	396	906	
August	651	71	622	
September . . .	495	30	512	
October	492	406	604	
November . . .	701	463	951	
December . . .	701	400	763	

The reduction of the combined balance-sheet total from over RM 12,000 million in 1928 to RM 8,000 million in 1937 is largely due to the gradual elimination of foreign items. If account be taken of the decline in the price level since 1928, it appears probable that the difference between the home credits granted then and at the present time is not so great as at first appears. The bill holdings of the big Berlin banks have more than doubled since 1933, while the aggregate bill holdings of the banking system have about trebled,

Large Berlin banks	1928	1932	1936	1937
	End-of-year figures in million RM			
Total of balance-sheet	12,298	8,803	7,653	8,071
Cash	422	254	257	256
Bills and cheques	2,579	1,221	2,069	2,620
Treasury bills etc.	152	479	442	407
Securities	285	791	996	998
Advances and loans	4,910	4,382	3,132	3,012
Reimbursement credits	1,419	901	193	190
Deposits (total)	10,654	7,326	6,342	6,781

the Provincial and State banks and Girozentralen having taken proportionately more. In 1936 there was an increase in the volume of bills of longer maturities than the usual three months: such bills held by the five large Berlin banks increased from 5 per cent. of their total bill holding at the end of 1935 to 32 per cent. at the end of 1936. By the end of 1937 this percentage had fallen to 24 — there being some reduction in the absolute volume of the longer bills held, while their total bill holding increased by 27½ per cent.

In Italy bank rate has remained unchanged at 4½ per cent. but a certain tension has been experienced on the open market as shown by an increase in the Milan private discount rate for 4 months' commercial bills from 4½–5 per cent. in June to 5–5½ per cent. in July 1937. There has been an increased credit demand by trade and industry in general, the total amount of advances from the banks mainly for industrial and commercial purposes having risen from Lit. 27,100 million in August 1936 to Lit. 29,800 million in June 1937. On the other hand, savings deposits held at the credit institutions rose from Lit. 68,900 million at the end of 1936 to Lit. 72,100 million at the end of 1937, the net increase over the year being Lit. 3,200 million as compared with an increase of Lit. 7,400 million during 1936. The annual report of the Banca d'Italia for 1937 explains that, "in the conditions prevailing over the year, funds which during the depression tended to flow into bank deposits were directed into industrial investments or government securities. As a matter of fact, in 1937, while the increase in deposits has been less marked than in the preceding year, private issues have increased and at the same time the State has placed on the market an important amount of Treasury bills". The funds obtained by the Government in these and other ways have permitted a reduction in the State's advances from the Banca d'Italia by Lit. 2,000 million to Lit. 1,000 million during the year 1937.

In other European countries market conditions have also remained relatively easy. Bank rate in Finland, for example, which is quoted at 4 per cent., does not give an adequate indication of conditions on the market, which may be better appreciated from the fact that no rediscounts for the commercial banks have taken place for 4½ years, in a country where the banks are normally always indebted to the central institution (at times heavily, owing to the marked seasonal movements of trade).

Outside Europe also, short-term interest rates have been maintained at exceptionally low levels. As mentioned in last year's Annual Report, none of the new central banks in overseas countries, i. e. Canada, New Zealand, India and the Argentine, had then rediscounted a bill for its member banks and this remains true for 1937 also.

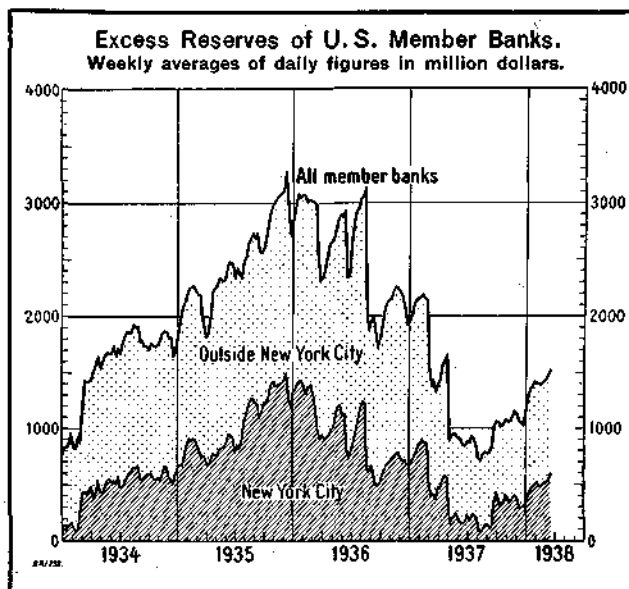
In the United States reductions were made on 21st August 1937 in the discount rates of the Federal Reserve Banks at Atlanta and Chicago from 2 to $1\frac{1}{2}$ per cent., and a week later in that of the New York Reserve Bank from $1\frac{1}{2}$ to 1 per cent. Although this latter rate is the lowest ever quoted by a central bank, the reduction was of relatively little importance as the buying rate of the New York Reserve Bank for 90-day bankers' acceptances, which more closely corresponds to the official bank rate in Europe, remained unchanged at $\frac{1}{2}$ per cent., to which it was reduced in October 1933. It was hoped, however, that, as a result of reducing the discount rates of the Reserve banks, the member banks would if necessary turn to them to borrow rather than sell securities. To understand the deeper significance of the changes in discount rates of the various Federal Reserve districts in 1937 (by 4th September the rates in all districts outside New York were down to $1\frac{1}{2}$ per cent.), it is necessary to examine the development of the position in New York. The commercial banks in this centre are much more sensitive than the banks in the interior of the country to the influence of Federal Reserve policy (changes in discount rate, in reserve requirements and open-market operations), as well as to gold movements and the operations of the Federal Treasury. For a number of years the complex movement of funds to and from New York (which may be called the capital account of the balance of payments of New York as a centre) had been consistently favourable to New York. Thus, from 1934 to 1936 the New York banks steadily gained reserves from gold imports. During the same period there were considerable withdrawals of funds from New York as a result of the operations of the Federal Treasury; in particular, funds raised in New York through sales of government securities to cover the budget deficit were spent by the government largely in other parts of the country, thus shifting reserves from New York to outside banks. But this movement was partly offset by the redeposit of surplus cash by country banks with their New York correspondents. From 1934 to 1936 the balance of the three factors mentioned was consistently towards an increase in the reserves of the New York banks. In 1937, however, this favourable balance of payments of New York was upset for a number of reasons and became very adverse in the first half of the year.

The Treasury policy of sterilising gold in the inactive account inaugurated in December 1936 reversed the effect of gold imports on the reserves of the New York banks; deposits at the banks were increased by the amount of the gold influx but no addition was made through this influx to their reserve balances, so that the gold imports actually exercised pressure on their cash ratios. Furthermore, the increase in the required reserves of all member banks, which was completed by the doubling of the original requirements from 1st May 1937, had a two-fold effect on the New York banks. In the first place,

It caused a large withdrawal of surplus reserves previously deposited in New York by the country banks (in the first half of 1937 New York lost nearly \$500 million of these inter-bank deposits). Secondly, the direct effect on the New York banks was greater than on banks in other parts of the country, because their demand deposits (against which a 26 per cent. reserve was to be kept) are more than ten times as great as their time deposits, which everywhere needed only a 6 per cent. reserve; for other large centres (Chicago and the Reserve City banks) demand deposits are only twice as large, and in the country time deposits actually exceed the volume of demand deposits:

U. S. member bank deposits and required reserves. December 1937	Deposits			Required reserves
	net demand	time	total	
	in million dollars			
New York	8,866	770	9,636	2,351
Chicago & Reserve City Banks . .	10,062	4,974	15,036	2,425
Country banks	4,932	5,696	10,628	1,032
Total	23,860	11,440	35,300	5,808

As New York City banks do not hold any important balances with correspondents, they must meet withdrawal of funds by using their own reserves, by the liquidation of assets, or by borrowing. During the first half of 1937 they resorted to all three of these courses. In May, June and July individual

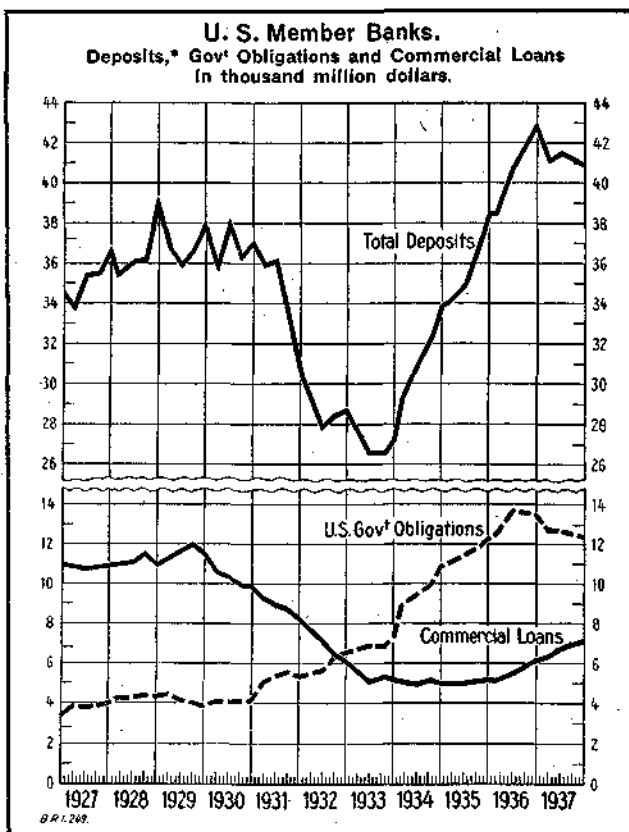


banks were forced to borrow Federal funds and by the middle of August the position had become particularly acute, the reserve balances held by all New York banks being less than 3 per cent. in excess of requirements (as compared with 40 per cent. in the earlier part of the year). Meanwhile these banks continued to liquidate investments as they had done on balance since the middle of 1936, and by September 1937 their holdings of government securities had fallen below \$2,800 million, the lowest level since the middle of 1934.

Relief came to New York in the second half of the year in a number of ways. Borrowing by the Federal Treasury to obtain new money ceased on balance as the remaining budget deficit was covered mainly by an accumulation of funds on the Old Age Reserve Account and the Unemployment Trust Fund (see

table on p. 90). Further, an attempt was made to relieve New York from a flow of funds to the interior in the autumn to finance the movements of the crops. This was the main reason for the reduction in the discount rates of the Federal Reserve banks at Atlanta and Chicago, as explained in a statement by the Board of Governors, viz. "... The reduction of the discount rates in the two large agricultural districts of Atlanta and Chicago should serve to assist the member banks to utilise credit directly available in these districts in order to meet banking requirements in connection with crop movements and business needs ..."

Of more importance, however, was the desterilisation in September 1937 of \$300 million gold, a proportion roughly corresponding to the cash needed by the banks to support the increase of deposits due to gold imports allocated to the "inactive account", and the purchase of \$38 million government securities by the Reserve banks in November 1937. (\$95 million had previously been bought in April 1937 during the transition to the higher reserve requirements.) In comparison with the large measure of sterilisation and contraction resulting from the reduction by \$3,000 million in excess reserves and the placing of \$1,400 million in the "inactive account", the relaxation allowed in the autumn of 1937, in volume less than 10 per cent. of the amount previously neutralised, appears very moderate.



* i. e. gross deposits. The total given in the table on the previous page is lower as reserve requirements are calculated on net demand and on time deposits.

By October a distinct easing of the position was noticeable and the excess reserves of the New York banks rose to \$400 million. The recession in business brought a reflux of currency and a decline in commercial loans, probably as a result of the running-off of business inventories, while the fall on the stock exchange caused a repayment of brokers' loans. Some country bank balances returned to New York and in November the security holdings of the New York banks increased considerably after the long period of liquidation.

In February 1938 a new step to ease the credit situation was taken with the decision to desterilise gold received up to a maximum of \$100 million a quarter. By the further decision of

April 1938, mentioned on p. 57, the whole sterilisation policy was abandoned and a cut was made in the legal minimum reserve requirements of the member banks. Excess reserves of all member banks rose immediately to \$2,500 million in mid-April 1938 and when desteralisation is completely effective it is estimated that they will attain \$3,800 million, an amount well above the highest levels of 1935-36.

The expansionist programme now adopted must be seen against the background of developments in 1937, when the total deposits of the member banks (excluding inter-bank deposits) declined slightly after the rapid increase of the preceding three years. The check in the growth of bank deposits which thus occurred was largely due to the decrease by \$1,850 million (for the first time since 1929) in the total volume of government and other securities held by all member banks, the purchases of government securities in the previous three years having been the principal cause of the rapid rise in deposits.

Open Market Rates in New York City.

Average for year in percentage per annum	4-6 months' commercial paper	90-days' bankers' acceptances	Stock exchange call loans
1935	0.76	0.13	0.56
1936	0.75	0.15	0.91
1937	0.95	0.43	1.00

Interest rates in the open market showed a slight tension in 1937, especially in the first part of the year, but nevertheless remained very low. One reason for these low rates is the scarcity of material on offer compared with

the increased volume of funds available for short-term employment. The following table shows the bulk of the available short-term employments of money.

