BANK FOR
INTERNATIONAL SETTLEMENTS

FORTY-SECOND ANNUAL REPORT

1st APRIL 1971 – 31st MARCH 1972

BASLE

12th June 1972

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FORTY-SECOND ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 12th June 1972

Gentlemen,

I have the honour to submit herewith the forty-second Annual Report of the Bank for International Settlements for the financial year which began on 1st April 1971 and ended on 31st March 1972.

In the course of the financial year an issue to central banks of a further 16,400 shares was made, thereby raising to 481,125 the total number of shares issued and paid up to the extent of 25 per cent. Details of this small change in the capital structure of the Bank can be found in Chapter VII of this Report.

After deduction of the transfer of 7,531,416 gold francs to the Provision for Exceptional Costs of Administration, the net profit for the year amounted to 148,832,656 gold francs, compared with 99,448,906 gold francs for the preceding year.

The Board of Directors recommends that, in application of Article 51 of the Bank's Statutes, the present General Meeting should allocate the sum of 17,888,437 gold francs in payment of the preferential dividend of 6 per cent. per annum, or 37.50 gold francs per share, and that from the remainder of the net profit it should appropriate 8,944,219 gold francs — a sum falling within the statutory limit of 20 per cent. — in payment of the maximum further dividend of 3 per cent. per annum, or 18.75 gold francs per share. These dividends are payable in respect of the full year in the case of 464,725 shares and in respect of nine months in the case of the 16,400 shares issued at the end of June 1971.

The Board further recommends that 61,000,000 gold francs be transferred to the General Reserve Fund, 24,400,000 gold francs to the Special Dividend Reserve Fund and 36,600,000 gold francs to the Free Reserve Fund.

If these proposals are approved, the Bank's total dividend for the financial year 1971–72 will amount to 56.25 gold francs per share on 464,725 shares and to 42.1875 gold francs per share on the 16,400 shares issued in June 1971. The sums in question are payable to shareholders on 1st July 1972 in Swiss francs and amount, on the basis of the central rate at present in force, to 76.60 and 57.45 Swiss francs per share respectively.

Chapter I of this Report gives an analysis of the crisis of the dollar and the international monetary system. The following three chapters review economic and monetary developments and policies, foreign trade and payments, gold production, changes in monetary reserves, and foreign exchange markets and regulations. The fifth chapter gives a survey of developments in the Euro-currency market and the sixth deals with the operations of the European Monetary Agreement. Chapter VII concerns the Bank's activities during the financial year, the Balance Sheet and the financial results.

I. THE CRISIS OF THE DOLLAR AND THE MONETARY SYSTEM.

In 1971 the long stretch of deficits in the United States' balance of payments, and the mounting tensions in the international monetary system itself, reached a breaking point. After some months of acute disturbance in foreign exchange markets, the United States was obliged formally to suspend the convertibility of the dollar on 15th August and almost all major currencies were subjected to a period of floating. While some clash of views on the steps to be taken to restore order to the system prevailed for several months, a new structure of pegged exchange rates was agreed upon at a Ministerial meeting of the Group of Ten in Washington on 18th December. This agreement involved a devaluation of the dollar and revaluations of several other Group of Ten currencies, as well as a widening of exchange margins from the previous 1 per cent. on either side of parity to 2 ¼ per cent.

All in all, this was an unprecedented episode in the history of international monetary relations — far different in both its causes and its procedures from the currency realignment in 1949. It was different also in that it implied fundamental changes in the Bretton Woods system, although the full scope of these changes is not yet apparent.

The following elements contributing to the 1971 crisis will be discussed: first, the external deficit of the United States; secondly, the policy measures used to reduce the deficit; thirdly, the surpluses which were the counterpart of the US deficit; fourthly, the growing instability of the monetary system itself; and lastly, the events which immediately precipitated the crisis. The chapter ends with a description of the Smithsonian agreement of 18th December and the reactions of the exchange markets up to the spring of this year.

The US balance of payments.

Among the contributing factors to last year's monetary crisis, the progressive deterioration of the payments position of the United States was certainly foremost. This section traces developments in the balance of payments to see how fundamental disequilibrium evolved.

The US economy, in contrast to the productive facilities of most other belligerent countries, emerged enormously strengthened from the second world war. Its resulting dominance in the world economy was reflected in the strength of the balance of payments. Despite the tight quantitative controls that most other countries maintained on imports, the United States accumulated a surplus on transactions in goods and services totalling $32 milliard during the four years 1946–49. Thus, even after disbursements of aid and loans amounting to over $26 milliard, almost $6 milliard was added to external reserves. This was a clearly unsustainable situation.

The widespread devaluations against the dollar in the autumn of 1949 marked an important turning-point. Since then the United States has almost always been in overall external deficit, with a progressive worsening of its reserve position. The deficit era started with a jolt in 1950, when the official reserve transactions balance recorded a deficit of $3.3 milliard. But this immediate change was not simply a result of the devaluations; the decline in the surplus on trade account from $5.3 milliard in 1949 to $1.1 milliard in 1950 owed much to a continuation of the post-war shake-out in world trade and to the outbreak of the Korean war. Because so much of US trade in 1949 was with Canada, which devalued by only 9 per cent., and with Latin American countries, which largely stayed with the dollar, the immediate impact of the realignments was probably not over-severe. But later, as the European economies recovered and expanded their trade potential, the 1949 realignments were no doubt a significant factor in international industrial competitiveness.

However, the trade surplus, while not regaining the heights of earlier years, rebounded to $3.1 milliard in 1951 and reached $4.8 milliard in 1956. Meanwhile, in other areas of the balance of payments, net official spending abroad did not change greatly, averaging in total some $4.5 milliard per annum, though the emphasis shifted

United States: Balance of payments, 1950–71.*

Items (net)	Years or annual averages							
	1950–56	1957	1958–59	1960–64	1965–67	1968–69	1970	1971
	in milliards of dollars							
Merchandise trade	2.6	6.3	2.3	5.4	4.2	0.6	2.1	− 2.9
Military expenditure	− 2.0	− 2.8	− 3.0	− 2.4	− 2.7	− 3.2	− 3.4	− 2.9
Travel and transportation	− 0.1	− 0.2	− 0.7	− 1.1	− 1.5	− 1.7	− 2.0	− 2.2
Investment income	1.9	2.4	2.5	3.9	5.5	6.1	6.3	7.9
Other services and transfers	− 0.5	− 0.5	− 0.6	− 0.6	− 0.7	− 0.8	− 0.8	− 0.7
Balance on goods, services and remittances	1.9	5.2	0.5	5.2	4.8	1.0	2.2	− 0.8
US Government grants	− 2.2	− 1.6	− 1.6	− 1.9	− 1.8	− 1.6	− 1.7	− 2.0
Balance on current account	− 0.4	3.6	− 1.1	3.3	3.0	− 0.6	0.5	− 2.8
Long-term capital Official	− 0.3	− 0.9	− 0.6	− 1.0	− 1.8	− 2.1	− 2.0	− 2.4
Private	− 0.9	− 2.9	− 2.1	− 3.0	− 3.4	0.6	− 1.5	− 4.1
Balance on current account and long-term capital	− 1.6	− 0.2	− 3.8	− 0.7	− 2.2	− 2.1	− 3.0	− 9.3
Short-term capital	0.1	0.3	0.8	− 0.5	1.3	5.8	− 6.5	−10.3
Errors and omissions	0.3	1.0	0.3	− 1.0	− 0.6	− 1.5	− 1.1	−10.9
Allocations of SDRs	—	—	—	—	—	—	0.8	0.7
Official reserve transactions balance	− 1.2	1.1	− 2.7	− 2.2	− 1.5	2.2	− 9.8	−29.8

* *Certain figures for 1950–59 are taken from H. B. Lary, "Problems of the United States as World Trader and Banker", NBER, New York 1963, page 13.*

away from reconstruction items towards military spending — partly influenced by the Korean war. The net outflow of private capital, of much concern in later years, did not — at least until 1956 — assume notable proportions. In sum, during the period 1950–56 the overall deficit averaged $1.2 milliard per annum and there was no clear trend in either direction. In this period the underlying strength of the dollar was not questioned, and the deficit was seen primarily as a constructive contribution to world economic recovery and expansion, and as a means of achieving a desirable redistribution of reserves.

In 1957 there was a rather freakish surplus. In a way, the optimists seemed vindicated, but subsequent years could hardly be expected to provide repeat performances. The surplus, at $1.1 milliard, was of pre-1950 proportions, as was the trade surplus of $6.3 milliard, which underpinned the overall position. But exports, particularly of petroleum and agricultural products, as well as earnings from shipping, had received a strong boost from the closure of the Suez Canal, while the coincidence of boom conditions in most European countries with a turn towards recession in the United States provided another temporary source of strength to the US external accounts.

The experiences of 1958 and 1959 well illustrated the transient nature of 1957's surplus. By 1959 the trade surplus was down to $1 milliard and the overall balance showed a $2.3 milliard deficit; the gold stock was drained of $3.3 milliard in two years. Recovery in the United States and recession in Europe made the cyclical position unfavourable to US trade in 1958, and in 1959 the domestic steel strike was a further adverse influence. But the fall in the trade surplus was more than could be explained by such factors alone. Indeed, the sharp rise in imports, particularly of cars, was indicative of the competitive strength that had been building up abroad during the fifties.

The balance of payments was also adversely affected in the second half of the fifties by the emergence of substantial long-term private capital outflows. While these had been of modest proportions in the earlier years of the decade, 1956 and 1957 witnessed a greatly increased net outflow. In particular, there was a surge in private direct investment abroad, which reached almost $2 milliard in 1956 and $2.4 milliard in 1957; most of it went to Canada and Latin America (which were in the dollar area), the flows to the latter being associated primarily with the western hemisphere oil boom following the Suez crisis.

With only two years of overall surplus in the fifties, with a cumulative deficit of over $12 milliard, with signs towards the end of the decade of a stronger competitive challenge ahead, and, indeed, with the prospect of larger capital outflows, the outlook at the turn of the decade was not good. In fact, the Economic Report of the President in 1972 stated that there had been "uninterrupted concern with the excess of US payments abroad over receipts from abroad since 1959".

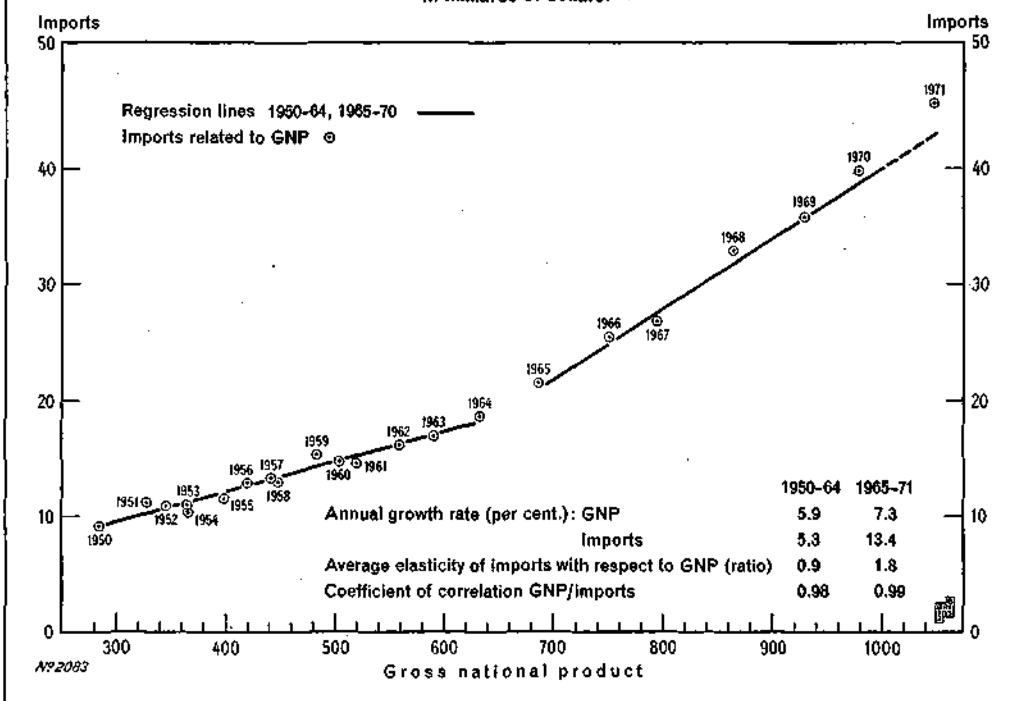
During the first five years of the sixties the deficits totalled almost $11 milliard. The trade surplus increased from the depressed $1.1 milliard of 1959 to an average of $5.4 milliard in 1960–64. A better performance might, however, have been hoped for. Europe was for most of this period experiencing a sustained boom while the United States was operating below capacity, the United States had considerably greater price stability, and US agricultural exports were boosted at times by bad harvests abroad.

In addition to the improvement in merchandise trade, there was a significant reduction in net military outlays. And earnings from investments abroad increased progressively as the earlier expansion of such investment bore fruit. On the other hand, with the boom in travel abroad gathering pace, the net deficit on travel and transportation account was substantially higher.

As anticipated above, the capital accounts showed growing deficits in this period. Almost all the current-account improvement was offset by outflows of short and long-term capital. The expansion of capital outflows was associated in particular with the boom in foreign markets, more confidence in political stability, and the general adoption of convertibility in 1958. Interest in the Common Market was an additional incentive. It was during this period that the US authorities began to introduce measures in an attempt to stem the tide of investment abroad.

As short-term capital flows had become important and were by nature reversible, growing attention was paid to the basic balance (i.e. the balance of current and long-term capital transactions) as an indicator of the underlying payments position. The overall and basic balances did indeed begin to diverge significantly in 1959, and over the first five years of the sixties the total basic deficit amounted to only $3.3 milliard, with the years 1961 and 1964 actually recording tiny surpluses. However, any hopes that these surpluses heralded a trend of continuing improvement were soon dashed. After 1964 the external picture became increasingly adverse, despite some wide year-to-year fluctuations in the various balances. This worsening pivoted upon a substantial decline in the trade surplus.

United States: Gross national product and merchandise imports.
In milliards of dollars.