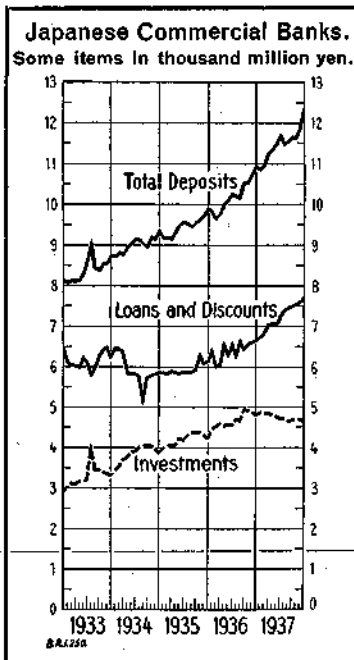
United States - Short-term Money Employments.

At end of year in \$ millions	1928	1937
U. S. Government notes	2,817	10,547
certificates	2,045	—
bills	—	1,952
Total	4,862	12,499
Commercial paper	383	279
Bankers' acceptances	1,284	343
Call money on stock exchange . . .	6,440	688
Grand Total . . .	12,969	13,809

The total has, indeed, risen slightly from about \$13,000 to \$13,800 million but the composition has greatly changed, government paper now predominating while call money has shrunk to little over one-tenth of its former volume.

The credit position in Japan like that of several other countries has been dominated in

recent years by government deficit borrowing, largely absorbed by the banks. As a result of the more pronounced industrial activity and the rise of prices in 1936, the banks sharply increased their industrial and other loans, and then began to curtail their holdings of government securities. The graph shows the changes thus effected in the combined balance-sheets of the Japanese commercial banks.



In the middle of 1937 occurred the incident in North China which was followed by the outbreak of hostilities. A little later the Japanese Government announced its budgetary programme including large allocations for military expenditure to be covered by bond issues. A period of stringency developed in the market and the day-to-day loan rate rose sharply.

The Bank of Japan, in co-ordination with the government, then undertook a series of emergency measures. The Bank's lending rate for loans and discounts with government bond collateral was lowered to 3.29 per cent. — equal to bank rate for rediscounts of commercial bills (which remained unchanged). As the Tokio banks borrow in this way rather than by rediscounting, the effect was very similar to a decrease in bank rate and facilitated the absorption of new government issues. In August the Bank acquired some government securities in the open market and in addition made loans

through the Industrial Bank of Japan. On 25th August the gold stock was revalued and part of the revaluation profit used to take up government issues. As a result of these measures the market was eased in September and by October day-to-day rates had declined to the lowest level for over four years. In March 1938 the Bank of Japan's rate for loans and discounts with collateral other than government bonds was also decreased.

Bank of Japan Lending Rates in Percentages.

Dates of changes	Rediscounts of commercial bills	Loans and discounts with govt bond collateral	Loans and discounts with other collateral
1931, 5th November	6.57	6.94	7.30
1932, 12th March	5.84	6.21	6.57
8th June	5.11	5.48	5.84
18th August	4.38	4.75	5.11
1933, 3rd July	3.65	4.02	4.38
1936, 7th April	3.29	3.65	4.02
1937, 15th July	3.29	3.29	4.02
1938, 12th March	3.29	3.29	3.46

In China, a form of banking restriction was introduced, first in Shanghai and later in other centres, after the outbreak of hostilities in August 1937. After the bank "holiday" when all the banks were closed withdrawals were limited to a small proportion of the amount of deposits. Liquid funds were thus largely immobilised and an artificial stringency brought about. Operations entailing the change of ownership of deposits were permitted so that there were two types of circulating media in existence at the same time,

the notes of the government-controlled banks available for all purposes and the "clearing" money or bank balances with restricted uses (called by the Chinese name of "Wei-wah"). These measures, although leading to serious difficulties for what business remained in the war area (particularly as a discount appeared on the "clearing" money), proved of assistance with the other steps taken to protect the exchange value of the Chinese dollar. On the whole, the waging of war on a large scale in the East has so far had less effect on the credit systems of the two countries concerned than might have been expected.

From a credit point of view, the year 1937 is indeed remarkable in this and other parts of the world primarily for what did not happen. The recovery of the previous years crested into a speculative boom in the spring, followed by a period of uncertainty in the summer and a decline in the winter, and throughout this period many bank rates (and even market rates) gave no flicker of recognition of the changes in business conditions. The immobility of certain bank rates is exemplified by the following table:

Central Banks' Discount Rates.

Country	Official discount rate	Last change	Number of months unchanged (to March 1938)
England	2	June 1932	69
Germany	4	Sept. 1932	66
Sweden	2½	Dec. 1933	52
Finland	4	Dec. 1934	40
Roumania	4½	Dec. 1934	40
Yugoslavia	5	Feb. 1935	38

In part the maintenance of relatively low rates reflects a long-trend change in the general interest level as determined by the supply of and demand for capital. Even during the most pronounced period of business activity in the winter of 1936-37, private investment in a number of countries never rose

to a volume at all comparable with that attained, for instance, in 1927-28. The creditor countries are in possession of large and increasing monetary reserves, while opportunities for foreign lending are relatively small. Their markets are characterised as a rule by a vast volume of funds seeking short-term investment and at the same time by a contraction in the volume of commercial bills and other securities suitable for such investment. While certain speculative tendencies connected with the abundance of cheap money were observable in the early months of 1937, the caution generally observed by credit institutions and, indeed, by the public itself — to some extent unfortunately the result of fears and hesitations — made it appear less urgent to take steps which would in any way prejudice the cheap money policy.

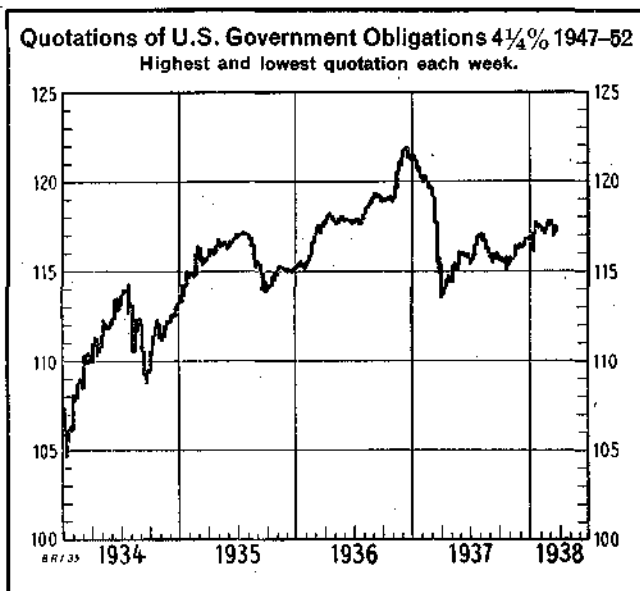
2. LONG-TERM MARKETS.

While in 1937 very little change is found in the price of short-term credit, some rather important fluctuations occurred in long-term interest rates as represented particularly by the yield obtainable on long-term government

securities. Broadly speaking, the year may be divided into two parts: during the first half long-term interest rates showed a distinct upward tendency; in the second half the movement was reversed and government securities tended to find firmer ground. In the first part of the year gilt-edged securities had to compete with a growing demand for capital for industrial and other purposes, while in the second half the recession which appeared in the United States and spread to other countries tended to cause some switching from industrials into government securities.

These generalisations are of course of unequal significance in different countries and to obtain a clearer idea of the history of the year it is necessary to examine in some detail the more important capital markets in which developments of particular interest took place.

The sharp fall that occurred in the quotations of United States government securities during the first quarter of 1937 can be seen from the example given in the graph. The average yield of government bonds (according to



Standard Statistics Co.) increased from 2.27 per cent. in December 1936 to 2.67 per cent. in September 1937, from which it declined again to 2.54 per cent. in the last month of the year. The two most important factors influencing the market have been the interruption of the purchases by American banks, which had been going on continuously for some years, and the growth of funds for investment under the social security scheme, which provided a new means of absorption of government securities.

The following table shows the half-yearly movements of some important holdings of U. S. government securities:

In \$ millions	Member banks			Federal Reserve Banks	Old Age Reserve and Unemployment Trust Fund
	New York City	All other	Total		
1936, January-June	+ 937	+ 465	+1,402	-	+ 19
July-December	- 554	+ 428	- 126	-	+ 45
1937, January-June	- 579	- 277	- 856	+ 96	+ 516
July-December	- 35	- 283	- 318	+ 38	+ 559

The selling of government securities by the banks, which in a large measure was connected with increases in the legally required reserves, started with the

New York City banks in the last half of 1936 and spread to other banks only in the course of 1937. On the other hand, the New York banks ceased selling in the autumn of 1937 and even added to their holdings in the latter months of the year, while the other banks continued to unload.

The purchases of the Federal Reserve banks in 1937 were relatively small and were undertaken purely to ease the market at critical periods. There was, however, an interesting change in the distribution of maturities in that the Reserve banks reduced their holdings of shorter-term securities and increased their holdings of government bonds of five years' maturity and over.

The increase in the volume of government securities held by the Old Age Reserve Account and the Unemployment Trust Fund was not due to purchases made on the market. The Social Security taxes are paid into the Federal Treasury and are treated as cash receipts, against which an allocation of ad hoc bonds is made. The effect of the rapid accumulation of these reserve funds is brought out below in a table which shows the special issues to these and other Trust Funds, the influence of the payment of the Soldiers' Bonus, and the movement of other net cash expenditure on the position of the Federal Treasury.

United States - Cash Position of Treasury.

In \$ millions	Increases in "special issues"				"Sol- diers' Bonus"	Total special issues and "Sol- diers' Bonus"	All other cash income (+) and expen- diture (-) net	Call on market for new money (1)
	Old Age Reserve	Un- employ- ment Trust Fund	Other Trust Ac- counts	Total				
1936, First quarter	-	+ 7	- 2	+ 5	-	+ 5	- 244	239
Second "	-	+ 12	- 120	- 108	+ 945	+ 837	- 2,504	1,667
Third "	-	+ 15	- 15	0	- 433	- 433	- 548	981
Fourth "	-	+ 30	- 25	+ 5	- 60	- 55	- 856	911
1937, First quarter	+ 135	+ 124	- 85	+ 174	- 33	+ 141	- 402	261
Second "	+ 132	+ 125	+ 495	+ 752	- 29	+ 723	- 969	246
Third "	+ 123	+ 146	+ 78	+ 347	- 25	+ 322	- 144	- 178 (2)
Fourth "	+ 123	+ 167	+ 32	+ 322	- 18	+ 304	- 291	- 13 (2)
1938, First quarter	+ 123	+ 119	+ 50	+ 292	- 13	+ 279	- 110	- 169 (2)

(1) i. e. other financing including sales of U. S. Savings Bonds.

(2) net redemptions.

The inflow of funds, particularly to the Old Age Reserve Account and the Unemployment Trust Fund, exceeded net cash out-payments in the last two quarters of 1937 and the first quarter of 1938, so that, on balance, it was not necessary to have recourse to the market for new money. In the fiscal year 1938-39 over \$1,000 million are expected to come into the Treasury for the investments of these two funds.

The place of the government as a borrower was not taken, as might have been hoped, by private corporations seeking capital. In fact domestic capital issues fell off sharply during the second half of the year.

United States Domestic Capital Issues.

In \$ millions	Net govern- ment issues*	All other new domestic capital issues
1936, First quarter	239	351
Second „	1,667	504
Third „	981	497
Fourth „	911	597
1937, First quarter	261	619
Second „	246	669
Third „	(-178)	479
Fourth „	(- 13)	309

* i. e. last column from previous table.

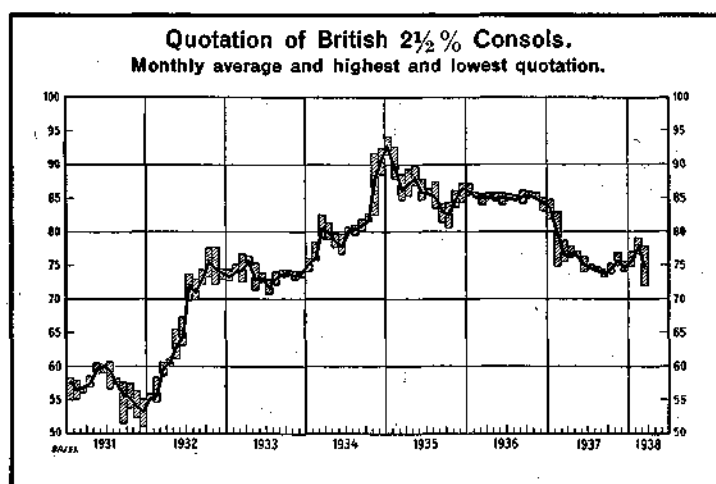
U. S. Steel Corporation during five years, 1933-37, spent \$250 million on rehabilitation and new construction, of which approximately \$225 million were provided from the company's own resources. This ploughing back of profits has, however, been made more expensive, and the volume reduced, by the operation of the undistributed profits tax in force since the passing of the Tax Act of 1936.

The market for British government securities was also influenced by factors similar to those described for New York but in a lesser degree. The banks reduced their investments in 1937 by some £24 million, or nearly 4 per cent. of their aggregate holdings at the beginning of the year, with which may be compared the sales by American banks amounting to \$1,175 million (£235 million), i. e. 8½ per cent. of their holdings. The sales in London were due largely to an increased demand for advances from the banks, while their cash reserves remained unchanged and their bill holdings declined. Support came to the market from the continued increase in the amounts to be invested by the Post Office and Trustee Savings Banks, the National Health and Unemployment Insurance Funds and similar funds managed by official agencies. The total invested by such funds in government and government-guaranteed

The total of new domestic issues during the year (not including government issues) was \$2,076 million; for comparison, it may be mentioned that in the years 1924-28 the annual average was \$5,580 million. Funds for new investment in industry may of course be derived from sources other than issues on the market, for example, the

securities amounted early in 1937 to some £800 million, about 25 per cent. more than the total investments of the clearing banks.

Another factor in the market was the first borrowing by the government for defence purposes; net issues, however, were not large. £100 million 2½ per cent. National Defence Bonds 1944-48



were floated in April 1937 but some £30 million Treasury bonds had been redeemed in February 1937. As the graph shows, the price for Consols (a good indication of market conditions) declined until the last quarter of the year when the recession in business created a new interest in gilt-edged securities. Despite the recovery that occurred the yield on Consols rose on balance from an average of 2.96 per cent. in December 1936 to 3.35 per cent. in December 1937. In the latter month the $3\frac{1}{2}$ per cent. War Loan was again quoted above par, the price at which dealings opened after the big conversion of 1932. The change in conditions for municipal borrowers since 1935 may be illustrated by the terms of two issues for the London County Council:

Date	Amount in millions	Rate per cent.	Issue price	Maturity
1935 January	£10	$2\frac{3}{4}$	100	1960-70
1937 June	£10	$3\frac{1}{2}$	$100\frac{1}{2}$	1952-62

More onerous terms and a shorter life for the second loan did not assure it the warm reception given to the first, for 89 per cent. was left with the underwriters.

To avoid congestion of the market, issues for new capital by municipalities and public boards (such as that above) are regulated by the Bank of England. Only domestic industrial borrowers of new capital may

raise funds as and when they choose. But with a rising rate of interest at long term and the weakness of equity shares on the stock exchange, particularly in the latter part of the year, issues fell off abruptly, as in the United States.

English Capital Issues.

£ millions quarterly	Domestic industrial issues
1936, First quarter	51
Second "	39
Third "	26
Fourth "	50
1937, First quarter	51
Second "	27
Third "	16
Fourth "	20

Including securities introduced directly on the stock exchange the total domestic issues (other than for the government) fell from £388 million in the year 1936 to £244 million in 1937. Conversions also fell off during the year, those on domestic industrial account amounting to only £12 million, against £30 million in 1936 and £45 million in 1935.

The characteristic feature of the German bond market has been the further progress made in the programme of consolidating the floating debt — or, viewed from another aspect, the covering of current budgetary needs more on the capital market than on the money market:

German Reich Loans in 1937.

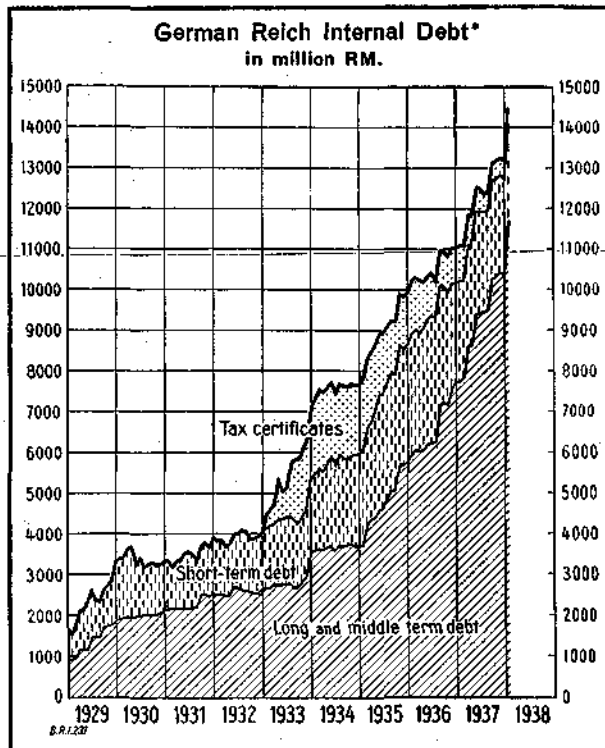
RM millions	Announced	Subscribed and issued	Maturity
1937, March	500	700	7-12 years
May	600	800	10-15 "
August	700	850	10-15 "
December	1,000	1,200	13-18 "

Each of the 1937 loans bears interest at $4\frac{1}{2}$ per cent. and was issued at $98\frac{3}{4}$. It has been possible, however, successively to increase the length of the loans and a further $4\frac{1}{2}$ per cent. loan of

RM 1,000 million, issued in April 1938 also at 98 $\frac{3}{4}$, was of 15–20 years' maturity. Further, each loan has been oversubscribed although the size has gradually been increased. Since the beginning of the programme in 1935 some RM 9,500 million of the short-term debt of the Reich have now been consolidated (including the loan issued in April 1938).

The effects of these consolidations on the published figures of the Reich's internal debt (which omit the "work-creation" and other special bills) are illustrated in the graph. The President of the Reichsbank in his speech to

the General Meeting in March 1938 explained how the increase in the debts of the Reich was counterbalanced by a decrease of private debts, so that there had been a shift of debt from private persons to public authorities, rather than an increase of the country's total indebtedness. The limit beyond which government indebtedness could not go, he said, was, from a budgetary point of view, the level above which interest and amortisation service could no longer be maintained – and, from a monetary point of view, the level above which the short-term credit requirements of the government could no longer be met on the money market, but must be covered by the printing of



* including only debt incurred after 1924.

notes. These limits had not been disregarded in the past, nor would they be in the future. Further the improvement in the economic situation of Germany now made it possible to dispense with the method of intermediate financing by special bills (Sonderwechsel); the necessary funds, when not provided for in the regular budget*, could be procured directly from the market by the issue of Reich Treasury certificates and Reich bond loans. Treasury certificates (not rediscountable at the Reichsbank as the special bills are) would not be issued in excess of an amount which could be consolidated without difficulty at maturity.

This programme of long-term borrowing for current needs, and of consolidation of the large volume of outstanding special bills, brings into particular prominence the importance of saving in the country. A partial picture is given by the figures of the savings banks:

* The tax and customs receipts of the Reich amounted to RM 9,022 million in the financial year ended 31st March 1929: they fell to RM 6,647 million in 1932–33 and to RM 6,846 million in 1933–34, rose to RM 11,553 million in 1936–37 and for the year just ended may be estimated at little short of RM 14,000 million.

German Savings Banks.

RM millions	Net deposits	Interest etc. added	Total year's increase	Total deposits at end of year
1934	241	463	704	12,814
1935	503	502	1,005	13,819
1936	309	487	796	14,615
1937	861	574	1,435	16,050

In addition, the savings made through life assurance policies and the retention of surplus profits by industrial companies have been considerable (the Loan Stock Law, which limits the distribution of dividends by joint stock companies

and encourages the ploughing back of profits, was prolonged in December 1937 for a further three years). These and other sources provided the accumulation of savings to take up the issues of Reich consolidation loans; from the middle of 1936 some relaxation has been made in the strict canalisation of savings into Reich issues in favour of certain capital requirements under the second Four-year Plan.

In Italy the quotations of government securities tended to weaken somewhat in the first part of the year, reaching their lowest point in July, after which there was some improvement. In 1937 the average quotation for the year of the 3½ per cent. Rendita 1906, for example, was 73.75 against 74.77 in 1936 and 86.72 in 1934. Of interest is the increased activity in industrial financing, as shown by the statistics relating to joint stock companies:

Italian Joint Stock Companies' Capital.

in million lire	New companies formed	Increases of capital	Capital reductions	Liquidations of companies	Net capital increase (+) or reduction (-)
1934	414	3,134	3,664	3,347	- 3,463
1935	311	2,787	1,811	1,512	- 225
1936	354	2,608	1,327	925	+ 710
1937	2,283	3,282	621	2,054	+ 2,890

Shipping companies account for Lit. 1,000 million of the liquidations, offset by increases of capital for about the same amount of companies belonging to the same class. Lit. 1,800 million of the capital of new companies formed during the year is accounted for by two issues of 4½ per cent. 20-year debentures for Lit. 900 million each made under the auspices of the Industrial Reconstruction Institute, whose functions were broadened and placed on a permanent basis during the year. The first issue was in connection with the flotation of the Shipping Finance Company (Finmar) formed to complete the reorganisation of the Italian merchant marine: the second covered the requirements of the Steel Financing Company (Finsider) formed to acquire stock in companies engaged in the iron and steel industries, to provide for their technical co-ordination and to grant them financial assistance.

Many increases of capital are projected for 1938. The recent decree by which a tax of 10 per cent. is levied on the capital of joint stock companies

authorised the companies to issue new shares to the amount required to pay the tax and permitted the issue, at the same time, of two bonus shares for each new paid-up share.

The Paris market was dominated in 1937 as in previous years by the borrowings of the French Treasury. The following table prepared from the published statistics of the Treasury shows the form which this borrowing took in the past two years:

Net Borrowing of French Treasury.

In Fr.fcs millions	1936	1937
Direct borrowing		
Bank of France	+ 19,448	+ 12,471
Caisse des Dépôts et Consignations	+ 802	+ 667
Total	+ 20,250	+ 13,138
Market borrowing		
Short-term: Ordinary Treasury bills	- 9,537	+ 530
Special Treasury bills (up to one year)	+ 4,455	- 1,890
Caisse de pensions de guerre (one-year bills)	-	+ 2,648
Total	- 5,082	+ 1,288
Middle-term: Special Treasury bills (2 to 10 years)	+ 2,000	+ 570
National defence bonds (3 to 9 years)	-	+ 5,360
Total	+ 2,000	+ 5,930
Long-term: 5 per cent. 30-year bonds	+ 800	-
4½ per cent. 60-year rentes	-	+ 8,000
Total	+ 800	+ 8,000
Miscellaneous	- 1,369	+ 800
Grand Total	+ 16,599	+ 29,156

This table does not include all the capital resources of the Treasury as it omits, inter alia, the exceptional profit of Fr.fcs 7,650 million from the revaluation of the Bank of France's gold reserve in 1936. (For this and other reasons there are, for example, differences between the borrowing from the Bank of France shown in the table and the advances given in the Bank's return - but they do not substantially change the picture.) One reason for the higher borrowing in 1937 was the maturity of Fr.fcs 4,100 million 1936 special Treasury bills of six months to one year and Fr.fcs 5,400 million 4½ per cent. Treasury bills of 1934. In 1937 there was a certain shift towards borrowing at longer maturities, the most important issue being Fr.fcs 8,000 million 4½ per cent. rentes floated in March 1937, with special conditions as to payment of interest and principal involving guaranteed exchange rates in sterling and dollars at those near the level existing at the time of issue.

Out of the profits from the revaluation of the Bank of France's gold reserves in July 1937 a fund of Fr.fcs 6,800 million was formed to support the market for government securities. Rates for government borrowing have,

however, remained at a high level. For example, an issue of 5 per cent. Treasury bills of three, six and nine years in December 1937, which produced slightly over Fr.fcs 3,000 million, was made on terms which, including the premium on redemption, gave a yield of 6¾ per cent.

The amount of private industrial issues was greater in 1937 than in the previous year, especially in the last quarter - the total for the year increased from Fr.fcs 1,127 million in 1936 to Fr.fcs 2,550 million. The yield on new issues (demi-net) of private bonds was at its lowest in June at 6.3 per cent., rising as high as 7.9 per cent. in November 1937. These high interest rates are reflected in the quotations of industrial shares which remained depressed throughout the year. It is, however, significant to note that whereas in earlier years there was a net withdrawal of deposits from the national and ordinary savings banks, amounting for 1936 to over Fr.fcs 5,000 million, in 1937 there was a net surplus of deposits of about Fr.fcs 600 million.

In Japan also the capital market in recent years has been dominated by heavy government borrowing, the internal public debt of the country having doubled between 1931 and 1936 (the external debt being reduced by normal amortisation).

Japanese Government Bonded Debt.

At end of year in million yen	Internal	External	Total
1931	4,525	1,477	6,003
1932	5,150	1,398	6,549
1933	6,400	1,421	7,821
1934	7,243	1,408	8,651
1935	8,208	1,373	9,581
1936	9,072	1,323	10,395
1937	10,585	1,308	11,893

Almost all of the internal debt is funded, only a relatively small amount of Rice Purchase Notes being outstanding. During 1936 and the first part of 1937 the issue of new internal bonds by the government continued on a decreasing scale but, as a result of the war with China, the budget was greatly expanded and,

although taxation has been considerably increased, it became necessary to issue a large volume of bonds on the market in the last quarter of the year. Bond issues in the first nine months amounted only to Yen 404 million, about two-thirds of the figures for the corresponding periods of 1935 and 1936, but as a result of the issues of the fourth quarter the increase of 1,513 million Yen in the internal debt for 1937 as a whole was the greatest recorded for any year.