Merchandise trade has always been the largest element and hence the foundation of the US payments position. Furthermore, the growth of trade over the years considered here was phenomenally large: exports rose from $14.2 milliard in 1951 to $42.0 milliard in 1970, and imports from $11.2 to 39.9 milliard. Excluding military goods, merchandise trade earned the United States a surplus which, though fluctuating, averaged $2.9 milliard per annum during the fifties and $5.4 milliard in 1960–64. At its peak the surplus amounted to some 30 per cent. of exports and equalled more than 1 per cent. of the gross national product. It is noteworthy, even so, that the trade surplus increased much less than did total trade. While the latter almost doubled between 1951 and 1965, the trade surplus grew by little more than 60 per cent.

In the six years 1965–70 the surplus averaged only $2.7 milliard and, after adjustment for cyclical factors in both the United States and foreign countries, the trend was decidedly adverse. Comparing the average for 1969–70 with that for 1964–65 — which helps to eliminate much of the cyclical influence — US exports were 51 per cent. higher, an increase not greatly different from that between 1959–60 and 1964–65. Imports, however, were 90 per cent. higher, while manufactured goods imports were 140 per cent. higher. This was the main area of deterioration in the trade balance compared with earlier years; it can be seen from the accompanying graph that the relation of imports to gross national product changed quite sharply after 1964. The following table relates particular categories of imports to appropriate indicators of demand. Within a rise of 22 per cent. in the total import ratio, the ratios for food products and industrial supplies barely changed between the first and the second half of the decade, while the ratios for capital goods, cars and consumer goods rose by 84, 66 and 46 per cent. respectively. What explanations can be found for this performance?

United States: Ratio of merchandise imports to related domestic indicators.

Items	Average 1960–64	Average 1965–69	1970	1971
	in percentages			
Total imports ÷ total domestic demand	2.92	3.56	4.11	4.36
Foreign passenger cars Imports of foreign models ÷ US demand for all passenger cars	5.64	9.34	16.13	16.67
Capital goods Imports of capital goods, except automotive, ÷ investment in producers' durable equipment, except automotive	3.01	5.54	7.34	7.66
Non-food consumer goods, except cars, petrol and oil Imports ÷ consumer expenditure	2.41	3.51	4.67	4.98
Foods and beverages Imports ÷ consumer expenditure	4.15	4.27	4.67	4.66
Supplies and materials Imports of industrial supplies and materials ÷ domestic demand, excluding services	2.49	2.62	2.69	2.80

Source: US Department of Commerce, Survey of Current Business, March 1972, page 38.

The most obvious changes in US economic conditions in the latter part of the sixties were the excessive pressure of demand and quite rapid price inflation, initiated by the Vietnam war. Whereas for quite a few years previously the US economy had been operating below capacity, the situation was the reverse in the years 1966–69, with unemployment averaging well below 4 per cent. of the labour force. After restrictive monetary policy was applied in 1969, 1970 saw a sharp recession. However, although the excess demand conditions that existed for most of this period undoubtedly contributed to the lower average level of the trade surplus, the evidence of a continuous deterioration even after cyclical adjustment calls for some further explanation.

The high pressure of demand at this time did indeed set off a marked increase in cost inflation. Following a declining trend up to 1964, unit labour costs in manufacturing rose by 13 per cent. over the next five years. This, together with the net unfavourable impact of currency realignments in this period, had a distinct adverse effect on the competitive position of the United States in international trade. In fact, prior to the mid-sixties the United States had generally enjoyed a more satisfactory record than others in containing wage costs, despite a lower rate of increase in productivity. Although some individual countries — Japan for instance — were able to establish an ever-widening cost advantage, this was not on average the case, as the table below shows. After the mid-sixties, however, the trend reversed, although the upsurge of inflation in Europe in 1970 yielded some further gain for the United States. A similar picture emerges from data on comparative export prices.

United States: Changes in relative cost and price position, 1961–71.

Years	Unit labour costs in manufacturing	Unit value of exports of manufactured goods
	Ratio of United States to competitors, 1964 = 100	
1961	104.6	99.9
1962	103.9	101.2
1963	101.0	100.8
1964	100.0	100.0
1965	96.9	102.3
1966	96.5	103.4
1967	99.4	105.2
1968	104.7	107.7
1969	106.4	108.4
1970	100.8	106.9
1971 (1st half)	98.0	107.6

Source: Economic Report of the President, January 1972, page 152.

It is clear, therefore, that in the period 1966–69 the United States suffered a loss of competitiveness from inflation which must explain in part the accompanying fortunes of the trade balance. However, the growth of the trade surplus over more than a decade previously had been rather sluggish. Hence, it is evident that forces other than inflation lay behind the unsatisfactory development of the trade balance over the longer term. This is particularly true when account is taken of the fact that there must have been important feedbacks to US exports from the growing US deficits on military and capital accounts and from official foreign aid (including loans).

Looking at the longer-term development of the various categories of US trade, in food products and industrial supplies and materials, the United States' net imports were about the same in 1970 as in 1950. However, for automotive products, the United States swung from being a small net exporter up to the late sixties to become a net importer, to the extent of $2.3 milliard in 1970; this deterioration started after the automotive pact with Canada in 1965, but imports from Europe and Japan have also risen very sharply. More importantly, for other consumer goods the United States ceased being a net exporter after 1957; imports in this category doubled between 1961 and 1966 and again between 1966 and 1970, while exports took the whole decade to double their value; as a result, net imports totalled $4.8 milliard by 1970. Meanwhile, on the brighter side, net exports of capital goods (other than automotive products) grew from $2.2 milliard in 1950 to $10.6 milliard by 1970. While for a country to become a net importer of consumer goods, financed by exports of capital goods, is probably a feature of an advanced stage of economic maturity, very heavy reliance is thereby placed on a continuing expansion of net exports of capital goods. Although such an expansion was achieved, it was not large enough, and in fact imports of capital goods, though still quite small absolutely, grew during the sixties at a rate about twice as fast as similar exports.

To account for these trends one must recognise the gradual decline in the United States' relative competitive position as other countries built up their productive capacity and technological strength. In the early post-war years the United States could simply out-produce the rest of the world. Real national income per head did not recover its pre-war level in western Europe until 1949, by which time in the United States it was about 60 per cent. above its pre-war level — a growth which Europe took a further twelve years to achieve. Therefore, with relative disregard for price, there was an enormous thirst for US goods — a thirst which was frustrated by the scarcity of dollars and only satisfied to the extent that dollars became available in payment for US imports or through various loan and aid programmes. Up to well into the fifties, while the dollar scarcity restricted the capacity of the rest of the world to buy US goods, higher US imports, by supplying dollars, tended to generate higher US exports.

But the productive dominance of the United States was gradually reduced, for over the whole twenty-year period 1951–70 the US economy grew in real terms at only 3½ per cent. per annum, compared with 5½ per cent. for other OECD countries taken together. Simply in terms of demand generation, this faster growth abroad might have worked towards higher US exports, leading the trade surplus from strength to strength.

An important offsetting factor, however, was the structural change on the supply side that accompanied this more rapid growth in other economies. Industrialisation proceeded apace, facilitated by significant shifts of labour out of agriculture and by ready assimilation of new technologies. Meanwhile, wage rates in the United States remained much higher than elsewhere. With the expansion of the scale and efficiency of industry in other countries, goods which were of comparable quality to those already produced in the United States were produced abroad at prices which were often extremely competitive. This resulted in the gradual erosion of the dominance of established US products both in foreign markets and in the United States itself. And foreign industry also began to market products which were not being made at all in the United States — small cars being a leading example; while this probably indicated some slowness of US producers to adapt to the public's changing tastes, primarily it reflected the growing inability of US firms to compete with the prices set by producers who were based in countries with much lower wage rates and who had sufficiently narrowed the technological gaps between themselves and their US counterparts. Had the pattern of relative wage rates between the United States and other countries evolved differently, then the paths of competitiveness and hence of trade would have been correspondingly different. But, in the event, the divergence in the pace of increase of wage rates was relatively narrow, and the much higher level of money wages that existed in the United States after the second world war prevailed throughout the period, magnified early on by the 1949 realignments.

As to other balance-of-payments items during the latter half of the sixties, the Vietnam war led to a sharp rise in the deficit on military transactions, after a period of some contraction since 1958: by 1970 the net deficit stood at $3.4 milliard, against $2.1 milliard in 1964 and in 1965. Meanwhile the upward trend of the net deficit on travel and transportation continued, reaching $2.0 milliard in 1970. Net investment income was always a reliable, and usually a growing, source of surplus. The net inflow rose steadily to reach $6.2 milliard in 1968, but showed no further rise over the following two years because of a fairly sharp increase in interest payments to foreigners on placements in the United States.

In considering movements on capital account during this period, it should be remembered that the authorities' main efforts to contain the overall deficit, which are discussed later, were directed at capital outflows. In general, such measures achieved some success up to the end of the decade. The net outflow of private long-term capital fell back from around $4.5 milliard in 1964 and 1965 to an average of $1.2 milliard over the next five years — even giving way to an inflow in 1968. A large part of this change was attributable to a surge of foreign investment in US long-term securities; the inflows were very heavy in 1968 and 1969, far in excess of the already substantial outflow of US capital into foreign securities. The net outflow of direct private investment reached $3.6 milliard in 1966; this abated somewhat, as a result of official measures, to $2.4 milliard by 1969, only to surge back to $3.5 milliard in 1970. The underlying character of this particular deficit did itself hint at a growing overvaluation of the dollar. For, whereas direct investment overseas had historically been associated principally with the procurement of primary products for the US economy, an increasing proportion (at least until controls restrained it) had become oriented towards manufacturing industry, often in order to benefit from the lower labour costs referred to above, but also in order to reap the advantages of proximity to suppliers and to markets, and of production inside tariff walls. This process contributed to the expansion of the competitiveness of foreign-based production as a whole. Of course, as with all direct investment overseas, there were favourable feedbacks to the US balance of payments via exports and investment income. But, while it is not possible to identify the total effect of any particular investment on the external position, investment in manufacturing, being differently motivated, can be expected to be ultimately less favourable to the overall balance of payments than investment in primary industries.

Bringing together all current and long-term capital transactions, the basic balance showed a persistent and large deficit in the period 1965–70, amounting to around $3 milliard in each of the years 1967, 1969 and 1970. There was, however, a net inflow of short-term capital — as a result of heavy borrowing abroad by US banks and corporations — in each of the years 1965–69, amounting in 1969 to the large sum of $5.6 milliard, after taking into account unidentified flows, which in that year were offsetting. The official reserve transactions balance actually recorded significant surpluses in 1968 and 1969. These results were the best since the forties for the overall balance, but such strength as they indicated was quite superficial, being built on large inflows of short-term funds which by their very nature were both volatile and reversible. Little surprise, therefore, that 1970 witnessed a massive net short-term outflow of $7.6 milliard, which contributed to an unprecedented overall deficit of $9.8 milliard. This in turn put pressure on the US reserves, which had already been much drawn down by two decades of deficits. Together with the massive build-up of liabilities to foreign official agencies, the external position by the end of 1970 was very weak indeed — poised for a crisis under the strain of almost any adverse developments.

US measures to limit the deficit.

The sudden emergence of substantial external deficits and gold losses in 1958 and 1959 greatly disturbed the US authorities and remained a cause of concern over the years that followed. But from the start the scope of policy measures to correct the deficit was limited by the priority given to several other considerations. Firstly, in the period 1958–65 the economy was generally operating without excess pressure on resources, so that the remedy of restrictive fiscal and monetary policy was unacceptable. This was also the case in 1970–71. Secondly, the authorities wanted to adhere to fair trading practices and were against any general barriers to imports. The restrictions arranged on imports of certain products over the years were aimed at protecting domestic producers rather than at correcting the balance of payments. Thirdly, it was regarded as unsafe to reduce the overall level of security commitments abroad merely to help the balance of payments. And, finally, an article of faith, adhered to with growing insistence, was that the official parity of the dollar was inviolable, and could not be changed to achieve a general increase in the official value of gold or to obtain a realignment of currencies.

The remaining scope for action was therefore limited to economising on foreign currency expenditures on defence, seeking defence outlays by foreign governments in the United States, tying and reducing economic aid to other countries, and controlling capital exports. More nebulous were the measures of export promotion and export credit and efforts to attract foreign tourists to the United States.

The tying of development aid to purchases of US goods began under President Eisenhower's administration, and limited steps were taken to shift defence procurement from abroad to the United States. Concurrently, efforts were made to get other countries to remove remaining restrictions on dollar imports, to increase their contributions to development aid and to take over part of the foreign exchange cost of US defence expenditures in Europe. In early 1960 the first of a series of export promotion campaigns was begun.

Early in 1961 the new administration of President Kennedy announced further measures. In procurement for defence forces stationed overseas, goods produced in the United States were to be preferred, even where costs were up to 25 per cent. — later 50 per cent. — higher. Other steps were the tying of the bulk of US bilateral development aid and the negotiation of offsets to the foreign exchange costs of military forces in Europe. Also, the duty-free allowance for returning US tourists was cut from \$500 to \$100 and certain tax incentives to invest abroad were removed.

In an attempt to check the outflows of funds which developed from the relatively higher interest rates in Europe, the monetary authorities endeavoured, under "operation twist", to manage operations in government securities so as to bring about a rise in short-term rates; at the end of 1961 they raised the interest rate ceilings for time deposits with US banks. When this proved inadequate, the interest equalization tax was imposed in mid-1963 on US citizens' purchases of securities issued by borrowers in developed foreign countries.

The retreat into controls on private capital movements soon gathered pace. New measures announced in early 1965 included a voluntary restraint programme for bank lending abroad and for outflows for direct investment by large corporations, together with extension of the interest equalization tax to cover bank and non-bank term loans to foreigners. Subsidiary proposals included a pruning of government employment abroad and of foreign military assistance. More restrictive quantitative ceilings were introduced for 1966 and 1967 under the capital outflow programme. But, on government account, the savings achieved earlier were soon dwarfed by the expansion of Vietnam-related expenditure.

Rather drastic new measures were announced in January 1968, with the aim of cutting the prospective deficit for the year by at least \$2½ milliard. Of this, \$1½ milliard was to come from broader-based and stronger controls on private capital outflows. These were made mandatory for corporations and placed a moratorium on outflows for direct investment in western Europe in 1968 while strictly limiting reinvestment of earnings there. Direct investment outflows to other developed countries were also to be cut back and short-term assets abroad were not to be increased. Investment financed by borrowing abroad was, of course, left unrestricted and subsequently expanded sharply. For banks the ceilings on total foreign claims were lowered, no term loans to Europe were to be granted or renewed and short-term credits there were to be cut back by 40 per cent. during 1968. Other financial institutions were asked to reduce their total foreign claims and not to make new loans or investments in Europe.