The principal holders of Japanese government securities are given below:

End of year in million yen	Bank of Japan	Other special banks	Ordinary commercial banks	Trust companies	Treasury Deposit Bureau	Total
1933	682	281	1,568	154	1,348	4,033
1934	647	327	2,017	245	1,614	4,850
1935	729	323	2,205	277	1,740	5,374
1936	829	323	2,561	360	1,910	5,983
1937	1,387	342	2,500	410	2,248	6,887

To these figures must be added the holdings of insurance companies and municipal and local public bodies, so that the volume held by private individuals is comparatively small, being given at 17 per cent. of the total at the end of 1935.

The government security holdings of the ordinary commercial banks decreased on the year under the pressure of advances to industry, reaching their lowest point, Yen 2,430 million, in August, after which some relaxation of the position occurred. The Bank of Japan took certain emergency measures on the market, including the reduction of the rate for loans with government security collateral from 3.65 to 3.29 per cent. As the latter rate is lower than the yield obtainable on current issues of government securities (generally $3\frac{1}{2}$ per cent. 11 or 17-year bonds at 98 or $98\frac{1}{2}$) the absorption of the new loans was facilitated. The Bank of Japan, which issues and underwrites nearly all government loans, was nevertheless forced to take up a large part of the new bonds floated during the year. In addition to the increase of Yen 558 million shown in the table, some Yen 200 million were taken up by the Special Fund created from the government's share of the book profit arising from the revaluation of the Bank of Japan's gold reserves.

In Switzerland, the Netherlands and Sweden the capital markets were under the strong influence of a large influx of funds, and the weight of money exerted a steady downward pressure on long-term interest rates, which in these countries did not encounter the setback that was experienced in London and New York during the first half of 1937.

In Switzerland the yield on the $3\frac{1}{2}$ per cent. Swiss Federal Railways Loan (A-K), for example, declined throughout the year to 3.2 per cent. in December. This yield corresponds to a market price of 104 for these bonds, which is the highest attained since the issue was first made in 1899. Conversions rose to Sw.fcs 433 million in 1937 compared with Sw.fcs 246 million in the previous year, but new bond issues fell from Sw.fcs 419 million to Sw.fcs 276 million, no new money having been raised by the Confederation in the course of 1937.

On the Dutch market also bond flotations to obtain new capital declined over the year from Fl. 200 million to only Fl. 120 million. As industrial firms had large liquid reserves it was not necessary for them to have recourse to the capital market. On the other hand, issuing activity for conversion purposes was intense as the following figures show:

Year	Million Florins
1934	2,036
1935	175
1936	87
1937	2,131

Many conversion loans for municipalities and other public bodies were made, first on a 4 per cent. basis, later at $3\frac{1}{2}$ per cent., and towards the end of the year 3 per cent. bonds made their appearance. In September 1937 an issue of Fl. 912 million 3 per cent. bonds at $96\frac{3}{4}$ was made for conversion purposes by the government of the Netherlands Indies and guaranteed by the Dutch

Government. This loan was not fully successful, some Fl. 200 million remaining unsubscribed; but the market soon recovered its absorption capacity and in March 1938 the loan stood at a premium of around 3 per cent.

In these favourable conditions the Dutch Government made a conversion issue, in January 1938, to cover all outstanding 4 per cent. government bonds, amounting to Fl. 1,670 million — the largest loan ever floated in the Netherlands. The new issue, made at 99½, carries interest at 3 per cent. for the first ten years, to be increased automatically to 3½ per cent. for the remaining twenty-eight years of the life of the loan. The issue was a great success, some 95 per cent. of the called loans being converted, while cash subscriptions were so high that allotments amounted to only 2½ per cent. of the new money offered.

The pressure exerted by market conditions towards very low interest rates was so great that in February 1938 an investors' cartel was formed, uniting the largest institutional investors with the object of preventing the flotation of loans at rates which they consider excessively low.

In Sweden long-term interest rates as measured by the yield on government securities have reached 3 per cent., a level about ½ per cent. below the lowest interest rate ruling before the war, i. e. 3½ per cent. in the years 1897-98. A conversion issue for S.Kr. 150 million was made during the year by the State Mortgage Bank, 3 per cent. 60-year bonds being floated at a price of 98¼ (98½ being paid for new money). This issue, which was the largest non-government conversion transaction ever effected on the Swedish capital market, was very successful; S.Kr. 135 million of the maturing securities were directly exchanged and the acceptance of only S.Kr. 15 million cash applications was necessary to cover the non-assented bonds.

Also in a number of other countries conversion of government debt was undertaken during the year. In Norway a maturing 5 per cent. loan for N.Kr. 87 million was converted in May 1937 to a 4½ per cent. basis, and in January and February 1938 two 4 per cent. conversion issues of N.Kr. 100 million and N.Kr. 80 million respectively were made. In March 1938 a \$2.8 million 4½ per cent. loan in England was repaid with the proceeds of two internal 3½ per cent. issues negotiated with Norwegian banks. Two Belgian government internal loans of a 3½ per cent. type for B.fcs 2,500 million in all were placed at 97 during the year: this was the first time since the war that the Belgian government was able to borrow for long periods on such favourable terms. In addition issues of 5-year Treasury bonds at 2½ per cent. were made to a total of B.fcs 1,300 million.

In many overseas countries similar easy conditions prevail. In Australia there was a rapid fall in the yield on Commonwealth bonds in the first half of 1937, a reflection of the excellent export season of 1936-37. There was some slight reaction from June onwards but the generally favourable conditions (including a budget surplus) in the year enabled the Commonwealth government to issue two internal loans, the first for £A 7½ million in May 1937 bearing interest at 3⅞ per cent. and the second for £A 8 million in November 1937 with interest at 3¾ per cent. These loans were fully successful whereas

two rather similar loans in 1936 were undersubscribed. Improved conditions in Canada were also shown by a surplus on the budget compared with deficits in recent years. During 1937 the last of the tax-free bond issues of the war period was converted: by two operations \$236 million bonds bearing interest at $5\frac{1}{2}$ per cent. were replaced partly by some \$100 million of $3\frac{1}{4}$ per cent. bonds and partly by short and middle-term issues at very low rates.

The continuation of easy money conditions, which are now world-wide and such as have rarely or never existed before, is the more remarkable as it coincides with a rapid increase in gold production and heavy armament expenditure, two factors that in the period 1900-14 contributed to a rise in interest rates. But then the demand for funds to finance new enterprise of all kinds was much stronger than it is at present, not only in the field of international financing but also as regards internal investment in several important countries. Indeed, the weak point in the recovery of 1936-37 was the low volume of private financing of new business, lack of confidence in the future acting as a deterrent to an increase in industrial and other equipment.

The hardening of long-term interest rates that was experienced in the first half of 1937 in the capital markets of the United States and the United Kingdom, as well as in Japan, was not due to increased issuing activity compared with previous years but, in a rather curious way, reflected a change in the liquidity position of the commercial banks. The increased demand for industrial and other advances (largely connected with the rise in prices) which occurred in the winter months of 1936-37 led to a reduction in the commercial banks' holdings of government securities in the absence of a sufficient cash basis to allow the banks any further expansion of their assets. In that way the impact of the industrial demand for short-term funds was thrown on to the long-term market, while short-term rates remained more or less unaltered. The Board of Governors of the Federal Reserve System in their annual report for 1937 remark regarding these conditions in the United States: "... In recent years the bond market has become a much more important segment of the open money market, and banks, particularly money-market banks, to an increasing extent use their bond portfolios as a means of adjusting their cash position to meet demands made upon them. ..." This increased sensitiveness of long-term rates, an indirect result of the large holdings of government securities by commercial banks, has forged a new link between the short and long-term markets. In general, the present tendency towards more or less frozen short-term rates and more highly sensitive long-term rates is a new development that reflects fundamental changes in the credit structure not yet fully explored.

VI. DEVELOPMENTS IN CENTRAL AND COMMERCIAL BANKING.

The financial crisis of 1931, coming after two years of sharply falling prices, produced a number of emergency banking laws and direct government interventions in the credit structure of different countries. There followed a period of reconstruction and consolidation in which the opportunity was taken to incorporate the lessons of the crisis together with more general reforms into the banking laws already existing. As, in its turn, this period passes, there becomes less to record of this nature.

The most important general banking measures introduced during the past year appear to be those taken in Roumania, where the National Bank, in continuation of its policy of reconstruction and consolidation of the banking system, drew up a complete programme, of which certain parts were applied during the course of 1937. Particular attention was paid to the problems arising from the regulation of agricultural indebtedness in 1934. In many country districts the local banks had either disappeared or had insufficient resources to provide credit facilities in their districts. With the co-operation of the large Bucarest banks these deficiencies are being remedied. Certain modifications of the banking law were also made, submitting banking business to the authorisation of the Superior Banking Council and providing for inscription on a register of banking companies — the whole commercial banking law was codified in September 1937. In addition, three new bodies, the National Institutions for Agricultural Credit, for Credit to the Artisan Classes, and for Credit to Gold-Producing Companies, were formed with the participation of the National Bank.

In Czechoslovakia also a new law has been drawn up regulating the profession of banker by a system of concessions which may be withdrawn in certain conditions, together with other provisions, including one requiring the banks to become members of a central organisation.

In general, the gradual application of recent banking laws has been facilitated by the return to normal operating conditions of the banks affected by the crisis. The German banks, for example, which some time ago entirely repaid the emergency credits granted, have in the past year been able to place on the market that part of their capital previously held by public authorities, while in Switzerland the moratorium provisions regarding certain banks have naturally come to an end with the reconstruction of the banks concerned. A further indication of this recovery is the re-introduction of bank shares on the stock exchange in Hungary, where quotations had been suspended since 1931.

As regards central banking, mention should be made of the transformation of the already existing Bank of Ecuador, created in 1927, into a central bank with the sole right of note issue. At the same time new decrees were issued relating to the commercial banks, the mortgage bank, and the monetary unit of the country. In connection with the incorporation of Austria in the German Reich in March and April 1938, the Austrian National Bank entered

into liquidation and a series of measures were promulgated transferring most of its assets and liabilities to the Reichsbank. Elsewhere the measures taken in 1937 and the opening months of 1938 were generally complementary to earlier enactments.

In the United States the Board of Governors of the Federal Reserve System announced in September 1937 the general revision of the regulations governing discounts and advances for member banks, which had been under consideration since the passage of the Banking Act of 1935 which liberalised and made permanent certain emergency provisions previously adopted, permitting advances to member banks on any assets considered sound by the Reserve banks.

Credit granted to the member banks by the Reserve banks is of two classes: a) the preferred class conforming broadly to the stricter standards of the earlier law, to which the regular discount rate is applicable, and b) advances made under the liberalising features of recent legislation, to which a rate of at least $\frac{1}{2}$ per cent. above the regular rate is applied. The new regulations published in 1937 are notable in that for the first time instalment finance paper is admitted to the preferred class. There are, further, nine separate classifications of the paper acceptable as collateral coming under the non-preferred class.

In its statement accompanying the announcement of the changes the Board said:

"... Experience has demonstrated that the solvency of banks is better safeguarded by careful regard to the quality of the paper which they acquire than by strict observance of the form that this paper takes, and that greater emphasis on soundness and less emphasis on form is a sound banking principle ..."

A wider field is covered by the changes made in the Belgian credit system during 1937. The organisation of credit in Belgium has, indeed, been the subject of far-reaching measures since the crisis in the first part of 1935 which led to the devaluation of the currency on 1st April of that year. The measures taken in 1935 applied almost exclusively to the private banking structure and consisted of a general banking law governing the activities of the commercial banks, the creation of the Institute of Rediscount and Guarantee and the inauguration of a Banking Commission closely associated with the National Bank and charged with the application of the new banking law.

Further changes were made in 1937 and several Royal Decrees were issued, in execution of the law of 10th June 1937, for the purpose of revising the statutes of the National Bank of Belgium, the Caisse Générale d'Epargne et de Retraite, the Office Central de Crédit Hypothécaire, the Office National du Ducroire and the Caisse Centrale du Petit Crédit Professionnel. Other Royal Decrees created a Caisse Nationale de Crédit aux Classes Moyennes, an Institut National de Crédit Agricole and a Conseil de Coordination des Institutions de Crédit aux Classes Moyennes. Besides its participation in the Conseil des Institutions de Crédit and its long-standing collaboration in the Conseil Général de la Caisse Générale d'Epargne et de Retraite, the National Bank is or will be represented in the majority of the eight existing financial

organisations created by special law, such as the Société Nationale de Crédit à l'Industrie, l'Institut de Réescompte et de Garantie, le Fonds d'Amortissement de la Dette Publique, etc.

Without going into detail regarding the newly created bodies and the changes made in the laws regulating other institutions, the principal alterations in the statutes of the National Bank, confirmed by the extraordinary session of shareholders in August and September 1937, may be summarised. Sundry administrative changes were made owing to the increasing number and complexity of the problems to be dealt with by the management of the Bank and the great number of duties to be performed by its directors in the various sister organisations. Further, in order to guarantee the impartiality of the Bank, the disqualifications attaching to members of the General Council were made more severe: the Governor, Vice-Governor and Directors of the Bank may not be members of any commercial enterprise, nor of any enterprise which is commercial in form, except the bank of issue of the Belgian Congo, the Bank for International Settlements and the financial organisations of public interest created by special law.

On the business side the most important changes are those relating to the National Bank's discount operations and the powers granted to conduct open-market operations. The provisions governing the Bank's discount operations have been revised to bring them into line with current market practice: the maximum maturity of trade bills admitted to discount has been extended from 100 to 120 days while the form and the character of the paper admitted to discount have been left to the judgement of the Bank, which enables it more easily to follow the development of commercial and banking practice.

The National Bank was further authorised, in performance of its function as a regulator of the market, to engage in open-market operations through the purchase and sale of government securities. As this technique is new in Belgium it appeared desirable to guard against the diversion of any operations undertaken from their legitimate money market purposes. Certain limiting provisions were therefore included: a) the maximum amount of short or middle-term securities which the Bank may buy was fixed at B.fcs 500 million, while the total value of such bills was not to exceed B.fcs 200 million for more than twelve consecutive months; b) as regards long-term securities, the maximum which the Bank may buy was fixed at B.fcs 1,000 million, while securities purchased must have been issued at least two years previously and be quoted on the stock exchange. The maximum of B.fcs 1,000 million will be automatically increased by amounts equal to the total repayments or realisations of government securities held by the Bank before the new provisions came into force.

The National Bank of Belgium explains in its annual report that open-market operations presuppose not only a detailed preliminary study but also the realisation of certain technical conditions. The new open-market policy is not to be considered as a substitute for discount policy but as complementary to it.

Authorisation to undertake open-market operations, in some cases narrowly circumscribed, in others more widely framed, has in recent years been

included in the statutes of newly established central banks and has also been granted to a number of the older banks which previously lacked such powers (e. g. in addition to the National Bank of Belgium: the Nederlandsche Bank, the Norges Bank and others). In these countries it was considered that discount policy did not always give the central bank sufficient control over the credit structure and that other forms of intervention must be provided for. These must naturally be adapted to the particular country where they are exercised; for example, the absence of a wide money market outside the banks introduces technical conditions quite different from those obtaining in London and New York. Moreover, the character of the operation must be dependent upon the trend of the market, and apart from purely transitory measures (as at periods of passing stringency during heavy income tax payments) the main object of the operations undertaken in recent years on the London market, for instance, has been to prevent an undesirable extension of the credit base consequent upon an inflow of funds from abroad. By a reduction of the securities held in the Issue Department of the Bank of England and still more by the sale of Treasury bills by the Exchange Equalisation Account this object has been attained. A central bank authorised to undertake open-market operations cannot, of course, absorb funds from the market unless it is already provided with a large holding of suitable securities. These necessary technical conditions were present in the Argentine, for example, where the central bank was able to offset the effects of the favourable balance of payments and the influx of foreign funds by the sale on the market of the Pesos 400 million of government securities it had possessed from its foundation. In this way the cash holdings of the commercial banks were not allowed to expand to excessive proportions.

Open-market operations are one of the forms of intervention designed to promote the establishment of sound credit conditions, i. e. conditions in which the credit system will meet the needs of healthy growth and development without giving encouragement to speculative abuses. These operations affect primarily the volume of credit outstanding and, as was pointed out in the report of the National Bank of Belgium, should be considered not as a substitute for discount policy but as complementary to it.

In view of the experience gained in 1937 it is not inappropriate to recall the relevant passage of the London Resolutions:

"... they (i. e. the central banks) should endeavour to adapt their measures of credit regulation, as far as their domestic position permits, to any tendency towards an undue change in the state of general business activity. An expansion of general business activity of a kind which clearly cannot be permanently maintained, should lead central banks to introduce a bias towards credit restriction into the credit policy which they think fit to adopt, having regard to internal conditions in their own countries. On the other hand, an undue decline in general business activity in the world at large should lead them to introduce a bias towards relaxation.

In pursuing such a policy the central banks will have done what is in their power to reduce fluctuations in business activity and thereby also undue fluctuations in the purchasing power of gold ..."

The extent to which instruments of credit policy may be able to contribute to the maintenance of a relatively stable price structure, or to effect such price changes as may be desired, is a matter which has attracted great attention in recent years. On 2nd August 1937 the Board of Governors of the Federal Reserve System in the United States dealt with this question in an important statement on the objectives of monetary policy. The statement, of which extracts are given below, referred especially to proposals which had been made as to the possibility of a central monetary authority's achieving and maintaining a specified domestic price level.

"... The Board assumes that, while price stabilization is stated as the objective of such proposals, the authors regard stability of prices merely as a means toward a more important end, namely, the lessening of booms and depressions and the increase in the national output and well-being, in the belief that through the maintenance of a stable price level the broader objective will be achieved.

The Board is in full agreement with the ultimate objective of the proposals to promote economic stability, which means the maintenance of as full employment of labor and of the productive capacity of the country as can be continuously sustained ...

... That wide fluctuations in the price level are disastrous is beyond question and determined efforts should be made to prevent such fluctuations as would endanger economic stability. The Board is convinced, however, that the broader objective of maximum sustainable utilization of the Nation's resources cannot be achieved by attempting to maintain a fixed level of prices, and that, therefore, price stability should not be the sole or principal objective of monetary policy.

Stabilization of individual prices by monetary means is not proposed, nor would it be feasible. Proposals for price stability necessarily refer to some index or average of prices. There is no general agreement on the question of what constitutes a satisfactory price index for this purpose, although the general wholesale commodity price index is often suggested.

No matter what price index may be adopted as a guide, unstable economic conditions may develop, as they did in the 1920's, while the price level remains stable; business activity can change in one direction or the other and acquire considerable momentum before the changes are reflected in the index of prices. There are situations in which changes in the price level would work toward maintenance of stability; declining prices resulting from technological improvements, for example, may contribute to stability by increasing consumption. There are other situations when the restoration and maintenance of relatively full employment may be possible only with an advance in prices. Correspondence between price stability and economic stability is not sufficiently close, therefore, to make it desirable to restrict the objective of monetary policy to price stability.

... Inasmuch as the management of the country's monetary system is not an exact science, since it involves forecasting and dealing with many uncertainties, it is essential in determining an objective to leave scope for judgment and discretion.

Monetary authorities may contribute to economic stability by exerting an influence to maintain a flow of funds conducive to as full a use of the country's productive resources as can be continuously sustained and to keep the banking machinery of the country in sound condition. The Board recognizes that even an adequate supply of money will not perform its functions adequately if the banking structure through which it must operate is in an unsound condition, and that a sound banking structure cannot be sustained if the supply of money is insufficient, and a deflation is under way. ...

... The Federal Reserve System can regulate within limits the supply of money but there are other factors affecting prices and business activity fully as powerful as the money supply. Many of these factors are non-monetary and cannot be controlled by monetary action. Their effect on business activity may express itself in an increased or decreased rate of use, or turnover, of the existing supply of money as well as in a change in the supply itself. The influence that the Federal Reserve System can exercise over the interest rate has an important bearing on business activity, but it may be entirely offset by other factors.

It is essential to recognize the limitations on the effectiveness of monetary policy. Monetary factors are only one of the groups of forces affecting business activity.

To sum up, the Board believes that economic stability rather than price stability should be the general objective of public policy. It is convinced that this objective cannot be achieved by monetary policy alone, but that the goal should be sought through coordination of monetary and other major policies of the Government which influence business activity, including particularly policies with respect to taxation, expenditures, lending, foreign trade, agriculture and labor. ..."

While credit measures have some influence on the activity of business and the trend of prices, they have to be carried out in conditions affected by political and other influences which are often little adjusted to the exigencies of the most appropriate monetary policy.

VII. CURRENT ACTIVITIES OF THE BANK.

1. OPERATIONS OF THE BANKING DEPARTMENT.

The balance sheet of the Bank as at 31st March 1938, examined and found correct by the Bank's auditors, is reproduced in Annex II to the present Report. It shows a total of 644 million Swiss gold francs of 0.29... grammes of fine gold, against 619 million at 31st March 1937. The method of conversion into Swiss gold francs of the various currencies represented by the Bank's assets and liabilities has remained the same throughout the year, the basis adopted being the official selling price for gold in New York and the rates quoted for the various currencies against dollars. As in the preceding year, therefore, changes in the gold value of certain currencies have to be taken into account in comparing the figures at the beginning and at the end of the financial year. The value of the French franc, for instance, calculated in Swiss gold francs gave an equivalence of 14.04 Swiss gold francs to 100 French francs at 31st March 1937 and 9.38 Swiss gold francs to 100 French francs at 31st March 1938.

The movements of the Bank's resources and, up to a certain point, the course taken by its activities during the financial year were determined by the policy pursued by the central banks in connection with their reserves. The first few months of the financial year and in particular May and June 1937, during which the tendency to a "flight from gold" developed, were marked by a considerable increase in the volume of transactions in gold and in foreign currencies effected through the Bank, since the central banks had recourse to conversions of gold into foreign exchange and vice versa. The summer months, on the other hand, were characterised by quieter movements reflecting those on the gold and foreign exchange markets. From September to December there was a slight resumption of activity in this field, followed by a period of calm lasting until February; while the following month showed a considerable development in our operations.

An examination of the movement of our resources in gold and foreign currencies reveals the existence of certain fundamental tendencies. This fact emerges from a study of the following table, which gives, for certain characteristic dates in the financial year, the figures of the deposits entrusted to us by central banks and the total of our gold holdings, consisting of gold in bars, included in the balance sheet, and gold held in safe custody on accounts which are kept separate from the Bank's official statement:

In millions of Swiss gold francs	31st March 1937	31st May 1937	30th Sept. 1937	31st Dec. 1937	31st March 1938
Deposits of central banks for their own account	129.6	215.8	247.0	178.9	179.2
Gold in bars	45.1	51.0	18.3	13.8	20.9
Earmarked gold	433.0	382.7	358.7	403.6	479.1
Total of gold held by the B. I. S. .	478.1	433.7	377.0	417.4	500.0

The seesaw character of the movement persisted until the end of December. The increase shown at the end of May 1937 in the deposits of central banks for their own account was largely attributable to a substantial deposit constituted as a result of an international credit operation, the proceeds of which had been left with us by the beneficiary central bank to be gradually withdrawn. During the last months of the financial year, gold held under earmark at the Bank moved independently of the deposits of central banks, which showed remarkable stability.

A comparison of the principal items of the Bank's balance sheet at 31st March 1937 and at 31st March 1938 calls for the following remarks:

1. Liabilities.

The total of long-term commitments at 31st March 1938 is equivalent to 259.2 million Swiss gold francs against 274 million at 31st March 1937. As in the preceding financial year, this change is attributable solely to the difference in the counter-value in Swiss gold francs of the foreign currencies in which the deposits in question are entered to account. There has been no change in the expression of these deposits in foreign currency since September 1936, at which date they still appeared in our situation with a counter-value totalling 293.6 million Swiss gold francs. Thus the reduction of 34.4 million between September 1936 and March 1938 is entirely due to changes in the value of certain currencies.

The movement of deposits of central banks for their own account has been shown in the table given above. The figure for the beginning of the financial year is the lowest recorded for that year, the maximum having been reached at the end of September with 247 million. Deposits of central banks for account of third parties, which stood at 4.2 million at 31st March 1937 and at 3.3 million at 31st March 1938, have remained between a maximum of 4.4 and a minimum of 2.3 million. Deposits of other depositors, which had declined to 0.2 million at 31st March 1937, rose to 7.6 million at 30th September, to fall again to 2.2 million at the end of the financial year.

On the other hand, the total of sight deposits expressed in a weight of gold has mainly shown a declining tendency since the beginning of the financial year, when the figure was 23.3 million. At 30th June 1937 it had fallen to 8.3 million. Since then it has shown a slight but continuous advance to 9.6 million at 31st March 1938.

2. Assets.

Each of the items composing the readily available assets of the Bank has shown a decline during the financial year, as appears from the following table:

In millions of Swiss gold francs	31st March 1937	31st March 1938
Gold in bars	45.1	20.9
Cash holdings in foreign currencies	25.6	22.2
Sight funds	26.5	15.8
Rediscountable portfolio	232.0	229.6
Total	329.2	288.5

With the exception of the rediscountable portfolio, which has never fallen appreciably below the present figure, the readily available assets have shown fairly considerable fluctuations during the year. The figure for gold in bars exceeded 51 million and declined to less than 10 million according as the Bank's policy led it to increase or reduce the surplus of assets in bar gold over sight deposits (gold), this surplus representing the Bank's stock of gold for its own account which may be said to form a margin in hand for gold transactions. The total of cash holdings in foreign currencies fluctuated between 52 and 20 million, while sight funds, after having risen to nearly 43 million, declined again, in altered circumstances, to some 13 million.