The new administration of President Nixon was committed to easing the direct investment controls as a matter of principle. In April 1969 it raised the minimum investment subject to the programme from \$200,000 to \$1 million, thereby reducing the number of firms reporting quarterly from 3,400 to 650. The limit was later raised to \$2 million for 1971. A number of provisions, including those on reinvestment of earnings abroad, were liberalised and the guide-lines for banks were eased, particularly to encourage export financing, which was finally exempted entirely in August 1971.

New agreements negotiated with foreign countries to restrain their exports to the United States — such as had for some time applied for beef, steel and cotton textiles —

came into operation in the course of last year for woollen and synthetic textiles. Legislation approved in early August further expanded Export-Import Bank resources and permitted US corporations to establish domestic exporting subsidiaries with tax-deferment privileges similar to those granted to foreign subsidiaries.

By now ingenuity and morale were becoming exhausted. The whole range of measures to shore up the position of the dollar had proved inadequate against the forces that were leading to devaluation, although hopes prevailed in some quarters that this solution could still be avoided. Such hopes hinged on halting domestic inflation and securing reductions in non-tariff barriers to US exports. The continued contraction of hostilities in Vietnam would also assist and there was a belief that certain other currencies should be revalued. But even if time had allowed such adjustments to be made, they would have been unlikely to eliminate the underlying trend weakening the dollar — which was, as suggested above, due to more fundamental forces.

In so far as the US deficit was connected with the priority given to other objectives — such as the effort to gain reasonably full utilisation of domestic resources, or to maintain adequate defence forces abroad or reasonable outflows of capital and aid — there was no obligation under the Bretton Woods system for a sovereign nation to put balance-of-payments considerations foremost. Even with regard to the inflation that came with the Vietnam war, the United States was not the first country to fail to come to practical grips with such a problem. But what was not in the spirit of the system was the insistence that the parity of the dollar was beyond consideration as an instrument of basic external adjustment. How and when this sort of adjustment might have been appropriate also involves appraisal of developments outside the United States.

The balance of surpluses and deficits.

As is well known, the official settlements deficits in the international monetary system must, as a matter of arithmetic, be equal to the surpluses — after account has been taken of new monetary gold and, more recently, of allocations of SDRs, both of which provide a net surplus to the system without a corresponding deficit. More particularly, there must be a net surplus for other countries taken together which corresponds to the US deficit. As regards the reserve statistics in the following table, however, differences also arise because: (1) except in the case of the United Kingdom, reserve changes outside the United States are shown net of any negative EPU or IMF positions, but not of any other official liabilities; (2) some dollar reserves are held in banks outside the United States and therefore cannot be covered by US data on official liabilities; and (3) the data certainly contain some statistical discrepancies.

It is important to recognise that the equation above is a simple identity which does not carry any implication as to the causes of the imbalance. In particular, some countries may develop persistently large surpluses which impose deficits elsewhere in the system — just as readily as deficits of the United States, due to failure to take effective measures of adjustment, may impose surpluses on other countries. Furthermore, whereas the persistent deficits of overvalued currencies force adjustment in the end by the evaporation of reserves and borrowing capacity, the system as such does not impose adjustment on undervalued currencies. Thus, the question of which countries have the responsibility for adjusting a situation of general imbalance cannot be determined mechanically; it is a matter of judgement and therefore gives scope for a clash of views.

Looking at the reserve change for 1950–57 from this viewpoint, one may say that the German surplus stands out as enormously large and that either the 1949 devaluation of the Deutsche Mark was a mistake or there should have been a subsequent revaluation as the economy recovered. That no revaluation occurred before 1961 is not a criticism of the authorities, but rather a reflection on the generally rigid attitude towards fixed official parities that prevailed in this period. In fact, the German authorities have been foremost in recognising the adverse aspects of a large, persistent surplus. They considered a revaluation in 1956, and again in 1957 with considerable pressure from several of their partners in the European Payments Union. But diverse opinions could not be crystallised to the point of action. Though much less important

Official reserve movements (including SDRs), 1950–71.

Countries	1950 to 1957	1958 to 1968	1969	1970	1971						
					Year	Jan. to March	April to May	June	July	Aug.	Sept. to Dec.
	In milliards of US dollars										
United States											
Official assets .	— 1.2	— 9.1	+ 1.2	— 2.5	— 2.4	— 0.1	— 0.5	— 0.3	— 0.2	— 1.2	+ 0.0
Official liabilities	— 5.9	— 9.9	+ 1.5	— 7.3	—27.4	— 4.6	— 7.2	+ 1.5	— 2.3	— 7.6	— 7.3
Total	— 7.1	—19.0	+ 2.7	— 9.8	—29.8	— 4.7	— 7.7	+ 1.2	— 2.5	— 8.8	— 7.3
United Kingdom											
Official assets .	+ 0.6	+ 0.0	+ 0.1	+ 0.3	+ 3.6	+ 0.5	+ 0.2	+ 0.1	+ 0.2	+ 0.9	+ 1.7
Official liabilities	— 0.1	— 7.6	+ 1.2	+ 2.9	+ 0.4	+ 1.3	— 0.3	— 0.2	+ 0.2	+ 0.5	— 1.0
Total	+ 0.5	— 7.6	+ 1.3	+ 3.2	+ 4.0	+ 1.8	— 0.1	— 0.1	+ 0.4	+ 1.4	+ 0.7
Other developed countries . .	*+ 8.9*	*+25.8*	*— 2.4*	*+13.8*	*+28.2*	*+ 5.8*	*+ 5.2*	*— 0.3*	*+ 1.2*	*+ 9.5*	*+ 6.8*
Austria	+ 0.4	+ 1.0	+ 0.0	+ 0.2	+ 0.5	+ 0.0	+ 0.0	+ 0.1	+ 0.1	+ 0.2	+ 0.1
Belgium.	+ 0.2	+ 1.0	+ 0.2	+ 0.5	+ 0.4	+ 0.2	+ 0.2	— 0.1	+ 0.1	+ 0.2	— 0.2
Canada	+ 0.7	+ 1.1	+ 0.1	+ 1.6	+ 0.9	+ 0.2	+ 0.0	— 0.0	+ 0.1	+ 0.1	+ 0.6
France	— 0.4	+ 3.7	— 0.9	+ 1.0	+ 3.5	+ 0.5	+ 0.5	+ 0.0	+ 0.5	+ 1.7	+ 0.2
Germany	+ 5.0	+ 4.8	— 2.6	+ 6.5	+ 4.3	+ 2.2	+ 3.2	— 2.3	+ 0.3	— 0.3	+ 1.2
Italy	+ 0.6	+ 3.9	— 0.3	+ 0.3	+ 1.1	+ 0.7	+ 0.1	— 0.1	+ 0.0	+ 0.4	— 0.0
Japan.	+ 0.5	+ 2.1	+ 0.7	+ 1.2	+10.4	+ 1.1	+ 1.2	+ 0.7	+ 0.3	+ 4.4	+ 2.7
Netherlands . .	+ 0.6	+ 1.4	+ 0.1	+ 0.7	+ 0.3	+ 0.3	— 0.0	— 0.0	— 0.0	+ 0.0	+ 0.0
Spain	— 0.0	+ 1.0	+ 0.1	+ 0.5	+ 1.4	+ 0.3	+ 0.1	+ 0.2	+ 0.2	+ 0.2	+ 0.4
Sweden	+ 0.2	+ 0.3	— 0.1	+ 0.1	+ 0.3	+ 0.1	+ 0.1	+ 0.0	+ 0.0	+ 0.0	+ 0.1
Switzerland . .	+ 0.2	+ 2.4	+ 0.1	+ 0.7	+ 1.6	— 0.5	— 0.7	+ 1.2	— 0.6	+ 2.1	+ 0.1
Australia	+ 0.2	+ 0.1	— 0.2	+ 0.4	+ 1.6	+ 0.4	+ 0.4	+ 0.1	+ 0.1	+ 0.1	+ 0.5
New Zealand . .	—	— 0.1	+ 0.1	+ 0.0	+ 0.2	+ 0.0	+ 0.1	+ 0.0	+ 0.0	+ 0.0	+ 0.0
South Africa . .	+ 0.0	+ 1.2	— 0.1	— 0.4	— 0.3	— 0.1	— 0.0	— 0.1	— 0.0	— 0.0	— 0.1
Other	+ 0.5	+ 1.9	+ 0.5	+ 0.5	+ 2.0	+ 0.4	— 0.1	+ 0.1	+ 0.1	+ 0.4	+ 1.1
Less-developed countries . . .	*+ 1.6*	+ 3.2	*+ 1.5*	*+ 3.1*	+ 4.2	*+ 0.8*	*— 0.1*	*+ 1.6*	*— 0.0*	*+ 0.0*	*+ 1.9*
Total, excluding US and UK	*+10.5*	*+29.0*	*— 0.9*	*+16.9*	+32.3	*+ 6.5*	*+ 5.1*	*+ 1.4*	*+ 1.2*	+ 9.5	*+ 8.7*
Note: New monetary gold* .	+ 3.8	+ 2.1	+ 0.1	+ 0.3	— 0.1	—0.04	+0.01	—	—0.01	—0.02	—0.04

*Valued at $35 per ounce.

quantitatively, the surpluses of Italy, the Netherlands and Austria may seem over-large in relation to their international transactions in the sense that comparable surpluses for all countries would have required a gigantic growth of global reserves for the system as a whole. These remarks are not to deny the benefit to particular countries and to the system as a whole of some redistribution of reserves in the fifties.

However this may be, it is apparent that the US deficit would not have been substantially reduced by a few scattered revaluations, as many other countries would have benefited as well. The general situation was one of moderate surplus for most countries, somewhat offset by a few deficits. And the fact that surpluses were taken to so great an extent in dollars indicates that the norm in the system was for most countries to aim at some growth of dollar reserves as the volume of their external transactions increased. In this sense a deficit was imposed on the dollar — as the reserve currency of the system. This being so, it cannot be said that the dollar was generally overvalued at that time, particularly in the light of the large-scale foreign aid given by the United States and the widespread discrimination against dollar imports practised by other countries. The United States was playing the rôle of creator of reserves for the system — a rôle into which it had been cast by the circumstances of the post-war situation.

The next period in the table, 1958–68, shows a dramatic change. The average US deficit practically doubled as compared with 1950–57. At the same time the average surplus of the other developed countries, excluding the United Kingdom, which went deep into deficit, more than doubled, from $1.1 to 2.3 milliard a year. To a considerable extent these surpluses were concentrated in a few countries — France, Germany, Italy and Switzerland. And in the case of France the increase in reserves between the end of 1957 and the May 1968 crisis was nearly $6½ milliard. It is also true, however, that most other developed countries, again excluding the United Kingdom, had reserve increases during the sixties that were of fairly major proportions. And from 1968 onwards Japan's reserves began to grow very fast. The situation was, therefore, both that certain currencies appeared to be undervalued and that sometime in the course of these years the dollar had become overvalued against the currencies of most other developed countries. When account is taken of the kinds of measures resorted to by the United States to minimise the deficit, noted in a preceding section, the case for the overvaluation is strengthened.

When did the overvaluation of the dollar become noticeable? One must guard against hindsight here; but, even so, the deficits averaging almost $3 milliard in 1958–60 were a sign that could have been given greater weight. They were more than cyclical and chance aberrations, as they signalled not only the post-war reconstruction of the European economy but also its much-increased strength. The price rise on the gold market in 1960 shows that there was a significant body of opinion that considered a devaluation of the dollar parity more than a theoretical possibility. It has often been contended in the United States that the gold parity of the dollar could not be changed without precipitating a comparable universal change in par values. There is, however, the hard fact that the Deutsche Mark and the guilder were unilaterally revalued in 1961, and it is rather obvious that more significant changes in the structure of parities could have been obtained had US policy been oriented in this direction.

As the underlying situation worsened with the onset of the Vietnam war, the probability of the dollar's overvaluation became a certainty, particularly after the devaluation of sterling presaged the correction of the UK deficit — with inevitable adverse reactions on the dollar. One clear piece of evidence was the drop in the US trade surplus to $0.6 milliard in 1968. Another was the recovery of the trade balance by only $1.4 milliard in the recession year 1970; despite special factors, this may be compared with the recovery by $3.8 milliard in the recession year 1960, when the total value of US trade was less than half as large.

The growing disequilibrium of the system.

The erosion of the US reserve position from 1950 onwards was related not only to the factors discussed above bearing on the deficit in the balance of payments, but also to the development in the Bretton Woods system itself of a state of semi-permanent crisis. It was in 1960 that the first clear sign of this appeared.

The essence of the Bretton Woods system was the maintenance of fixed par values for the currencies of Fund members — except in cases of fundamental disequilibrium — and the fostering of liberal trading and exchange practices. The resources required to meet those objectives in cases of temporary difficulties were to consist of reserves in gold, of dollars convertible into gold, and of borrowing facilities available at the IMF. Given the steady increase in the volume of international trade and payments, the effective functioning of the system depended on two conditions: that there be a regular increase in total reserves and IMF facilities adequate to ensure that countries with realistic exchange rates could finance the greater swings apt to arise in their balances of payments; and that the increase in the total reserves of the system be shared between gold and dollars in such proportions that, given appropriate policies in the United States, the convertibility of the dollar into gold remained assured. It was this latter condition that came into question in the autumn of 1960, owing to the shortage of new monetary gold relative to the growth in the official liabilities of the United States. This shortage began to undermine the workings of the system by throwing back on the US gold stock an increasing part of the rest of the world's demand for monetary gold.

The situation that emerged dramatically in 1960 had in fact been developing throughout the fifties, though at first only gradually: the United States was in payments deficit while the rest of the world taken together was running a surplus well in excess of new monetary gold and of the amount of reserves that countries were prepared to hold in dollars. During the years 1950–57 countries other than the United States added $5.5 milliard to their gold reserves, including $2.6 milliard obtained by converting dollars at the US Treasury. In addition, they added $5 milliard to their dollar reserves in the form of short-term claims on the United States. Thus, a large part of the rest of the world's reserve gains during these eight years was at the expense of the net reserve position of the United States. This was only possible without a threat to the convertibility of the dollar because of the huge gold reserves, amounting to $24.6 milliard, held by the United States at the beginning of the fifties. Even at the end of 1957 the US reserve position was very strong, with a gold stock of $22.9 milliard and reserve liabilities of $7.9 milliard.