The composition of our portfolio is such that, at the end of the financial year, the volume of commercial bills and bankers' acceptances, totalling 126.8 million, was larger than that of Treasury Bills, totalling 102.8 million, and thus the proportion maintained between the two items during the past four years was reversed.

The decline in readily available assets is offset by an increase in time funds at interest and in "Sundry Bills and Investments" which also comprises the whole increase in the balance-sheet total. The first of these two items has risen from 28.7 to 53.9 million Swiss gold francs and the second from 259.4 to 300.5 million. Among "Sundry Bills and Investments" it may be noted that those maturing in less than three months have risen during the financial year from a total of 95 to 146 million, those at three to six months have fallen from 75 to 64 million, and those at more than six months show a slight increase from 89 to 90 million.

The development of our operations calls for the following remarks:

There has been a further increase in the tendency of central banks, mentioned in the preceding Annual Report, to repay the credits placed at the disposal of their markets in the form of investments for indeterminate periods, and the Bank has, in the majority of cases, replaced this type of investment by seasonal credits, or by credits granted for the development of international trade, to which further reference is made below.

As other financial institutions the Bank has, during the past year, been faced with the difficulty of finding suitable investments at remunerative rates of interest.

It is true that on certain important markets the low level of short-term rates has not persisted throughout the financial year; but the periods of monetary stringency have usually been brief. To cite one example only, the rates for American Treasury bills at three months rose from about 0.20 per cent. in the middle of July 1937 to 0.45 per cent. at the beginning of September, only to fall back to 0.25 per cent. at the end of the same month and to 0.05 per cent. at the end of December.

It has thus been necessary to reconcile these investment difficulties with constant attention to the maintenance of balanced exchange positions. With a capital expressed in Swiss gold francs, a long position in some currency or other is inevitable, and exchange positions expose the Bank to a monetary risk unless there is a possibility of immediate conversion into gold.

It has been possible, however, to limit exchange risks to amounts which are amply covered by the reserves expressly created to meet them.

As mentioned above in connection with movements of gold kept in safe custody for account of central banks, it was principally during the first quarter, and again towards the end of the financial year, that the Bank's gold operations attained their greatest volume. The technique of these operations has remained very much as described in the preceding Annual Report, with the complication, however, that movements of gold effected by central banks were nearly always in the same direction. During the greater part of the year the enquiries received were either nearly all requests for gold or nearly all offers; transfers all moved in one direction, so that it was almost impossible to offset one against the other. In the last month of the financial year opportunities again occurred to effect offsetting operations and thus to establish such business on a more normal basis.

Mention should also be made of a somewhat increased activity in the granting of credits to central banks for the specific purpose of facilitating commercial transactions. The difficulties experienced in obtaining ordinary credits and therefore of covering forward exchange risks by exporters when exchange restrictions are in force, or currencies subject to pressure, have made it desirable to provide for special facilities. The Bank has been able to render some assistance in the arrangement of such facilities by credits granted to central banks; in certain cases reciprocal credits have been arranged under which the credits granted by a central bank in its own currency have been counterbalanced through the intermediary of the Bank for International Settlements by credits obtained by it in a foreign currency from another central bank.

These operations — as well as enquiries to which they have given rise — have helped to reveal more clearly the real difficulties in certain areas and the limited extent to which international financing can be expected to function where basic monetary and commercial conditions remain unsettled.

2. TRUSTEE AND AGENCY FUNCTIONS OF THE BANK.

The position in respect of the annuity payments of Germany, Hungary, Bulgaria and Czechoslovakia arising from the New Plan adopted at the Hague Conference of January 1930, has remained unchanged throughout the year under review and during that period the Bank has received nothing in respect of the annuity payments of those Powers.

The situation in connection with the service of the German External Loan 1924 and the German Government International 5½ % Loan 1930 has also remained unchanged during the year under review in so far as the respective Trustees are concerned; since 1st July 1934, the German Government has not furnished to the respective Trustees any of the funds required in the currencies of the various issues for the service of these Loans. Nevertheless, certain groups of bondholders have continued to benefit under special agreements concluded between the German Government and various other Governments. The bondholders specified in these agreements have been able to obtain

payment in the currency of their country of domicile of the whole or a part of the nominal value of their coupons. Moreover, as regards bondholders who do not receive payment of the full nominal amount of their coupons in this manner but have not surrendered their right to such payment, the German Government has continued to offer to liquidate the outstanding amounts by a payment in Reichsmarks calculated at the Reichsbank's official rate of exchange, the employment of such Reichsmarks being governed by principles similar to those regulating the use of registered marks. The Trustees for the respective Loans are not parties to any of these special agreements, have had nothing to do with their execution and have considered them as incompatible with the General Bonds and the international agreements relating thereto. The Swiss gold franc equivalent of the various currencies relating to the respective Loans which were deposited in the names of the Trustees, as at 31st March 1938, is shown in Annex VI.

During the year under review, the Bank, as Trustee for the Austrian Government International Loan 1930, has regularly and punctually received and distributed the monthly service instalments required pursuant to the terms of the General Bond. The operations of the Sinking Fund during the year have resulted in the redemption of bonds of a total nominal value equivalent to about 4,790,000 Swiss gold francs. A Statement of Receipts and Payments, as certified by the auditors, for the last completed loan year to 30th June 1937, is appended as Annexes IVa and IVb. In order to show the position to the last interest coupon due date, there is also appended as Annex V an Interim Statement of Receipts and Payments for the half-year to 31st December 1937. In addition, the Swiss gold franc equivalent of the funds relating to this Loan which were deposited in the name of the Trustee as at 31st March 1938 is shown in Annex VI.

The Bank has continued to act as an intermediary for the settlement of the financial questions involved in the transfer of the Saar Territory to Germany. The German Government undertook to repurchase the mines, railways etc. in the Saar from France for a lump sum of 900 million French francs to be paid in a manner agreed upon and over a period of five years. The following table shows the progress made in the repurchase and the manner in which it has been effected:

In millions of French francs	Period to 31st March 1937	Year to 31st March 1938	Total
French francs and other foreign currencies collected in the Saar and exchanged for reichsmarks	274.4	-	274.4
Free deliveries of coal	237.2	151.0	388.2
Payments by the German Government as compensation for surface damages, indemnities, taxes, etc.	14.8	4.0	18.8
	526.4	155.0	681.4

The Bank has also placed its services at the disposal of the French and German Governments in connection with the financial questions which are involved in the execution of an agreement for a modification of the Franco-German frontier.

In its capacity as intermediary for the service in Switzerland of the French National Security 4½ % Loan 1937, the Bank, on behalf of the French Government, nominated the Swiss banks and branches of French banks in Switzerland who are acting as Paying Agents for the Loan. The Bank has received from the French Government the amounts in Swiss francs required to meet the 1st September 1937 and 1st March 1938 coupons of the Loan presented in Switzerland and has provided the various Paying Agents as and when necessary with the funds required to pay all coupons on presentation.

3. NET PROFITS AND DISTRIBUTION.

It is for the present General Meeting to consider the declaration of a dividend and to make appropriations to reserves. The net profit for the year, after making allowance for contingencies, is 9,011,956.53 Swiss gold francs, the Swiss gold franc being as defined by Article 5 of the Bank's statutes i. e. the equivalent of 0.29032258... grammes fine gold. This compares with a figure of 9,071,570.02 Swiss gold francs for the seventh fiscal year. In the balance sheet as at 31st March 1938, all currencies are valued at or below the least favourable market rate prevailing on that date and all assets are valued at or below market quotations, if any, or at or below cost. In computing the above profits, no account has been taken of exchange gains arising by reason of the Bank's happening to be short in any depreciated currency; whereas exchange losses have been written off.

After providing for the Legal Reserve that is required by Article 53 of the Statutes, to an amount equal to 5 per cent. of the net profits, i. e. 450,597.83 Swiss gold francs (1937: 453,578.50 Swiss gold francs) it is recommended that the General Meeting declare a dividend at the rate of 6 per cent. per annum in respect of the eighth fiscal year. The payment of this dividend requires 7,500,000 Swiss gold francs (1937: 7,500,000 Swiss gold francs). The net profits still remaining after the declaration of the dividend would amount to 1,061,358.70 Swiss gold francs, the appropriation of which is fixed by Article 53 of the Statutes.

Exercising the discretion vested in it by paragraph (c) of Article 53 of the Statutes, the Board of Directors has determined to place to the credit of the Special Dividend Reserve Fund provided for by the Statutes, the sum of 212,271.74 Swiss gold francs, which is the maximum amount which it is permissible, under the Statutes, to set aside for this purpose out of the net profits of the present year (1937: 223,598.30 Swiss gold francs).

After making provision for the foregoing items, you are requested, from the balance still remaining, to make an appropriation to the General Reserve Fund in the manner stipulated by paragraph (d) of Article 53, to the amount of 424,543.48 Swiss gold francs (1937: 447,196.61 Swiss gold francs). The

aggregate of the Legal, Dividend and General Reserves at the end of the eighth year would then be 24,270,934.82 Swiss gold francs.

The same article of the Statutes lays down the distribution of the sum finally remaining, namely, 424,543.48 Swiss gold francs, between such of the Governments or central banks of Germany and the countries entitled to share in the annuities payable under the New Plan, defined in the Hague Agreement of January 1930, as shall have maintained time deposits at the Bank subject to withdrawal in not less than five years. No central bank has such time deposits at present but the following Governments have these deposits and are entitled, in view of this minimum duration of their deposits, to participate in the residual amount of 424,543.48 Swiss gold francs (1937: 447,196.61 Swiss gold francs) in the following sums:

Annuity Trust account deposits in accordance with Article IV (e) of the Trust Agreement:—	Swiss gold francs	
	1937/38	1936/37
France	133,407.30	131,366.53
Great Britain	52,132.53	51,335.04
Italy	27,230.48	26,813.93
Belgium	14,730.44	14,505.10
Roumania	2,573.54	2,534.17
Yugoslavia	10,710.82	10,546.97
Greece	882.36	868.86
Portugal	1,691.18	1,665.31
Japan	1,691.18	1,665.31
Poland	49.02	48.27
	<u>245,098.85</u>	<u>241,349.49</u>
German Government non-interest-bearing deposit in accordance with Article IX of the Trust Agreement	122,549.43	120,674.74
French Government deposit (Saar)	1,806.20	2,703.89
French Government Guarantee Fund in accordance with Article XIII of the Trust Agreement	55,089.—	82,468.49
	<u>424,543.48</u>	<u>447,196.61</u>

The accounts of the Bank and its eighth Annual Balance Sheet have been duly audited by Messrs. Price, Waterhouse & Co., Chartered Accountants. The Balance Sheet will be found in Annex II, as well as the certificate of the auditors to the effect that they have obtained all the information and explanations they have required and that in their opinion the Balance Sheet, together with the note thereon, is properly drawn up so as to exhibit a true and correct view of the state of the Bank's affairs according to the best of their information and the explanations given to them and as shown by its books. The Profit and Loss Account and the Appropriation Account are reproduced in Annex III.

4. CHANGES IN BOARD OF DIRECTORS AND EXECUTIVE OFFICERS.

At the Extraordinary General Meeting held on 3rd May 1937 the amendments to the Statutes referred to in the seventh annual report were adopted. As indicated in that report, these amendments make it possible to separate the functions of the Chairman of the Board of Directors and the President of the Bank. The election of Sir Otto Niemeyer as Chairman of the Board

and of the undersigned as President of the Bank, previously decided upon by the Board subject to the adoption of the amendments referred to, thereupon became effective. The resignation of Dr. Trip as Chairman of the Board and President of the Bank, a dual position which he had held with great distinction for the two previous years, also became effective on the same day. For his signal services the Bank owes Dr. Trip, who remains a member of the Board, a debt of deep gratitude.

Governor E. Labeyrie, an ex-officio director whose cordial collaboration was much valued, was succeeded upon his retirement as Governor of the Bank of France by M. Pierre Fournier, hitherto Vice-Governor. M. Fournier had served on the Board as an Alternate for some time previously, and his participation as an ex-officio director was warmly welcomed. M. Fournier nominated M. de Boisanger as his Alternate. The term of office of Mr. Kano, upon expiry in May 1937, was renewed by the Governor of the Bank of Japan. Mr. Yanagita was reappointed in July as substitute nominee by the new Governor of that institution. M. Galopin, whose term of office expired in December, was reappointed by the Governor of the National Bank of Belgium for a further term of three years.

The death in December last of M. Franck, Governor of the National Bank of Belgium, removed an ex-officio director who had served on the Board since the foundation of the Bank. The eminent services rendered by Governor Franck to the Bank were recognised by all, and the loss of so valued a collaborator and so staunch a friend of the Bank was deeply deplored. In December the Board also learnt with much regret of the death of Dr. Vissering, formerly President of the Netherlands Bank and a member of the Board in the early days of the Bank.

M. Georges Janssen, the successor of the late M. Franck as Governor of the National Bank of Belgium, joined the Board as an ex-officio director in January and appointed M. Baudewyns as his Alternate in place of M. Goffin, who had resigned.