Changes in official monetary gold stocks.

Periods	Total (= new monetary gold)	United States	International institutions	Rest of the world
	in milliards of US dollars			
1950–57	+ 3.8	– 1.7	—	+ 5.5
1958–60	+ 1.7	– 5.1	+ 1.0	+ 5.8
1961–65	+ 2.7	– 4.0	– 0.8	+ 7.5
1966–May 1968	– 2.8	– 3.3	+ 0.8	– 0.3
June 1968–July 1970	+ 0.8	+ 1.5	– 0.4	– 0.3
August 1970–August 1971	—	– 1.7	+ 2.9	– 1.2

The position began to worsen much more rapidly from 1958 onwards, when the US deficit increased sharply. During the two and a half years from the end of 1957 to mid-1960 other countries' net purchases of gold from the US Treasury amounted to $3.4 milliard, considerably more than in the whole of the eight preceding years. At the same time, their official dollar holdings went up by a further $1.7 milliard. It gradually became clear that the dollar was heading for a difficult situation that only strong corrective action, including possibly a rise in the dollar price of gold, could avert.

The rate of US gold losses became even more rapid from mid-1960 onwards, amounting to $632 million in the third quarter of the year. This added to the growing uncertainties about the dollar; and the coming US presidential election in November raised further doubts about the relationship of the dollar to gold. Consequently, there was a sharp increase in market demand for gold, which pushed the London fixing price up between mid-July and mid-September from $35.09 to $35.24 per fine ounce. At that level the market price was, for the first time since the reopening of the London gold market in March 1954, above the point at which it would have paid to buy gold from the US Treasury and ship it to London for sale on the market. In other words, the market price of gold had got out of line with the monetary price. While much of the increase in market demand for gold at that time came from private sources, there was also some official buying, which continued even after the market price was out of line. Evidently some monetary authorities preferred to pay a slightly higher price for gold in the market rather than convert dollars at the US Treasury.

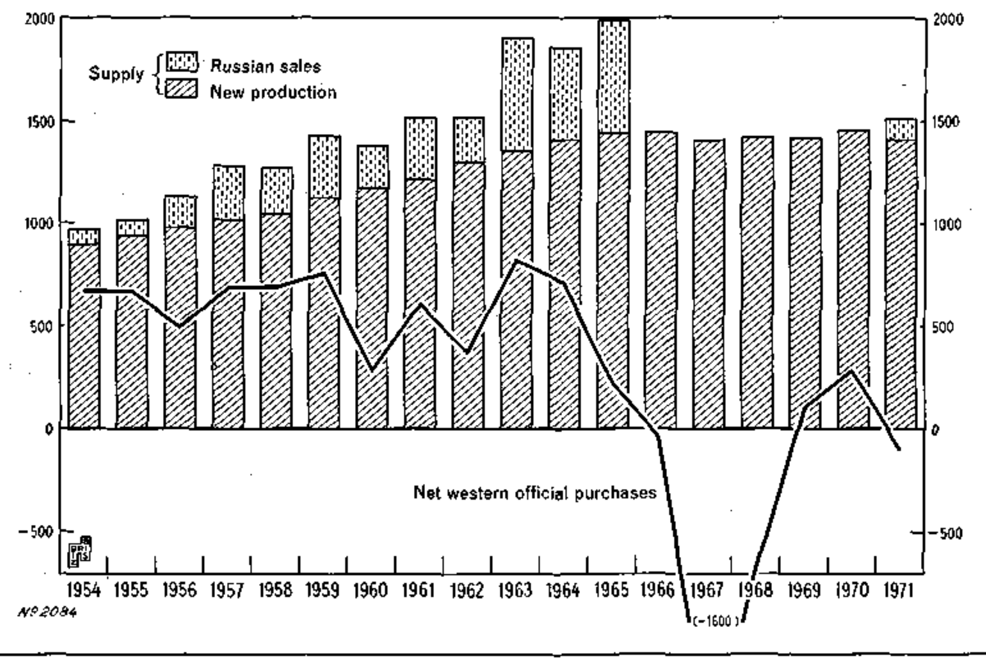
A renewed upsurge of demand sent quotations briefly as high as $40 per fine ounce in late October. Although conditions eased quite rapidly after the Democratic candidate for the Presidency had denied any intention to change the US gold parity, the market price did not get back into line with the monetary price until February 1961. The wide gap between the two prices that opened up in late October 1960 marked a watershed in the evolution of the Bretton Woods system. The attention of the world had been drawn to the growing shortage of new gold and to the associated threat to the convertibility of the dollar into gold at the existing parity.

Although by early 1961 conditions in the gold market were temporarily back to normal, the former absolute confidence in the dollar was never again restored. The gold market was less and less able to balance supply and demand at $35 per fine ounce; US reserves continued to decline; and the monetary system was less and less able to generate autonomously an adequate increment to total reserves. This process was spread out over a long period, as it was not until March 1968 that the market price of gold was separated from the official value. The slowness of the process was made possible by a variety of palliative measures and devices. Some of these were taken by the United States on its own account and others by the leading financial countries acting in concert. Although these measures often served as a temporary boost to confidence, they were at the same time constant reminders of the system's fragility.

So far as the gold market is concerned, the first measures were taken shortly after the October 1960 crisis. In the last weeks of 1960 the United States began to sell gold to the market in order to hasten the return to more normal conditions. Then, early in 1961 President Kennedy reaffirmed his country's intention to maintain the existing official dollar price of gold. By March 1961 the London market fixing price for gold was down to $35.08 per fine ounce. But the combination of a continuing large US deficit and further substantial US gold losses, plus the emergence of the political crisis over Berlin, pushed the price up again to $35.20 per fine ounce at end-August 1961. At that point the leading European central banks decided to refrain from buying gold in the market. Later in the same year the United States began discussing with European countries the idea of concerted official sales in the gold market in order to keep the market price in line at times of heavy demand. In November 1961 the central banks of Belgium, France, Germany, Italy, the Netherlands, Switzerland, the United Kingdom and the United States agreed jointly to supply to the market any gold needed for that purpose — the US share in the syndicate being 50 per cent.

Early in 1962, as it appeared that there might be a surplus of gold in the market, the same group of central banks agreed to co-ordinate their buying, with the purchases shared among the countries in the same proportions as their market sales. These selling

Supply of gold and net western official purchases.
In millions of US dollars, valued at $35 per fine ounce.



and buying arrangements became known as the Gold Pool, the agent of which was the Bank of England.

From its inception to the end of 1965 the operations of the Gold Pool were sometimes on the selling and sometimes on the buying side of the market. During this period, however, the Pool was on balance a net buyer of gold, since new supplies, with the aid of rather substantial sales by the USSR, were still adequate to permit an annual increase in total official gold holdings. This bore out the basic assumption of the Gold Pool that over time supply would be in excess of demand. After the end of 1965, however, the USSR stopped selling to the market, and in 1966, for the first time, there was a slight decrease, of $45 million, in total monetary gold stocks. From then onwards the situation was rather precarious, with the Gold Pool being a net supplier to the market.

In 1967 this movement accelerated, as monetary gold stocks fell by $230 million in the first nine months of the year. Immediately following the devaluation of sterling in November, market demand for gold rose to unprecedented levels. The devaluation of sterling appeared to the market as the forerunner of a dollar devaluation, despite official US reassurances to the contrary. Very heavy sales were made by the Pool to keep the price down, leading to a decline of $1.4 milliard in total monetary gold stocks during the last quarter of the year. A new and larger buying wave occurred in March 1968, which reduced official gold stocks by a further $1.4 milliard in the first quarter of the year. This led to the decision to suspend the operation of the Gold Pool, the market being left free to find whatever price would equate supply and demand. The admission of what was called the "two-tier" price system for gold — one official and the other free — marked a basic change in the Bretton Woods system.

While the gold crisis of March 1968 was linked to the devaluation of sterling and the persistent US payments deficit, the more fundamental cause was the change that had been taking place over a decade or more in the relationship between new supplies of gold and non-speculative market demand. In fact, industrial and saving demand for the metal had roughly doubled between 1956 and 1966, to the point where it was absorbing practically the whole of current western production. Except, therefore, in the case of sales by the USSR, there was in effect no longer any new gold available for adding to monetary reserves. Virtually the whole of the 1967–68 speculative demand had thus to be met by the Gold Pool. A corollary of this situation was that any future additions to gold reserves outside the United States would have to come, if at all, overwhelmingly from the US gold reserves. With these standing at $10.7 milliard in March 1968, the scope for further conversions of dollars at the US Treasury was becoming very limited.

Once the size of gold losses had become a threat to the maintenance of the gold convertibility of the dollar at the existing parity, the US authorities started early in the sixties to seek arrangements for facilitating the financing of the deficits incurred that would limit gold losses, quite apart from measures to reduce the deficit. One way in which this was done was by giving exchange guarantees on dollars bought from the market by central banks which might have been presented for conversion. The techniques used were swap operations between the Federal Reserve Bank of New York and other central banks for movements of funds that might be temporary, and the issue to foreign monetary authorities of US Treasury paper denominated in the creditor country's currency.

The swap facilities were started in 1962 on the authorisation of the Federal Open Market Committee; accordingly, the New York Federal Reserve Bank negotiated a network of reciprocal credit lines with certain foreign central banks and the BIS. By August 1962 facilities totalling $700 million had been arranged, and the size of the swap network grew steadily over the succeeding years until by mid-1970 it had reached over $11 milliard. This enormous expansion was not simply related to the Federal Reserve's needs to procure foreign exchange. The swap facilities were used also to help the Bank of England finance the huge balance-of-payments deficits of the United Kingdom during the years 1964–68; in addition, the network was periodically expanded so as to demonstrate that the authorities would be able to absorb speculative movements of private short-term funds, however large they might be.

Between March 1962 and August 1971 the Federal's gross swap drawings amounted to $11.8 milliard. But during most of this period the sums outstanding were relatively moderate, seldom exceeding $500 million at any one time. The only exceptions were during late 1967 and early 1968, when the drawings reached almost $2 milliard at one point, and in the year leading up to August 1971, when they rose from $0.3 to 3.0 milliard. Thus, the intention of using swaps as a short-term facility was adhered to. In general, the swaps were executed for a period of three months, with the possibility of several renewals. Repayment always took place within a year — either by a reversal of the market flows that had led to the swap being drawn in the first place; or in cash, through use of US reserve assets; or by replacing the swap debt with US Treasury securities carrying a guarantee against devaluation of the dollar. The network proved to be a flexible and useful instrument in managing market flows of funds.

The issue of foreign currency securities constituted, in fact, a sort of second line of defence for the US gold stock, behind the swap network and sharing the common purpose of facilitating the financing of the US payments deficit. The first issues were made to Italy and Switzerland in 1961–62. By September 1965 the total outstanding had reached nearly $1.3 milliard, of which four-fifths was held by Germany and Switzerland. After declining to under $0.9 milliard in mid-1967, the amount outstanding rose to a new peak of $2.3 milliard in 1969, of which Germany and Switzerland accounted for nearly 90 per cent. It then declined over the following twelve months by about $1 milliard, owing mainly to encashment of securities by the Deutsche Bundesbank to replenish Germany's exchange reserves following the 1969 revaluation of the Deutsche Mark. Further substantial issues to Switzerland in 1971, however, brought the total of outstanding issues up to nearly $2 milliard again by the end of last year.

The United States also economised on the use of its gold reserve by drawing on other reserve assets, i.e. its reserve position in the IMF and, from 1970 onwards, its SDR holdings. These types of financing were similar to swap drawings and foreign currency bond issues, in that the creditor country received a guarantee against dollar devaluation; in addition, however, they were similar to conversion into gold, in that the guarantee was a gold-value guarantee.

The first US drawings on the IMF were made in early 1964; and altogether between that time and August 1971 gross US drawings on the Fund totalled nearly \$3.4 milliard. Of this amount, \$1.1 milliard represented so-called "technical" drawings. These had the specific object of providing other countries with currencies eligible for use in repaying Fund drawings, at times when US dollars could not be employed for that purpose and when, therefore, the repayments might have been made at the expense of US gold reserves. The remaining \$2.3 milliard of US drawings on the Fund served simply to mop up excess dollars in the hands of foreign monetary authorities.

The United States was able to draw currencies on this scale from the Fund without using up its gold tranche mainly because, over the same period, other countries — chiefly the United Kingdom and France — themselves drew substantial amounts of dollars from the Fund. In this and other ways, the payments deficits of the United Kingdom and France enabled the United States to postpone going off gold longer than might otherwise have been possible. In fact, the last phase of the collapse of the gold/dollar system may be said to date from late 1969, when both the United Kingdom and France went decisively into payments surplus.

Finally, the US authorities were able to slow down the decline of the gold stock by political and moral suasion. This approach was effective partly because of the sheer political importance of the United States and partly because there was a widespread belief that a suspension of dollar convertibility would entail what came to be known as the collapse of the monetary system. This phrase evoked a vague but disagreeable-sounding state of affairs, which suggested awful consequences for economic prosperity and political stability.

In addition to the signs noted above, the mounting pressures in the system may be seen from the change in the way in which the growth of global reserves came about during the sixties. It might have been thought that as the shortage of new monetary gold became more acute, and as the ratio between US reserves and its foreign official dollar liabilities became more unfavourable, global reserves would simply not have been able to grow at an adequate rate. In fact, however, the annual growth rate of reserves in the form of gold, foreign exchange and Fund reserve positions actually increased quite markedly, from 2.3 per cent. in 1955–61 to 3.1 per cent. in 1962–68. But at the same time the asset composition of the increase in reserves changed dramatically, away from gold and Fund reserve positions into foreign exchange holdings.

Thus, the increase in gold reserves fell from \$3.9 milliard during 1955–61 to virtually nothing during 1962–68. And even omitting 1967–68, when total gold reserves fell sharply, the rate of increase during 1962–66 was considerably less than that in

Changes in global reserves, 1955–69.

Items	1955–61	1962–66	1967–68	1962–68	1969
	in milliards of US dollars				
Total	+ 9.1	+ 10.1	+ 4.7	+ 14.8	+ 0.9
Gold	+ 3.9	+ 2.0	− 2.0	+ 0.1	+ 0.2
Foreign exchange	+ 2.9	+ 5.9	+ 6.5	+ 12.4	+ 0.4
of which special transactions	—	*+ 3.8*	*+ 9.2*	*+ 13.0*	*− 2.6*
Fund reserve positions	+ 2.3	+ 2.2	+ 0.2	+ 2.3	+ 0.3

1955–61. This decline occurred despite larger new gold supplies; western gold production and Russian sales in fact increased from an annual average of $1.3 milliard during 1955–61 to $1.7 milliard during 1962–66.

On the other hand, foreign exchange reserves went up more than four times as much during 1962–68 as they had during 1955–61, the average annual rate of increase rising from 2.3 to 7.2 per cent. This was accounted for by specially negotiated transactions between monetary authorities involving ad hoc creation of exchange reserves, almost entirely among countries of the Group of Ten. They can for the most part be explained by the United States' transactions to limit the drain on its gold reserve, and the United Kingdom's borrowing of external resources to defend the sterling exchange rate during the period of substantial payments deficits from late 1964 until the end of 1968. The importance of these special operations can be seen from the fact that during 1962-68 they accounted for more than the whole of the increase in foreign exchange reserves and for almost 90 per cent. of the total increase in gold, foreign exchange and IMF reserves combined. And when, in 1969, the United Kingdom began to repay its foreign indebtedness, one consequence was that the overall growth of reserves fell away to less than $1 milliard.

In other words, satisfying the demand for increased reserves had come to depend on some countries running payments deficits that could only be financed by special ad hoc credit creation. As the granting of ad hoc credits depended on there being something of a crisis situation, this meant that, by and large, global reserves could only grow as a result of crises. Looking at developments another way, the large volume of special reserve transactions was a means of delaying basic adjustments.

The idea that the increasing shortage of new gold reserves and external weakness of the dollar would one day lead to a crisis had been put forward by Professor Robert Triffin as early as 1959. Official recognition of the substance of this general thesis was evident in 1963, when what came to be known as the Group of Ten — the countries that participate in the IMF's General Arrangements to Borrow — and the IMF began to undertake examinations of the monetary system and of possible future needs for international reserves. The controversial questions of the monetary price of gold and of a new system based on flexible exchange rates were both, however, excluded from the mandates.

The discussions had not been going on very long before it became clear that opinions were sharply divided as to what the main problem was. On the one hand were those who maintained that the essential difficulty was the failure of the adjustment process in key countries — particularly the United States. On the other hand were those who considered that, given the growing shortage of new gold, dollar reserves also ought not to increase at their former pace: in their view, the main problem of the system was to provide for an adequate future growth of reserves, other than through gold and dollars.

By mid-1966 there was general agreement that at some point in the future existing types of reserve asset might have to be supplemented by the deliberate creation of reserve assets. An outline scheme for a new facility for "special drawing" rights at the IMF was submitted to, and adopted by, the Fund's 1967 Annual Meeting in Rio de

Janeiro. Special drawing rights were to be allocated to all participating countries for the purpose of helping to meet the longer-term needs of the monetary system for increased international liquidity. Decisions to allocate SDRs were to be taken, on the basis of proposals by the Managing Director of the Fund, by a majority of not less than 85 per cent. of the total voting power of participating countries. Allocations were to be made pro rata to countries' IMF quotas.

By April 1968 the outline scheme had been transformed into a legal document taking the form of an Amendment to the Fund's Articles of Agreement, and by July 1969 the Amendment had been approved by the necessary majority of the Fund's membership and came into force. Mainly at the request of those countries that had felt all along that the main problem was the adjustment process, certain provisions were included in the scheme, designed to avoid SDRs being used to finance persistent deficits and surpluses. In addition, the first activation of the scheme was made subject to "the attainment of a better balance-of-payments equilibrium" and "the likelihood of a better working of the adjustment process in the future". These considerations related particularly to the deficits of the United States and the United Kingdom. While it was not clear in the summer of 1969 that these countries were sure of attaining a better balance in their external payments, it was accepted that their efforts to do so were not likely to be weakened by the initial allocations of SDRs. Furthermore, it was recognised that, once they were effectively moving towards a better balance on external account, their efforts would be impeded if other countries were obliged to take defensive measures because of lack of growth in global reserves. In this connection, it was significant that there appeared to be only a few countries that were prepared to accept substantial reductions in their monetary reserves. Accordingly, it was decided to proceed with allocations of $3½ milliard on 1st January 1970 and of $3 milliard each in 1971 and 1972.

The introduction of special drawing rights was intended as a major step towards international management of the growth of global reserves. As things turned out, however, this action coincided with a large increase in the US payments deficit in 1970 and an even greater one in 1971. The $6½ milliard of SDRs allocated during these two years was therefore quite overshadowed by the parallel increase of exchange reserves, which amounted to $47 milliard.

Prelude to 15th August 1971.

The preceding sections have analysed the forces which were undermining the reserve position of the United States. It remains only to take note of the sparks which ignited the final run on the dollar. To some extent these were visible in 1970. Towards the end of that year there was a marked drop in the US trade balance, the average monthly surplus declining between the third and fourth quarters from $235 to 45 million on a balance-of-payments basis. In addition, there were large movements of short-term funds from the United States to Europe in 1970 due to disparities in monetary policies and interest rate levels. Superimposed on the basic US deficit, this outflow of funds produced a US external deficit of a size never before seen, though soon to be dwarfed by that of 1971.

1970 was not the first year in which interest rate differentials had caused considerable movements of funds from one side of the Atlantic to the other. In 1966, for instance, when the Federal Reserve tightened monetary conditions severely to combat the incipient inflation induced by the Vietnam war, US interest rates rose to their highest levels for several decades. To ease the squeeze, the US banks for the first time drew on the Euro-dollar market on a substantial scale; they borrowed some $3 milliard at short term in this way — putting the US official settlements balance just into surplus, for the first time since 1957, despite a basic payments deficit of $1.6 milliard.

The same thing happened in 1969, only on a much larger scale. With the renewed tightening of US monetary policy towards the end of 1968, the banks borrowed just on $9 milliard from their foreign branches during the first nine and a half months of 1969. This demand pressure raised the cost of three-month money in the Euro-dollar market from 7 to 12 per cent. between December 1968 and June 1969 and strongly affected European interest rates. Although the favourable effect on the US balance of payments of the banks' foreign borrowing was somewhat diminished by the fact that a good part of the funds that they took up in the Euro-dollar market came originally from resident sources, the net reserve position improved during 1969 by $2.7 milliard notwithstanding a $2.9 milliard basic payments deficit.

In this 1969 episode lay one of the seeds of the 1971 crisis. Clearly, US banks were not going forever to remain heavily in debt to their foreign branches. In fact, measures to discourage this were initiated in mid-1969 when the squeeze was most severe; and as monetary policy was eased in 1970, the banks began to reduce these borrowings, at first gradually and then rather rapidly from mid-year onwards. For the year as a whole the outflow of short-term funds from the United States amounted to $6.5 milliard (plus $1.1 milliard in the errors and omissions item), of which banks' repayments of the previous year's borrowings accounted for $5.1 milliard. It was this outflow, coming on top of a basic external deficit of $3 milliard, that turned the official settlements balance from the artificially favourable result for 1969 into a $9.8 milliard deficit in 1970.

The rather wide swing from restraint to ease in the posture of US monetary policy between 1969 and 1970 contrasted with an opposite shift in European policies. This shift in fact began in 1969, as part of the defences erected against the outflows of funds from Europe; it continued in 1970 as part of the effort to contain domestic inflation. The greatest contrast to US policy in this latter phase was to be found in Germany. In March 1970, at the time when the Federal Reserve was relaxing its squeeze, the Deutsche Bundesbank stepped up its restrictive monetary policy by raising its official discount rate from 6 to 7½ per cent. The main counterpart of the outflow from the United States was, therefore, the inflow to Germany. During the last nine months of 1970 Germany's reserves rose by $5.8 milliard, of which short-term capital flows accounted for $5.1 milliard. With three-month Euro-dollar rates declining from 8¾ to 7¼ per cent. between May and November 1970, while comparable domestic rates stood at 9–9½ per cent., there was a considerable incentive, and complete freedom, for the German non-bank sector to go abroad for funds. Although the Bundesbank lowered its rates later in the year, this was only to prevent the interest gap widening further.

Thus, the position at the end of 1970 was that the US basic payments balance was very weak, with barely any trade surplus left, and bound to weaken further as the economy picked up; that the monetary policy adopted to help bring about the pick-up was bound to produce further outflows of funds in the course of 1971; and that prevailing policies elsewhere were bound to attract more funds. And this at a time when the United States could not afford substantial further reserve losses; when the Group of Ten, after the inauguration of the SDR scheme, was busy talking about the need for greater flexibility of exchange rates; and when between August 1969 and June 1970 the French franc had been devalued, the Deutsche Mark floated and then revalued, and the Canadian dollar floated. Putting all these ingredients together, an explosive situation was in the making.

Matters got worse from the turn of the year onwards. In the United States the foreign trade surplus in the first quarter showed a clearly inadequate recovery, while the outflow of short-term funds accelerated following a continued fall in domestic interest rates. US banks repaid almost $5 milliard more to their foreign branches, so that the official payments deficit for the quarter came to $5.5 milliard.

In an effort to reduce the impact of the outflow on other countries' reserves the Export-Import Bank and the US Treasury issued $3 milliard of securities between January and April 1971 to the foreign branches of US banks. In Germany, however, the net inflow of funds and, with it, the rate at which monetary reserves were increasing accelerated. Despite a substantial seasonal outflow through the banks in January, net inflows averaged $700 million a month during the first quarter. From February the Bundesbank attempted to influence the situation by purchasing dollars forward in the exchange market so as to reduce the covered interest rate incentive for the inflow of funds. And with speculation on the Deutsche Mark having started towards the end of March, the official discount rate was lowered at the beginning of April from 6 to 5 per cent., and the forward purchases of exchange were continued simply in order to reduce the pressure on the spot market. Taking spot and forward purchases together, the Bundesbank bought $3 milliard during April alone.

The situation came to a head in the first two working days of May, when there was a further $2 milliard inflow which led the German authorities to close the exchange market. The immediate causes of the crisis were two: the suggestion made simultaneously and publicly, by leading German economic research institutes, that the Deutsche Mark be floated; and the knowledge that the Council of Ministers of the EEC was discussing the possibility of greater flexibility of Common Market currencies vis-à-vis the dollar. However, the crisis also demonstrated what can happen when the monetary policies of major countries are applied forcefully in opposite directions. And, moreover, neither the United States nor Germany had the satisfaction of stopping wage inflation by monetary restraint.

Austria, Belgium, the Netherlands and Switzerland, all of whose currencies had been drawn into the disturbance, followed the German example and closed their exchange markets on 5th May. After considering the alternatives of sharply easing monetary policy, imposing direct controls on the inflow of funds, or again revaluing unilaterally, Germany decided to allow the Deutsche Mark to float as from 10th May. The Netherlands followed suit, while in Belgium the regulated exchange market was reopened on the same basis as before, but with a more complete separation from the free market. Austria revalued by 5.05 and Switzerland by 7.07 per cent.

For a time these moves stopped, and even to some extent reversed, the earlier movements of funds. In Switzerland, where the National Bank had bought $600 million on 5th May before closing the exchange market, reserves were only $160 million higher at end-May than they had been a month earlier. Then in June the US net reserve position improved by $1.2 milliard, while Germany's declined by $2.3 milliard. In fact, between early June and 6th August, at the cost of bidding up the Deutsche Mark against the dollar, the Bundesbank sold a gross amount of $4.8 milliard to the exchange market; at the same time it had to take in $2.7 milliard through maturing forward exchange contracts.

Despite these developments, however, the exchange markets remained nervous and events soon broadened out from what had been in large part upward pressure on the Deutsche Mark in May to a general dollar crisis. By late May it was known that the US trade balance had taken a sharp turn for the worse in April into actual deficit, which continued in subsequent months. While trade was certainly being influenced adversely by cyclical developments — the recovery of activity in the United States parallel with recession in many other countries — and doubtless by labour difficulties in the United States as well, growing speculation over exchange rates was by now contributing to the worsening position, in particular to the acceleration of imports. But on top of all these cyclical and distorting factors there could be no denying the very poor performance of US trade.

The serious weakness revealed by the trade figures was reinforced in its psychological effect by the fact that already two countries had revalued against the dollar, while another two had allowed their currencies to appreciate in the market. The conviction grew that an upset in the relation between the dollar and virtually all other major currencies might be a near-term probability.

The August crisis proper began on the 6th of the month, when that same conviction was expressed in a report by a sub-committee of the US Congress. The report called for a general realignment of exchange rates against the dollar to correct the situation and added that the United States might otherwise have no choice but to take unilateral action to suspend the convertibility of the dollar. To the rest of the world this sounded like a tip straight from the horse's mouth. During the week that followed, the flight from the dollar into other currencies added $3.7 milliard to other countries' reserves, the largest single flight being $1.7 milliard into Swiss francs. But there were also substantial purchases of dollars by the British and French authorities, and smaller increases in a number of other countries' dollar reserves. Thus, the selling pressure on the dollar was general.

To meet requests for conversion of, or exchange guarantees on, the dollars purchased by central banks, the United States drew down its reserves by $1.1 milliard in the first half of August, bringing its total reserve loss since the beginning of the year to $3.1 milliard. It also drew $2.4 milliard on the Federal Reserve swap network. But, as the situation had become untenable, President Nixon announced on Sunday, 15th August, the suspension of convertibility of the dollar.

At the same time a 10 per cent. surcharge was imposed on dutiable imports, except for those under quota limitations, and imported investment goods were excluded from the tax credit allowed on new investments. It was announced that these measures would remain in force until an adequate revaluation of other currencies had taken place, various barriers to US exports had been eased, and a better sharing of defence burdens and a reform of the international monetary system had been agreed upon.

Floating exchange rates.

After being closed for a week, the major European exchange markets were reopened on Monday, 23rd August. All but one of the European countries allowed their currencies to float, and the dollar immediately declined on these markets. France alone held the exchange rate within the previous limits, though only for commercial and official transactions; for other transactions a financial exchange market was created on which the franc was free to find its own level.

The Japanese market was not closed on 15th August and the Bank of Japan continued to purchase dollars at the upper intervention limit for two weeks. With Tokyo the only important exchange market still open, however, a huge inward flow of funds at once developed — stemming mainly from foreign borrowing by Japanese corporations and from changes in leads and lags. Despite further tightening of exchange controls, the Bank of Japan had to absorb dollars on a scale so massive — about $4 milliard — that on 28th August the yen too was allowed to float. Thus, by the end of August two things at least were clear: the fixed par value system had been suspended, and a long-overdue adjustment process had been set in motion.