The premature and tragic death in September of M. Pierre Quesnay, the first General Manager of the Bank, came as a great shock to all his friends and colleagues and constituted a grievous loss for this institution. As one of the early supporters of the proposal to set up an international bank, M. Quesnay was always a fervent advocate of collaboration between central banks, a principle he successfully translated into practice. In him the Bank has lost not only a man of outstanding ability who rendered great service to the institution, but a man of great human qualities.

In January the Board appointed M. Roger Auboin as General Manager, whose work in connection with financial problems is well known not only in his own country but also abroad.

VIII. CONCLUSION.

In 1938 occurs the twentieth anniversary of the end of the world war which, by its far-reaching destruction of wealth and still more extensive damage to the delicate organism built up in the years of peace, undermined the world's monetary system. After great efforts at reconstruction orderly monetary conditions were established for a short period in the 'twenties. But the foundations proved insufficiently secure to withstand the shocks of the great depression, when the effects of a downward turn in the industrial cycle and a world-wide glut in agriculture were intensified by a severe financial crisis.

Once more the basis is being laid for the re-establishment of monetary order. Progress has been made over a widening area in the adjustment of currencies to levels which may be maintained permanently and thus in the establishment of a solid basis for exchange stability. The burden of international indebtedness has been reduced by repayments, conversions and other means and no longer constitutes any real obstacle to the attainment of currency equilibrium. Progress there has been, but what still remains to be done is in many respects as important as that which has already been accomplished, for present methods are still lacking in cohesion and are imperfect in their technique. But above all, that general confidence which is essential to international stability is not present.

A fundamental condition for monetary order is that within each individual country the domestic monetary arrangements should inspire confidence, for unrest is apt not only to affect the smooth working of the internal market but, by its repercussions, to impair the international monetary structure also. As M. van Zeeland emphasised in his Report, "each country must, above all, rely on itself; it is for each to take the necessary measures which will make possible its participation in international action. It has the right to expect of the other states that they will not confront it with artificial obstacles, and even that they will assume a general attitude in conformity with the requirements of a sincere spirit of international collaboration. But the decisive effort is essentially the responsibility of the individual state and of it alone". Indeed, governments of today are for the moment unlikely to bind themselves as regards future monetary action by formal treaties and other undertakings. They may, however, be willing to agree on certain general objectives to be pursued in their respective policies. Thus, in the Tripartite Agreement of September 1936 between the United States, the United Kingdom and France, to which three other countries, Switzerland, the Netherlands and Belgium, have since adhered, it was determined to avoid as far as possible any disturbance of the basis of international exchange and to arrange for consultations for this purpose whenever necessary. The agreement further stressed the importance of the development of international trade and of taking special action to relax progressively quotas and exchange controls with a view to their abolition. Finally, it expressed the hope that no currency depreciation would be undertaken in order to obtain unreasonable competitive advantages and thereby hamper the efforts to restore more stable economic relations.

Will it be possible in practice to ensure the general observance of these

principles? The answer to this question depends upon whether, financially and economically, sufficient equilibrium can be established between the different countries to permit an international monetary system to work smoothly.

Before the war there was as a rule no fundamental maladjustment of currencies and no pursuit by any important country of a policy likely to threaten the established equilibrium. Not only were more peaceful relations maintained in the hundred years 1815-1914 than in any other period of modern history, but the wars that occurred caused no permanent currency depreciations, the only significant exceptions being certain limited devaluations in Austria and Russia. There was no living memory of serious currency losses to make people fear for the substance of their savings or hesitate to grant commercial credits to foreign customers from apprehension regarding exchange and transfer difficulties. In such an age the monetary problems were mainly technical and unaffected by the current of national and international politics.

Today, on the contrary, not only the grave question of peace or war but also the general attitude of the different countries towards the promotion of an international exchange of goods and services has its influence; indeed, armaments and other measures that produce expansion predominantly in the national sphere may have unwonted repercussions on the foreign currency position. There is no overlooking the fact that an increase in "planned" activity creates new difficulties. It is not easy in any one country to achieve proper co-ordination between the plans that are elaborated in different departments of the government or for different branches of production. How much more difficult is it if, added to all this, each individual country draws up its own policies with almost complete disregard for those of other countries. No wonder that in such circumstances those who are preoccupied with the re-establishment of conditions that will guarantee a steady advance in prosperity, and therefore generally in the standard of living, stress the need for consultations as a means of avoiding contradictions and clashes of policy that would be harmful to all parties concerned.

There is no reason to believe that the difficulties are insurmountable. Adherence to a common currency system does not mean that individual countries will no longer be able to pursue internal policies of many different patterns. It does mean, however, that in doing so they will have to observe certain general principles with regard to their cost and price structure and their credit conditions, without which no monetary stability can be secured. The limitations they must thus impose upon themselves are in the direct interests of their own people, since the purpose is to safeguard the maintenance of a sound currency at home and the establishment of such monetary and credit relations with other countries as will enable industry and trade to be pursued without the crippling effect of incalculable monetary risks. After all, the monetary mechanism should be constructed and worked in such a way as to help and not hinder the exchange of goods nationally and internationally.

Respectfully submitted,

J. W. BEYEN,
President.

ANNEXES

CENTRAL BANKS OR OTHER BANKING INSTITUTIONS POSSESSING RIGHT OF REPRESENTATION AND OF VOTING AT THE GENERAL MEETING OF THE BANK

"The ownership of shares of the Bank carries no right of voting or representation at the General Meeting. The right of representation and of voting, in proportion to the number of shares subscribed in each country, may be exercised by the central bank of that country or by its nominee. Should the central bank of any country not desire to exercise these rights they may be exercised by a financial institution of widely recognized standing and of the same nationality, appointed by the Board, and not objected to by the central bank of the country in question. In cases where there is no central bank, these rights may be exercised, if the Board thinks fit, by an appropriate financial institution of the country in question appointed by the Board." (Article 15, Bank Statutes.)

Institutions	Number of votes
Bank of England, London	19,772
Banque Nationale de Belgique, Brussels	19,772
Banque de France, Paris	19,772
Banca d'Italia, Rome	19,772
Reichsbank, Berlin	19,772
Reichsbank, Berlin (attaching to the shares held by the Austrian National Bank in Liquidation)	4,000
The Industrial Bank of Japan, Tokyo	19,770
The First National Bank of New York, New York	19,770
De Nederlandsche Bank N. V., Amsterdam	4,000
Schweizerische Nationalbank, Zurich	4,000
Sveriges Riksbank, Stockholm	4,000
Bank von Danzig, Danzig	4,000
Finlands Bank, Helsingfors	4,000
Banque de Grèce, Athens	4,000
Bulgarska Narodna Banka, Sofia	4,000
Danmarks Nationalbank, Copenhagen	4,000
Banca Nationala a Romaniei, Bucarest	4,000
Bank Polski, Warsaw	4,000
Magyar Nemzeti Bank, Budapest	4,000
Národní Banka Československá, Prague	4,000
Norges Bank, Oslo	4,000
Banque Nationale du Royaume de Yougoslavie, Belgrade	4,000
Latvijas Banka, Riga	500
Lietuvos Bankas, Kaunas	500
Banca Nazionale d'Albania, Rome	500
Eesti Pank, Tallinn	100
	200,000

BALANCE SHEET

IN SWISS GOLD FRANCS (UNITS OF 0.29032258...)

ASSETS			
I—GOLD IN BARS.		20,906,770.13	% 3.3
II—CASH			
On hand and on current account with Banks		22,174,222.86	3.4
III—SIGHT FUNDS at Interest. . .		15,794,917.18	2.5
IV—REDISCOUNTABLE BILLS AND ACCEPTANCES			
1. Commercial Bills and Bankers' Acceptances	126,778,655.73		19.7
2. Treasury Bills	102,831,511.15		16.0
		229,610,166.88	
V—TIME FUNDS at Interest			
1. Not exceeding 3 months . .	52,364,145.50		8.1
2. Between 3 and 6 months . .	1,526,960.03		0.2
		53,891,105.53	
VI—SUNDRY BILLS AND INVEST- MENTS			
1. Treasury Bills.	91,364,860.14		14.2
2. Railway, Postal Administration and Other Bills and Sundry Investments	209,127,863.96		32.5
		300,492,724.10	
VII—OTHER ASSETS			
1. Guaranty of Central Banks on Bills sold	934,663.98		0.1
2. Sundry items	226,362.91		0.0
		1,161,026.89	
NOTE — The whole of the short term and sight deposits in various currencies (Item IV — Liabilities) are more than covered by assets either in the currencies of the deposits or in currencies free from exchange restrictions, and of the long term commitments the French Government Deposit (Saar) and the French Government Guarantee Fund (Items III — 3 and 4) are similarly covered. The remaining long term commitments (Items III — 1 and 2) which are recorded in a restricted currency (although the Bank's commitment in respect of Item III — 1 is not clearly established), are covered by assets of the same currency, the gold value of a substantial part of which is specially guaranteed. The Capital, Reserves and Surplus are represented to a large extent by assets in countries where exchange restrictions now prevail and do not permit of free conversion of their currencies into gold or other currencies; however, as to these assets an important part is secured by special contracts guaranteeing their gold value and in one case specifically permitting their transfer. Moreover, under Article X of the Hague Agreement of January 1930, the signatories thereto declared the Bank to be immune from any "prohibition or restriction of export of gold or currency and other similar interferences, restrictions or prohibitions".			
		644,030,933.57	100.0

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF THE BANK FOR INTERNATIONAL SETTLEMENTS, BASLE.

In conformity with Article 52 of the Bank's Statutes, we have examined the books and accounts and explanations we have required and that in our opinion the above Balance Sheet, together with the affairs according to the best of our information and the explanations given to us and as shewn by the concerned.

ZURICH, April 27, 1938.

AS AT MARCH 31, 1938

GRAMMES FINE GOLD — ART. 5 OF THE STATUTES)

LIABILITIES			
			%
I—CAPITAL			
Authorised and issued 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
of which 25 % paid up		125,000,000.—	19.4
II—RESERVES			
1. Legal Reserve Fund	4,237,607.60		
2. Dividend Reserve Fund . . .	6,315,304.73		
3. General Reserve Fund . . .	12,630,609.44		
		23,183,521.77	3.6
III—LONG TERM COMMITMENTS			
1. Annuity Trust Account			
Deposits	153,126,250.—		23.8
2. German Government Deposit	76,563,125.—		11.9
3. French Government Deposit (Saar)	938,000.—		0.1
4. French Government Guarantee Fund	28,608,923.65		4.4
		259,236,298.65	
IV—SHORT TERM AND SIGHT DEPOSITS (various currencies)			
1. Central Banks for their own account:			
(a) Between 3 and 6 months	6,950,871.81		1.1
(b) Not exceeding 3 months	127,410,948.67		19.8
(c) Sight	44,825,146.38		7.0
2. Central Banks for the account of others:		179,186,966.86	
Sight		3,308,162.32	0.5
3. Other depositors:			
(a) Not exceeding 3 months	1,170,325.14		0.2
(b) Sight	1,021,582.75		0.2
		2,191,907.89	
V—SIGHT DEPOSITS (Gold) . . .		9,623,220.20	1.5
VI—MISCELLANEOUS			
1. Guaranty on Commercial Bills sold	1,424,455.09		0.2
2. Sundry items	31,864,444.26		4.9
		33,288,899.35	
VII—SURPLUS			
Profit for the financial year ended March 31, 1938		9,011,956.53	1.4
		644,030,933.57	100.0

of the Bank for the financial year ending March 31, 1938, and we report that we have obtained all the information with the Note, is properly drawn up so as to exhibit a true and correct view of the state of the Bank's books of the Bank, as expressed in the above-described Swiss gold franc equivalents of the currencies

PRICE, WATERHOUSE & Co.
Chartered Accountants.