Moreover, a third thing soon became clear from many official statements made on the subject. This was that all the main countries wished to restore fixed exchange rates, and accepted that this should be done on a new and more realistic basis. However, as to how this was to be done, and on what conditions, opinions differed. The United States considered that the general de facto regime of floating rates could by itself lead to a new structure of equilibrium exchange rates — without any change in the legal parity of the dollar. And it is true that after 15th August there was a progressive and significant degree of further realignment, over and above what had taken place earlier in the year. In the US view, the emergence of new equilibrium rates in this way depended on allowing free play to market forces. The United States insisted also that its agreement to a realignment of rates and to removal of the import surcharge depended on fulfilment of its other objectives, particularly with respect to trade. Whatever the merits of this view — and the United States had for long agreed with other major countries in preferring fixed rates — it had no chance of being put into practice. Other countries were not prepared to see their currencies rise too far and too fast, and they therefore took steps to calm down the excited situation in the market. This was done partly by introducing new controls on capital inflows. In addition, however, they continued generally to buy dollars from the market as and when they saw fit. This was particularly the case with Germany and Japan, whose gross reserves rose by $1.7 and 2.8 milliard respectively between the end of August and the end of December. The United Kingdom's reserves, too, rose considerably during these months.

The reasons why countries were unwilling to allow completely free floating were various and not hard to find. In the first place, there was strong political opposition to raising the value of the currency, whether by floating or by revaluation, from interested groups like exporters. The fact that economic expansion in most countries had slowed down reinforced such opposition. Another reason for market intervention was that the degree of appreciation against the dollar was unequal, so that competitiveness not just vis-à-vis the dollar but vis-à-vis other currencies as well became an important consideration. Besides, most countries believed that the extent to which the exchange rate might be pushed around by speculative pressures had only a vague relation to the rate required for longer-term equilibrium of the basic balance of payments. Finally, the other countries rejected the US idea that the dollar parity to gold be exempted from participation in the realignment. Hence, they were not willing to let their currencies float up to the point where an adequate realignment became a fait accompli.

Besides its obvious political disadvantages to other countries, there were other objections to non-participation of the United States in the realignment. It was strongly felt that the United States, which had declared its currency to be in fundamental disequilibrium, was evading its responsibility under the IMF rules by being unwilling to devalue. And this was not an arcane, philosophical point, as some affected to believe, because it soon became clear that it was unlikely that adequate exchange rate adjustments could be brought about if the countries in fundamental disequilibrium refused to adjust. In particular, there were countries prepared to hold to their existing parities if the dollar devalued but which would not accept any suggestion that they change their own official parities. The telling point was made that market confidence could not be expected to be restored if the United States, with its long-standing external deficit, did not devalue the dollar. In addition, some countries believed that, in the face of the losses on their dollar reserves which they would take by revaluing, they were entitled to some offset in respect of their gold and gold-guaranteed assets.

As it became evident that a return to fixed rates under the conditions proposed by the United States was not negotiable, and as strong signs of shaken business confidence in the economic outlook appeared, the United States relaxed its hard-line position and the way was open for a negotiated realignment of rates. Before this could get under way, however, there had also to be some meeting of minds on how large an adjustment was needed in the basic balance of payments of the United States — from which the changes in parities could be determined. The United States arrived at the following view: it was projected that in 1972, on the assumption of "full employment" conditions in both the United States and its major trading partners, the US balance of payments would show an overall deficit of $11 milliard. Of this, $4 milliard would be on current account; $6 milliard would come from government grants and private long-term capital outflows, all of them to countries other than western Europe, Canada and Japan; and the remaining $1 milliard would be in the errors and omissions item. As compared with this projection, an overall surplus of $2 milliard was considered necessary, in the first place as a margin of safety, but also with the hopes of securing a surplus for some years to help restore the reserve position — as is generally an objective in cases of devaluation. The required adjustment therefore came to $13 milliard. And, as the projected net outflows on government and private long-term capital accounts were considered to be at minimal levels, it followed that the whole of the $13 milliard change would have to be on current account.

As against this view, calculations by the IMF and the OECD suggested that the size of the required adjustment was of the order of $9 milliard. This lower figure came about, firstly, because allowance was not made for a \$2 milliard US surplus and, secondly, because a considerably less pessimistic view was taken about the prospects for the US current account in 1972, on a cyclically-adjusted basis. Although they had for years been pressing the United States to put its balance of payments in order, the other countries mainly involved in the discussions unanimously preferred the international organisations' views about the size of the required adjustment.

Serious negotiation on the new exchange rate structure began at the end of November, when the Finance Ministers and central-bank Governors of the Group of Ten met in Rome. By that time the currencies of other Group of Ten countries, except the commercial French franc, had appreciated vis-à-vis their dollar parities by amounts varying from under 2½ per cent. for the lira and the financial French franc to over 10 per cent. for the Deutsche Mark and the yen. In Rome the United States moved a long way towards meeting the views of other members of the Group by agreeing not only to consider a realignment calculated to produce an improvement of less than \$13 milliard in its balance of payments but also to consider, as part of that realignment, a possible devaluation of the dollar.

While no agreement was reached in Rome, the way was prepared for agreement in Washington on 18th December. In the meantime, the appreciation of other Group of Ten currencies vis-à-vis the dollar had increased further, now that the willingness of the United States to consider devaluing the dollar had become apparent. By 17th December, excluding the commercial French franc, the appreciation ranged from about 4 per cent. for the lira to nearly 12½ per cent. for the Deutsche Mark and the yen. And even the commercial French franc stood almost 2 per cent. above par in New York on that day, after the Paris market had closed.

The Smithsonian agreement.

On 18th December agreement was reached at the Smithsonian Institute in Washington on the removal of the US import surcharge and a realignment of exchange rates that included a commitment by the US authorities to recommend to Congress a 7.9 per cent. devaluation of the dollar — equivalent to raising the US official gold price from \$35 to \$38 per fine ounce. In addition, four other countries — Belgium, Germany, Japan and the Netherlands — agreed to revalue their currencies vis-à-vis gold by amounts ranging from 2.8 per cent. in the case of the Belgian franc and the guilder to 4.6 per cent. for the Deutsche Mark and 7.7 per cent. for the yen. France and the United Kingdom simply accepted the proposed dollar devaluation, while Italy and Sweden proposed to devalue by 1 per cent. Switzerland decided to limit the further appreciation of the franc against the dollar to 6.4 per cent. The Canadian dollar continued to float.

As the United States was unable to devalue the dollar until Congressional action was taken, other countries intending to change their official gold parities did not do so at once. Instead they declared "central" rates for their currencies against the dollar, equivalent to the proposed new parities, while countries maintaining their gold parities adopted "middle" rates against the dollar. At the same time it was agreed that the margins on either side of the new rates against the dollar could be widened, on what was described as a temporary and permissive basis, from 1 to 2¼ per cent., giving a total spread of 4½ per cent. In fact the wider margins were at once adopted for all leading currencies. It was on 3rd April 1972 that President Nixon signed the bill authorising and directing the promised change in the par value of the dollar. Then, on Friday, 5th May, the United States formally notified the IMF of this change, which took effect the following Monday.

Realignment of leading currencies, 5th May–18th December 1971.

Currencies	Change against gold	Change against US dollar	New central or middle rate for the dollar	New lower and upper limits against the dollar
	in percentages		in currency units per US dollar	
Japanese yen	+ 7.7	+ 16.9	308.00	314.93 - 301.07
Swiss franc	+ 7.1	+ 13.9	3.84	3.9265 - 3.7535
Austrian schilling	+ 5.1	+ 11.6	23.30	23.82 - 22.78
Deutsche Mark	+ 4.6	+ 13.6	3.2225	3.295 - 3.150
Belgian franc	+ 2.8	+ 11.6	44.8159	45.8250 - 43.8075
Dutch guilder	+ 2.8	+ 11.6	3.2447	3.3175 - 3.171875
Pound sterling	—	+ 8.6	2.60571*	2.5471 - 2.6643*
French franc	—	+ 8.6	5.1157	5.2310 - 5.0005
Italian lira	— 1.0	+ 7.5	581.50	594.6 - 568.4
Swedish krona	— 1.0	+ 7.5	4.8129	4.920 - 4.705
US dollar	— 7.9	—	—	—

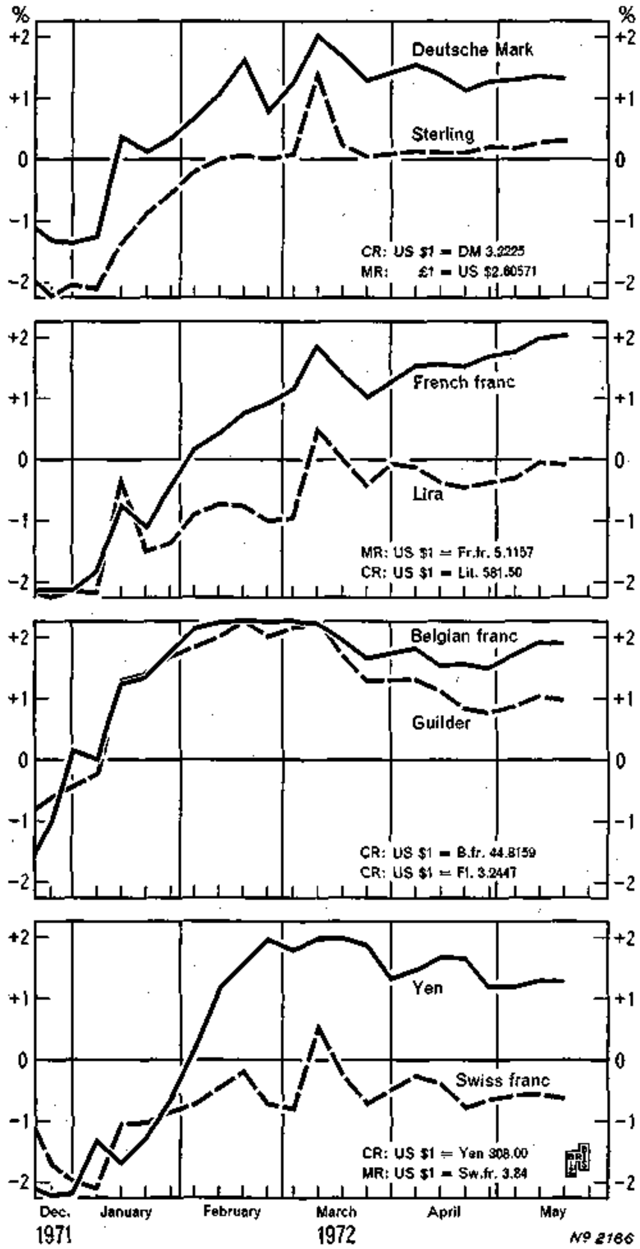
* Dollars per pound sterling.

Post-Smithsonian developments.

First reactions to the Smithsonian agreement were generally very positive, reflecting relief that the period of floating exchange rates was over. When the exchange markets reopened, all other major currencies were quoted well below their new rates against the dollar, and some of them — such as the pound sterling, the French franc and the lira — were close to their new lower limits. At first there was some reflux of the huge volume of speculative funds that had previously left the United States, though not on any substantial scale. One factor that was working against a large reflux was the continuing disparity between short-term interest rates in the United States and those in most other leading countries. In fact, this disparity became even greater in the first weeks of 1972, as US rates declined still further. Moreover, with other currencies well within the lower half of their new 4½ per cent. range of permissible fluctuation against the dollar, there was a possibility of making appreciable gains on the exchanges by waiting. Indeed the view was rather widely expressed at the beginning of the year that, quite apart from interest rate considerations, no substantial reflux could be expected so long as this state of affairs prevailed.

However, conditions in the exchange markets soon began to change. In the course of January most leading currencies strengthened considerably against the dollar and by the end of the month the Belgian franc and the guilder, in particular, had reached a point about 1¾ per cent. above their new central rates. This development, far from giving added impetus to any reflux of funds to the United States, in fact turned into a new wave of speculation against the dollar, which carried the Belgian franc, the guilder, the Deutsche Mark and the yen to, or close to, their new upper limits in February and early March. The fact was that doubts were beginning to be felt in the market about

Selected currencies: Spot quotations for the US dollar.
As percentages above (+) or below (—) central or middle rates.



the durability of the Smithsonian agreement when it was realised that the adjustment process would take considerable time and that in the interval foreign central banks might have to absorb large amounts of dollars.

After some weeks, however, the exchange markets took on a much better tone and central-bank intervention became largely unnecessary. Several considerations weighed in the market's more favourable view of the new exchange rate structure. One was the clear evidence that the central banks fully intended to support the agreement while the adjustment process was given an opportunity to show results. This came out from their readiness to buy dollars arising from sizable speculative movements of funds, as well as from new control measures imposed to impede such movements. In addition, it was made clear that the US balance of payments could be expected in the end to benefit substantially from the changed structure of exchange rates. And in the meantime the financing of the US deficit could largely be taken care of by a reflux of speculative funds, without the need for central banks to intervene much in support of the dollar.

* * *

In summing up the basic factors that produced the breakdown of the exchange rate structure last year, three may be distinguished. First of all the dollar became overvalued as post-war reconstruction proceeded abroad with other countries progressing to new records of output and efficiency. The United States maintained a significant advantage in productivity, but its higher cost levels became less appropriate to the new situation. And this was aggravated to some extent by undervaluation of a few other currencies. Secondly, with the Vietnam war, excess demand and inflation were allowed to get a grip on the economy, and these forces markedly worsened the US trade balance. Thirdly, as other countries' combined annual demand for reserves was increasingly in excess of what could be supplied from new gold production, the residual demand for reserves fell back on the United States as the reserve currency country of the system — which thus inherited a corresponding payments deficit. As a result the US reserve position, and even its reserve assets, became less and less able to support the convertibility of the dollar. Hence, apart from the development of the disequilibrium in the exchange rates, the dilemma arose of either a change in the general official value of gold or a change in the gold/dollar system.

The system, in effect, had changed in two respects before last year: in March 1968 the official and free-market values of gold were separated, after which the convertibility of the dollar was little more than formal; and in January 1970 a new reserve facility, special drawing rights, was introduced. Then, last December, an adjustment of exchange rates was put in force with the aim of correcting the overvaluation of the dollar and the undervaluation of the other principal currencies.

The system today rests upon a new basis. The dollar perforce remains inconvertible into gold or gold-guaranteed assets. For smaller countries, and for private holders, the dollar is convertible into other currencies in the market; larger countries can, of course, spend any part of their dollar holdings, but they have in a practical sense only limited possibilities of diversifying their reserves. At the same time, almost all countries have opted for fixed rates by pegging their currencies to the inconvertible dollar. As matters stand, additions to global reserves in the system can be provided in four ways: by further accumulations of dollars, by new allocations of SDRs, by increases in IMF reserve positions and by reserve holdings of currencies other than the dollar.

There are to be discussions of further changes in the system, but it is as yet not clear what they may be.

II. SURVEY OF ECONOMIC AND MONETARY DEVELOPMENTS AND POLICIES.

The domestic economic scene.

As it has turned out, the cyclical movements in process over the past year have been surprisingly little affected by the international currency upheavals that occurred. For most industrial countries the slow-down in the growth of economic activity that began in 1970 was more marked in 1971, and the situation remained sluggish into the spring of this year. This relative stagnation, while generally more pronounced than in 1967, was less intense and widespread than in 1957–58. In the lead of these developments were the United States and Canada, where the slump started in the late summer of 1969 and recovery began last year. In some countries, such as Belgium, France, the Netherlands and Switzerland, the expansion in 1971 was not much below the longer-term trend. However, the falling-off was appreciable in Germany, and even more so in Italy, Sweden and Japan. In the United Kingdom stagnation continued.

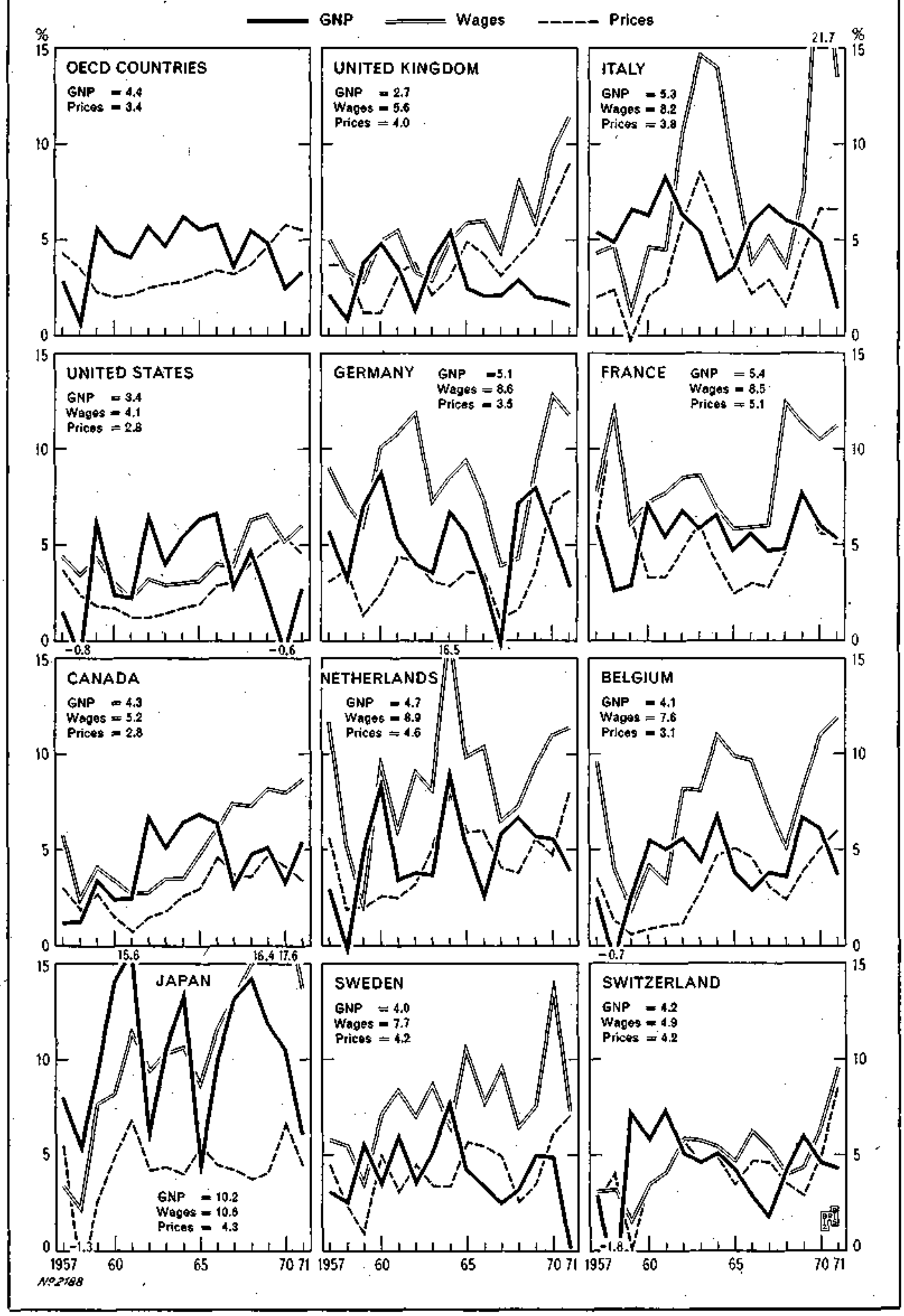
Inflation, however, remained unusually strong. For the OECD countries combined, the GNP price deflator in 1970 and 1971 averaged 5.6 per cent., well above the longer-term average. Compared with the previous year, price rises slowed down somewhat in the United States, Canada and Japan in 1971, but generally accelerated, in some cases quite sharply, in western European countries.

The comparative movements of wages, prices and production are shown in the graph. An acceleration in price rises has generally been associated with a speeding-up of wage increases relative to the growth of output. More significant is the evident change in recent years in many countries in the accustomed behaviour of wages and prices relative to output. In earlier years a slowing-down of real output, whether due to policy restraint or to autonomous forces, could be counted on to bring about a marked decline in wage and price inflation. It was this behaviour that led countries to rely on policies of demand restraint to curb the recent inflation.

But results have been disappointing. In both the United States and Canada wages rose much faster than before and price inflation assumed serious proportions. The experience of the United Kingdom was even more striking, as wage and price increases accelerated sharply from late 1969 onwards; and countries such as Belgium, the Netherlands and Switzerland also found wage/price trends less responsive than before to changes in demand pressures. Moreover, certain countries, such as France and Italy, experienced fairly sudden wage explosions which were not easily explainable by demand pressures. In Germany and Japan, too, wage behaviour broke away somewhat from its earlier pattern.

Against this background, the economic indicators in early 1972 did not make very cheerful reading. So far as industrial production is concerned, only in Canada and France was output rising at a satisfactory pace. In the United States, and to some extent in Italy and Sweden, production had strengthened, but it still did not compare

Changes in real output, wages and prices.*



* GNP = real GNP; wages = wage rates or earnings; prices = GNP price deflator. Inset figures are average growth rates 1957–71.

well with earlier peak levels. The pace of advance, though fairly steady, was also very slow by past standards in Japan, Austria, Belgium and the Netherlands, and in the latter two countries it had faltered around the turn of the year. In the United Kingdom and Switzerland industrial production continued to remain about level, but in Germany a strong recovery in early 1972 made good the slow decline over previous months.

Meanwhile, the problem of unemployment had become more widespread. Whereas in the United States and Canada unemployment had risen substantially in 1970, thereafter easing very little, it emerged in western Europe only gradually in the course of 1971 and early 1972. By far the most serious situation was that in the United Kingdom, where unemployment in early 1972 topped the million mark. In a number of countries the shake-out of labour was substantial and was associated with man-hour productivity gains of 5 per cent. or more.

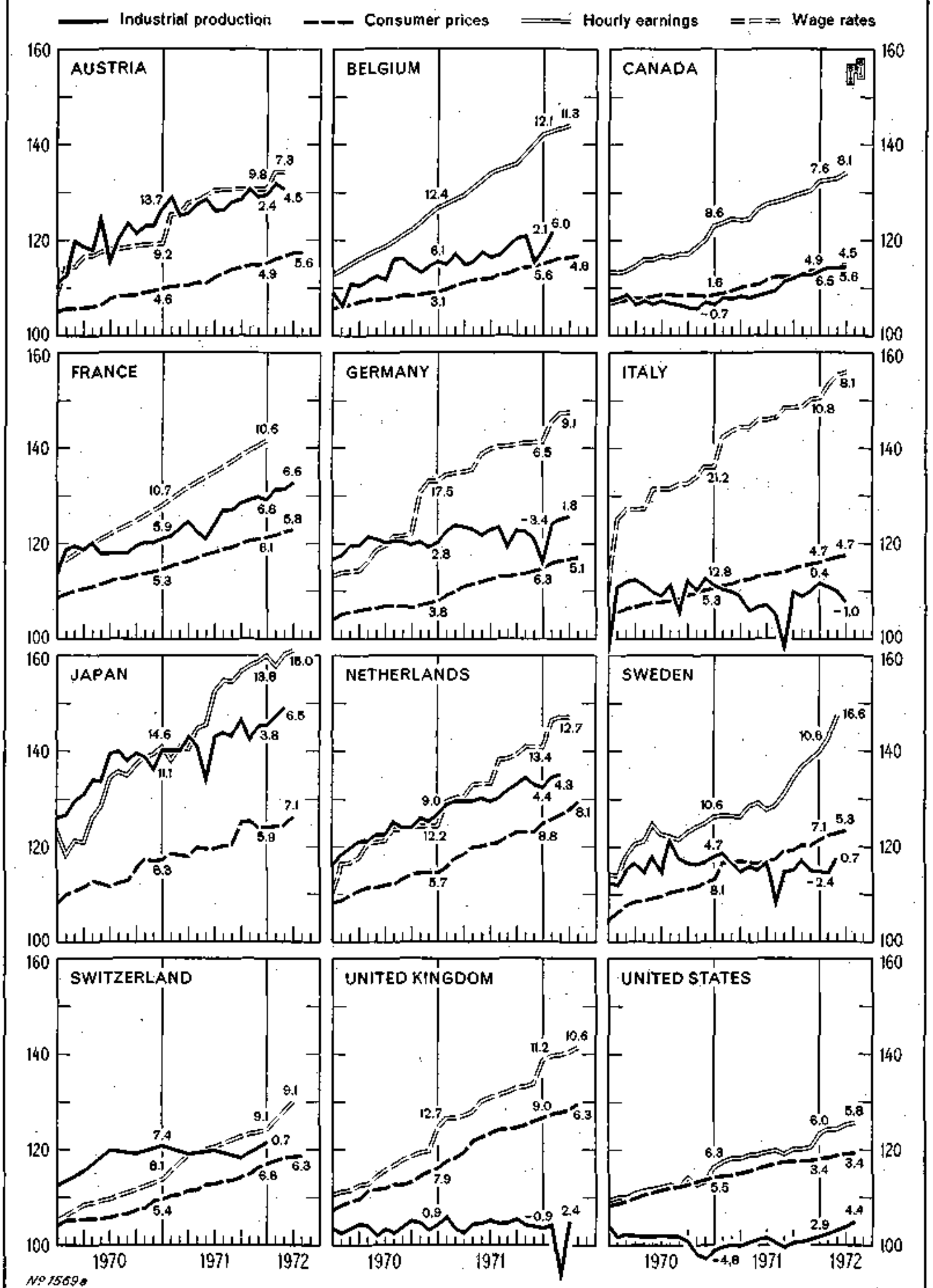
At the same time, however, wages in most western European countries were in early 1972 still running some 10–15 per cent. higher than they had been a year earlier. Only Germany and Italy had achieved some success in slowing down the wage spiral. Little deceleration in the rate of wage rises was perceptible elsewhere, and in the Netherlands and Switzerland there was even some speeding-up. Even in the United States, where wage/price controls were introduced in mid-August, it was clear that inflationary wage demands would remain a stubborn problem. In Canada and Japan, too, wage pressure did not ease up noticeably.

In this setting consumer prices in a number of countries accelerated during 1971 but thereafter rose slightly less rapidly. The main exceptions were the United States, Japan and Sweden, where a deceleration in price inflation was under way over the whole period. In the United States the twelve-month rate of increase in consumer prices in March 1972 was 3.5 per cent., whereas for other countries it ranged from 5 to 8 per cent. In the United States and Canada wholesale prices tended to rise at least as fast as consumer prices. Elsewhere they usually went up somewhat less or even declined — largely reflecting lower international commodity prices (with the major exception of oil) and, in a number of countries, the benefits of currency appreciation.

As to the pattern of demand, slower growth over the past two years has been associated in most countries with a falling-off in export expansion, accompanied by a distinct weakening of domestic fixed investment. The only major countries in which export growth did not show a deceleration in real terms in 1971 were Japan and the United Kingdom. In the United States an actual decline in exports as from last spring contributed to the dollar crisis and acted as a drag on economic recovery. The growth of real imports rose last year in the United States, the United Kingdom, Canada and France. Hence the widespread falling-off in export expansion was largely due to the weakening of import demand in continental Europe and Japan.

Industrial fixed investment has been at a low ebb in most countries. Whereas in Canada it has been recovering satisfactorily, the turn-round in the United States after the decline of 1970 was weak. Among European countries, actual declines were recorded in Italy, Spain and Sweden, while in Finland, Germany, the Netherlands and the United Kingdom investment expenditure was barely maintained. Only in Austria, France and Norway did investment outlays increase satisfactorily. The overall results partly

Production, prices and wages.
Indexes: 1968 = 100.



Note: The inset figures indicate percentage rates of change over twelve months.

reflected earlier restraint policies, which in western Europe were pursued well into 1970 and in some cases into 1971. But the squeeze of profit margins coming from the large rises in wage costs was also a contributing factor.

Residential construction developed much less uniformly. In the United States it shot up, boosted by an ample supply of credit, and a similar, though less marked, expansion occurred in Canada. In the United Kingdom house-building increased again after two years of steep decline, while sharp advances in Austria, Germany and the Netherlands compensated to some degree for the falling-off in plant and equipment spending. In Italy, on the other hand, this was by far the weakest element. In the Scandinavian countries housing construction also eased off under the influence of previous restrictive measures and of reduced backlogs of demand. In France and Belgium, too, this sector lacked buoyancy, while in Switzerland non-priority construction remained subject to direct controls.