PROFIT AND LOSS ACCOUNT

for the financial year ended March 31, 1938

		Swiss gold francs
<hr/>		
Net Income from the use of the Bank's capital and the deposits entrusted to it, after necessary allowance for contingencies		10,977,498.68
Commissions earned:—		
As Trustee (or Fiscal Agent to Trustees) for International Loans		145,177.45
In connection with special credits		84,244.25
Transfer fees		436.50
		<hr/> 11,207,356.88
Costs of Administration:—		
Board of Directors — fees and travelling expenses	224,008.98	
Executives and staff — salaries and travelling expenses	1,530,232.37	
Rent, insurance, heating, light and water	111,998.12	
Consumable office supplies, books, publications	90,987.81	
Telephone, telegraph and postage	61,512.35	
Experts' fees (Auditors, interpreters, etc.)	16,191.16	
Cantonal taxation	35,289.38	
Tax on French issue of Bank's shares	37,405.15	
Miscellaneous	87,775.03	2,195,400.35
		<hr/>
	NET PROFIT:—	9,011,956.53
		<hr/>

APPROPRIATION ACCOUNT

	Swiss gold francs
NET PROFIT FOR THE FINANCIAL YEAR ENDED MARCH 31, 1938	9,011,956.53
Applied in accordance with Article 53 (a) (b) (c) and (d) of the Statutes, as follows:—	
To the Legal Reserve Fund — 5 % of 9,011,956.53	450,597.83
	8,561,358.70
Dividend at the rate of 6 % per annum on paid-up capital	7,500,000.—
	1,061,358.70
To the Dividend Reserve Fund — 20 % of 1,061,358.70	212,271.74
	849,086.96
To the General Reserve Fund — 50 % of 849,086.96	424,543.48
Remainder	424,543.48

Distributed in accordance with Article 53 (e) (f) of the Statutes, as follows:—

	Swiss gold francs
Annuity Trust Account deposits in accordance with Article IV (e) of the Trust Agreement:—	
France	133,407.30
Great Britain	52,132.53
Italy	27,230.48
Belgium	14,730.44
Rumania	2,573.54
Yugoslavia	10,710.82
Greece	882.36
Portugal	1,691.18
Japan	1,691.18
Poland	49.02
	245,098.85
German Government non-interest-bearing deposit in accordance with Article IX of the Trust Agreement	122,549.43
French Government deposit (Saar)	1,806.20
French Government Guarantee Fund in accordance with Article XIII of the Trust Agreement	55,089.—
	424,543.48

TRUSTEE FOR THE AUSTRIAN

Statement of Receipts and Payments

Receipts

	American Issue \$	British and Dutch Issues £
1. BANK BALANCES as at July 1, 1936	781,009.57	108,940. 4. 1
2. RECEIVED FROM THE AUSTRIAN GOVERNMENT in respect of:—		
Interest coupons		
In cash	1,466,290.49	206,650. 9. 2
Accrued in bonds ceded for cancellation (see below)	8,539.42	1,232.16. 1
Bond redemption		
In cash	17,241.53	552.18.10
In bonds ceded for cancellation (see below)	613,786.47	86,422. 1. 2
Expenses	3,759.—	967.10.—
3. INTEREST RECEIVED on cash employed pending application to service of the Loan	1,079.09	291.15. 3
	2,891,705.57	405,057.14. 7

Payments

1. INTEREST		
Matured coupons paid and accrued interest paid on bonds purchased for redemption or ceded by the Austrian Government against refund of cash	1,483,417.60	209,394.10.—
Accrued interest on bonds ceded by the Austrian Government in part-payment of service instalments (see above)	8,539.42	1,232.16. 1
2. REDEMPTION		
Drawn bonds reimbursed	—	—
Bonds purchased by the Paying Agents	790.—	484. 5.—
Bonds ceded by the Austrian Government against refund of cash	—	—
Bonds ceded by the Austrian Government in part-payment of service instalments (see above)	613,786.47	86,422. 1. 2
3. EXPENSES		
Commission and expenses of Paying Agents and fees and expenses of Trustee	4,247.20	1,177. 5. 1
4. BANK BALANCES as at June 30, 1937, held in respect of the items shown on Annex IVb	780,924.88	106,346.17. 3
	2,891,705.57	405,057.14. 7

NOTE — The definitive bond of the American issue of the Loan contains a "gold coin" clause but the Austrian

AUDITORS'

We have audited the Books and Accounts of the Trustee for the Austrian Government International and Payments is correctly prepared therefrom and, read together with the Note thereon, properly by certificates obtained from the depositaries.

ZURICH, August 9, 1937.

GOVERNMENT INTERNATIONAL LOAN 1930

for the Seventh Loan Year (July 1, 1936 to June 30, 1937)

Italian Issue Lire	Swedish Issue Sw. Cr.	Swiss Issue Sw. Fr.	Austrian Issue Sch.	General Expenses	
				£	Sw. Fr.
3,152,692.52	527,914.69	801,881.12	2,093,756.75	—	—
5,897,937.76	632,236.88	1,481,733.93	3,872,487.57	—	—
41,736.53	—	6,780.27	—	—	—
6,830.03	216,335.—	91,709.70	1,543,832.30	—	—
2,460,079.97	—	524,070.30	—	—	—
30,208.50	2,867.25	7,554.40	18,096.04	300.—.—	27,548.95
8,884.01	4,006.27	2,236.19	—	—	—
11,598,369.32	1,383,360.09	2,915,965.91	7,528,172.66	300.—.—	27,548.95

5,859,478.15	642,530.—	1,498,570.93	3,935,640.06	—	—
41,736.53	—	6,780.27	—	—	—
—	202,910.—	—	—	—	—
—	—	55,327.50	19,650.—	—	—
6,559.15	—	33,990.—	1,560,721.92	—	—
2,460,079.97	—	524,070.30	—	—	—
32,657.32	3,458.91	7,775.05	23,375.65	300.—.—	27,548.95
3,197,858.20	534,461.18	789,451.86	1,988,785.03	—	—
11,598,369.32	1,383,360.09	2,915,965.91	7,528,172.66	300.—.—	27,548.95

Government, following the practice adopted in July 1933, has not provided the sums necessary to give effect thereto.

CERTIFICATE

Loan 1930 for the seventh fiscal year ending June 30, 1937 and certify that the above Statement of Receipts sets forth the transactions for that year. We have also verified the bank balances on hand at June 30, 1937

PRICE, WATERHOUSE & Co.
Chartered Accountants.

TRUSTEE FOR THE AUSTRIAN

Statement of Funds in the hands

The Bank Balances as at June 30, 1937 were held in respect of:—

- | | |
|--|--|
| 1. (a) Unpresented matured coupons | |
| (b) Interest coupons maturing on July 1, 1937 | |
| 2. Expenses accrued to June 30, 1937, but not claimed until thereafter | |
| Funds on hand for the liquidation of accrued or accruing liabilities | |
| 3. Bond redemption account | |
| 4. Other funds on hand (of which Sw. Fr. 5,609.80 is deposited with a bank, formerly a Paying Agent, which has suspended payments) | |
| Total balances on hand as per Statement of Receipts and Payments — Annex IVa | |

Statement of Bonds outstanding

- | | |
|---|--|
| Nominal value of bonds issued | |
| Less: Nominal value of bonds redeemed during:— | |
| 1. First six Loan years | |
| 2. Seventh Loan year | |
| Nominal value of bonds outstanding as at June 30, 1937 (see note below) | |

NOTE: When drawn for redemption,

GOVERNMENT INTERNATIONAL LOAN 1930

of Depositaries as at June 30, 1937

American Issue \$	British and Dutch Issues £	Italian Issue Lire	Swedish Issue Sw. Cr.	Swiss Issue Sw. Fr.	Austrian Issue Sch.
16,597.— 727,958.— 1,947.25	1,190.—.— 102,567.10.— — 2. 2	167,445.25 2,928,100.— 15,514.48	— 314,370.— 1,834.59	22,715.— 735,595.— 3,798.91	47,475.86 1,900,617.60 9,503.17
746,502.25 16,478.32 17,944.31 780,924.88	103,757.12. 2 88.—. 3 2,501. 4.10 106,346.17. 3	3,111,059.73 431.76 86,366.71 3,197,858.20	316,204.59 216,500.— 1,756.59 534,461.18	762,108.91 3,030.46 24,312.49 789,451.86	1,957,596.63 128.02 31,060.38 1,988,785.03

as at June 30, 1937

25,000,000	3,500,000	100,000,000	10,000,000	25,000,000	50,000,000
3,600,400 600,800	484,500 85,000	13,536,000 2,804,000	821,000 197,000	3,370,000 613,000	6,376,700 1,198,800
20,798,800	2,930,500	83,660,000	8,982,000	21,017,000	42,424,500

bonds are repayable at 103 per cent.

TRUSTEE FOR THE AUSTRIAN

Interim Statement of Receipts and

	Dollars
Nominal amount originally issued	25,000,000.—
Nominal amount outstanding as at December 31, 1937	20,600,800.—

Receipts

1. BANK BALANCES as at July 1, 1937	780,924.88
2. RECEIVED FROM THE AUSTRIAN GOVERNMENT in respect of:—	
Interest coupons	
In cash	707,045.90
Accrued in bonds ceded for cancellation (see below).	3,339.19
Bond redemption	
In cash	152,172.—
In bonds ceded for cancellation (see below)	184,370.—
Expenses	1,857.—
3. INTEREST RECEIVED on cash employed pending application to service of the Loan	666.57
	1,830,375.54

Payments

1. INTEREST	
Matured coupons paid and accrued interest paid on bonds purchased for redemption or ceded by the Austrian Government against refund of cash	726,879.41
Accrued interest on bonds ceded by the Austrian Government in part-payment of service instalments (see above)	3,339.19
2. REDEMPTION	
Bonds purchased by the Paying Agents	19,570.—
Bonds ceded by the Austrian Government against refund of cash	—
Bonds ceded by the Austrian Government in part-payment of service instalments (see above)	184,370.—
3. EXPENSES	
Commission and expenses of Paying Agents and fees and expenses of Trustee	2,374.83
4. BANK BALANCES as at December 31, 1937, in respect of:—	
Interest coupons maturing on January 1, 1938	721,028.—
Bonds drawn for payment on January 1, 1938	—
Matured coupons unrepresented	17,832.50
Bond redemption	149,080.32
Miscellaneous items (of which Sw. Fr. 5,609.80 is deposited with a bank, formerly a Paying Agent, which has suspended payments)	5,901.29
	1,830,375.54

GOVERNMENT INTERNATIONAL LOAN 1930

Payments for the half-year ended December 31, 1937

Sterling	Lire	Swedish Crowns	Swiss Francs	Schillings
3,500,000.—.—	100,000,000.—	10,000,000.—	25,000,000.—	50,000,000.—
2,885,400.—.—	82,370,000.—	8,982,000.—	20,788,000.—	41,946,100.—

106,346.17. 3	3,197,858.20	534,461.18	789,451.86	1,988,785.03
99,492.12.10	2,825,468.69	312,897.96	715,393.48	1,870,859.87
668. 9. 9	19,243.40	—	2,245.07	—
215.10.—	2,895.—	111,615.—	187,205.—	825,622.39
46,247.—.—	1,328,700.—	—	142,140.—	—
624. 7. 1	14,894.—	1,422.75	15,731.20	8,701.70
143. 1. 9	4,353.30	2,120.54	1,194.12	—
253,737.18. 8	7,393,412.59	962,517.43	1,853,360.73	4,693,968.99

102,379.14. 3	2,944,725.—	314,370.—	740,331.48	1,909,857.27
668. 9. 9	19,243.40	—	2,245.07	—
205.10. 9	—	—	21,630.—	—
—	—	—	72,100.—	630,722.56
46,247.—.—	1,328,700.—	—	142,140.—	—
711.19. 6	16,719.—	1,571.85	15,808.07	11,044.60
100,989.—.—	2,882,950.—	314,370.—	727,580.—	1,879,185.28
—	—	216,300.—	—	—
1,379.—.—	150,820.25	—	19,635.—	46,357.46
97.19. 6	3,326.76	111,815.—	96,505.46	195,027.85
1,059. 4.11	46,928.18	4,090.58	15,385.65	21,773.97
253,737.18. 8	7,393,412.59	962,517.43	1,853,360.73	4,693,968.99

INTERNATIONAL LOANS

FOR WHICH THE BANK IS TRUSTEE OR FISCAL AGENT FOR THE TRUSTEES

Funds on hand as at March 31, 1938

	German External Loan 1924	German Govt. International 5½% Loan 1930	Austrian Govt. International Loan 1930	Totals
Swiss gold francs				
FUNDS HELD IN RESPECT OF:—				
Redemption of bonds	639,518.75	729.51	507,282.48	1,147,530.74
Interest in respect of the next coupon falling due	—	—	3,074,056.88	3,074,056.88
Drawn bonds not yet presented for re- demption	3,568.67	—	—	3,568.67
Interest coupons due but unrepresented	75,036.82	70,266.60	232,031.65	377,335.07
Miscellaneous items	341,684.80	6,405.60	19,769.36	367,859.76
TOTALS . .	1,059,809.04	77,401.71	3,833,140.37	4,970,351.12

BOARD OF DIRECTORS

Sir Otto Niemeyer, London.	Chairman.
Prof. Alberto Beneduce, Rome.	} Vice-Chairmen.
Marquis de Vogüé, Paris.	
Dott. V. Azzolini, Rome.	
Prof. Dr. G. Bachmann, Zurich.	
Baron Brincard, Paris.	
Pierre Fournier, Paris.	
Alexandre Galopin, Brussels.	
Georges Janssen, Brussels.	
Hisaakira Kano, London.	
Montagu Collet Norman, London.	
Dr. Paul Reusch, Oberhausen (Rhineland).	
Ivar Rooth, Stockholm.	
Dr. Hjalmar Schacht, Berlin.	
Kurt Freiherr von Schröder, Cologne.	
Dr. L. J. A. Trip, Amsterdam.	
Seljiro Yanagita, London.	

Alternates

Adolphe Baudewyns, Brussels.	
Yves Bréart de Boisanger, Paris.	
Cameron Cobbold, London.	
Dott. Pasquale Troise or	} Rome.
Dott. Mario Pennachio	
Dr. Wilhelm Vocke or	} Berlin.
Ernst Hülse	

EXECUTIVE OFFICERS

Dr. J. W. Beyen	President.
Roger Auboin	General Manager.
Paul Hechler	Assistant General Manager.
Dott. Raffaele Pilotti	Secretary General.
Marcel van Zeeland	Manager.

9th May 1938.