A feature of the last two years in many countries has been lagging private consumption. In Canada, it recovered well last year and in Japan it continued to be fairly strong. In the United States, the United Kingdom and most continental countries, however, consumer spending was on the whole weak.

The high rate of personal saving in recent years has been somewhat puzzling and various explanations of it have been put forward. One is the income uncertainties arising out of higher unemployment and more industrial disputes. Other factors have been the desire to maintain "real" cash balances and also consumer resistance to higher prices. Still another reason in some countries is that stagnation in residential building affected expenditure on durable household goods.

In most countries public consumption provided an element of stimulus in 1971. In the Netherlands, however, such spending was kept in check, while the deceleration in Sweden was a belated outcome of budgetary restraint enacted earlier. In the United States public consumption levelled off after two years of decline.

By the latter part of 1971 and early 1972 practically all the major countries had adopted expansionary fiscal and monetary policies. In most cases, to be sure, capacity utilisation rates are still relatively low, and the prospect is that they will remain so throughout 1972. Also there is fairly general uncertainty about the evolution of exports following the exchange rate adjustments. The danger remains, none the less, that expansion will be allowed to gather momentum without the price/wage spiral having been checked to any significant extent.

Money, credit and capital markets.

It would, perhaps, be an exaggeration to say that a monetary "explosion" had occurred over the past year or so, but it is certainly true that the rates of increase in money and credit were unusually large. Whereas the nominal gross national product generally rose by about 8–12 per cent., the expansion of money and quasi-money was more in the neighbourhood of 12–16 per cent., and much higher in several countries.

Three principal factors help to explain this development. One was the effect of rising prices and wages in substantially increasing money and credit requirements.

Supply and use of resources.

Countries	Years	Sources of demand: Consumption: Private	Sources of demand: Consumption: Public	Sources of demand: Gross fixed domestic capital formation: Total	Sources of demand: Gross fixed domestic capital formation: Plant and equipment	Sources of demand: Gross fixed domestic capital formation: Dwellings	Sources of demand: Exports of goods and services	Resources: Imports of goods and services	Resources: Gross national product
		volume changes, in percentages							
Austria	1969	3.3	2.6	0.6	2.5	−10.4	16.9	7.7	6.1
	1970	6.0	2.3	11.6	13.8	− 3.2	18.5	18.6	7.8
	1971	7.2	3.6	12.0	.	.	4.7	6.9	5.2
Belgium	1969	5.9	6.5	5.6	7.0	1.2	15.9	15.9	6.7
	1970	3.9	4.5	7.0	8.0	3.5	14.1	9.8	6.1
	1971	3.9	5.1	5.1	.	.	4.8	6.3	4.2
Canada	1969	5.6	3.2	4.5	2.7	12.1	8.0	11.2	5.1
	1970	2.0	9.6	1.1	4.2	−10.7	9.9	− 0.1	3.3
	1971	6.1	4.5	6.2	4.0	16.1	5.0	9.8	5.4
Denmark	1969	9.2	7.6	13.0	10.4	25.8	9.3	13.4	8.4
	1970	4.0	6.4	5.2	6.3	0.4	6.8	8.0	3.0
	1971	1.9	6.5	4.2	5.7	− 3.0	4.0	2.0	3.1
Finland	1969	10.0	4.1	11.7	11.5	12.3	17.6	22.5	10.4
	1970	6.3	6.0	11.9	9.7	19.3	8.5	16.3	8.1
	1971	2.6	4.3	0.9	0.8	1.1	− 1.3	− 0.2	1.2
France	1969	6.7	4.4	9.9	11.8	8.5	17.9	22.5	7.7
	1970	4.3	3.8	6.8	7.8	6.1	17.0	8.5	6.0
	1971	6.4	3.2	6.0	6.3	3.0	9.2	9.2	5.3
Germany	1969	8.0	5.6	12.1	15.7	− 0.2	12.6	16.9	8.0
	1970	6.9	4.3	11.5	13.6	2.9	8.1	15.2	5.4
	1971	5.3	6.1	4.0	3.1	7.7	6.2	9.2	2.8
Italy	1969	6.1	3.1	8.1	5.2	14.8	13.6	20.6	5.7
	1970	7.8	1.9	3.4	8.5	− 7.4	6.6	17.5	4.9
	1971	2.6	4.2	− 4.9	− 2.2	−11.8	6.5	0.5	1.4
Japan.	1969	9.4	6.4	17.1	25.3	14.7	20.0	14.4	11.9
	1970	7.6	7.0	13.8	7.0	12.0	16.1	20.8	10.5
	1971	7.9	7.4	7.6	8.3	3.8	18.3	3.1	6.1
Netherlands. . .	1969	4.3	2.2	0.5	1.7	− 4.5	15.7	14.6	5.7
	1970	7.4	5.5	7.2	9.1	− 1.0	13.7	15.0	5.6
	1971	3.4	3.9	2.0	0.4	8.3	9.7	6.3	3.9
Norway	1969	7.8	7.7	− 5.7	− 7.6	3.6	6.9	5.0	5.7
	1970	2.8	0.5	14.7	14.5	15.5	1.4	12.2	3.0
	1971	5.6	3.7	12.1	13.0	8.0	2.9	3.7	4.9
Spain	1969	7.0	5.5	12.3	13.0	9.4	13.5	15.8	7.6
	1970	5.0	6.5	5.3	5.6	3.8	21.1	7.5	6.8
	1971	4.2	5.0	− 1.0	.	.	15.7	4.4	4.9
Sweden.	1969	4.2	5.3	4.5	4.9	2.9	12.8	14.2	5.0
	1970	2.2	7.2	3.4	5.2	− 2.6	9.1	9.9	4.9
	1971	− 0.2	4.2	− 2.4	− 1.5	− 5.6	5.2	− 2.4	0.2
Switzerland . . .	1969	5.2	2.6	7.0	5.8	11.1	12.9	13.0	6.0
	1970	5.3	2.3	8.0	9.2	4.7	8.6	13.7	4.6
	1971	5.5	3.7	7.9	10.0	1.4	2.9	5.4	4.3
United Kingdom .	1969	0.3	− 1.3	− 0.8	1.3	− 9.4	10.3	3.9	2.0
	1970	2.9	1.2	1.3	3.8	−10.0	4.8	5.6	1.9
	1971	2.5	3.2	0.6	0.1	2.9	5.6	6.3	1.6
United States . .	1969	3.7	− 0.6	2.5	3.0	0.4	6.1	8.1	2.6
	1970	1.4	− 4.0	− 3.7	− 2.7	− 7.6	7.6	3.1	− 0.6
	1971	3.3	0.1	5.2	0.4	25.9	− 0.2	4.8	2.7

In other words, rising costs, due mainly to wage pressures, had to be accommodated so as to avoid a more pronounced economic slow-down. The second was the widespread need — after a protracted period of monetary restraint — for business firms and individuals to improve their liquidity positions. Finally, there were the large international flows of funds prompted by exchange rate uncertainties and financed in substantial measure by credit expansion in the United States. All of these factors led to heavy borrowing on the capital markets and from banks.

In the United States the accelerated growth of money and credit was based largely on the Federal Reserve's increased purchases of government securities, which went up from $4.2 milliard in 1970 to $7.5 milliard in 1971. In contrast, monetary expansion in other countries was fed predominantly by large net inflows of foreign exchange, reflected in the following table under changes in the banking system's net foreign assets.

Confronted with a major problem of liquidity control, monetary authorities outside the United States sought to deal with it partly by exchange rate or exchange control measures designed to keep inflows within bounds and partly by traditional techniques such as increased reserve requirements and open-market operations. In the event, with the commercial banks in practically all countries showing a deterioration in their net short-term foreign position, the resulting net inflows of funds contributed to a very large rise in "reserve money" or the domestic monetary base (bank reserves plus currency in circulation). At the same time, the other counterpart of the monetary base (domestic claims of the monetary authorities) was either reduced or not increased. To some extent, of course, this reduction occurred more or less automatically, as the banks used their excess liquidity to improve their positions vis-à-vis the central bank. But, largely on the initiative of the monetary authorities, the central bank's claims on the government also declined. The main exceptions were Italy and Sweden, where, with overall demand particularly weak, monetary policy was quite expansive.

An additional problem was that, while currency in circulation and demand deposits had shot up sharply, the growth of savings and time deposits was comparatively moderate. Notable exceptions were Belgium, France, Germany and the United States, where good increases in savings deposits were recorded, the interest rates on these having been kept relatively high. In the United Kingdom and the United States, moreover, savings deposits with non-bank institutions providing mortgage financing rose steeply.

As far as bank credit to the private sector is concerned, advances rose very sharply last year for the reasons already indicated. Also, in some countries, as ceilings on bank credit were lifted, credit requirements previously met through other channels were redirected to the banks. France, Sweden and the United Kingdom were notable examples. In Germany, moreover, domestic bank credits increasingly took the place of borrowing from abroad. Growth of consumer credit also contributed significantly to the rise in private-sector borrowing in Canada, France, Germany and particularly the United Kingdom, where the controls on such lending were terminated. Furthermore, lending for house-building rose sharply in Canada, Germany, the United Kingdom and the United States. Finally, in several countries, including Canada, Italy,

The banking system: Monetary survey.

Countries	Years	Annual changes in main assets: Net foreign assets	Annual changes in main assets: Domestic credit to public sector	Annual changes in main assets: Domestic credit to private sector	Annual changes in main liabilities: Money	Annual changes in main liabilities: Quasi-money	Rates of change in domestic credit[1]	Rates of change in money and quasi-money[1]	Rates of change in nominal GNP[2]
		in milliards of national currency units					in percentages		
Austria	1969	3.26	3.90	19.74	4.69	16.59	14.1	12.0	9.7
	1970	3.45	3.53	23.65	4.29	20.66	14.4	12.5	12.6
	1971	3.30	4.98	32.59	10.64	23.36	17.5	15.3	11.2
Belgium	1969	7.50	28.50	16.20	9.80	29.50	9.7	7.7	10.9
	1970	11.20	21.40	27.00	32.20	12.90	9.6	8.2	11.5
	1971	27.70	19.70	37.50	45.40	31.50	10.3	12.9	10.2
Canada	1969	0.07[3]	— 0.89	2.05	— 0.69	1.41	4.7	2.6	10.0
	1970	1.40[3]	0.46	1.08	1.66	1.59	6.0	11.6	7.5
	1971	1.04[3]	— 0.18	4.70	3.96	1.16	16.5	16.4	9.1
Denmark	1969	— 0.61	— 1.00	6.76	3.05	1.96	11.4	10.4	13.3
	1970	0.29	— 1.26	3.87	— 0.33	2.26	4.6	3.6	10.5
	1971	1.17	— 0.55	6.16	2.90	2.53	9.5	9.8	9.8
Finland[4]	1969	203	— 64	2,096	472	1,478	13.8	13.0	14.2
	1970	341	— 112	2,686	819	1,959	15.4	16.4	11.5
	1971	993[5]	— 47[5]	2,568[5]	691[5]	1,927[5]	13.5[5]	13.6[5]	9.3
France	1969	— 9.35	3.51	22.99	0.76	16.64	10.0	6.1	16.2
	1970	13.71	— 1.42	44.12	23.15	22.13	14.5	15.1	12.0
	1971	17.78	1.77	49.57	26.06	33.79	15.2	17.3	11.1
Germany	1969	— 2.98	1.59	51.22	5.96	35.70	12.9	10.6	11.7
	1970	14.65	6.97	44.04	8.79	32.71	11.0	9.5	13.2
	1971	12.19	10.16	59.95	13.30	47.98	13.7	12.9	10.7
Italy	1969	— 751	1,162	4,285	3,384	1,104	15.2	12.0	10.2
	1970	299	2,644	4,139	6,873	— 518	16.2	15.3	11.8
	1971	487	2,793	4,449	5,111	2,062	15.1	14.9	8.1
Japan	1969	802	500	7,336	3,128	4,119	17.0	18.5	16.5
	1970	399	185	8,790	3,077	4,761	16.6	16.9	17.8
	1971	2,341	— 397	13,081	6,334	6,827	20.2	24.3	10.8
Netherlands	1969	0.85	0.26	2.65	1.57	2.18	12.7	11.1	11.7
	1970	2.02	0.23	2.63	2.70	— 0.12	11.1	6.9	10.5
	1971	2.63	— 0.79	3.04	3.91	1.41	7.9	13.3	12.2
Norway	1969	— 0.38	1.27	3.17	1.15	2.57	13.0	10.1	9.1
	1970	1.16	2.73	3.03	1.94	4.28	15.0	15.4	15.2
	1971	0.77	1.46	3.97	1.97	3.92	12.3	12.6	11.9
Spain	1969	— 17.21	16.97	271.02	89.41	178.88	18.2	18.8	11.4
	1970	46.47	23.22	226.73	41.24	214.49	14.4	15.1	12.3
	1971	83.71	28.15	314.54	175.15	292.55	17.2	24.0	13.3
Sweden	1969	— 1.77	2.80	2.24	— 0.64	1.72	9.2	2.1	8.7
	1970	0.67	— 0.43	2.66	1.48	0.94	3.7	4.6	11.3
	1971	1.36	2.41	4.71	1.64	4.26	11.5	10.7	7.3
Switzerland	1969	0.57[6]	1.42	11.45	4.30	11.53	14.6	19.3	9.0
	1970	3.04[6]	0.33	8.87	4.51	8.85	9.1	13.6	9.8
	1971	4.84[6]	0.96	8.71	8.08	2.63	8.8	9.6	13.2
United Kingdom[4]	1969	808	— 822	524	27	476	—1.4[7]	3.1	7.2
	1970	786	— 116	1,126	830	756	4.6[7]	9.7	9.2
	1971	1,889	— 739	1,600	1,055	1,335	3.7[7]	13.3	10.7
United States	1969	1.30[3]	— 5.70	19.30	7.80	— 12.40	3.0	—1.2	7.5
	1970	— 2.50[3]	25.50	13.40	8.10	44.60	8.4	13.4	4.8
	1971	— 1.50[3]	26.70	32.50	15.80	26.50	11.8	9.5	7.5

[1] December to December. [2] Year to year. [3] Monetary authorities only. [4] In millions of national currency units. [5] November to November. [6] National Bank only. [7] Estimate.

Source: IMF, *International Financial Statistics*. For Belgium, France, Germany, Japan, Spain and United Kingdom, national statistics.

the Netherlands and the United States, the banks made funds available to the private sector on a substantial scale via their subscriptions to security issues.

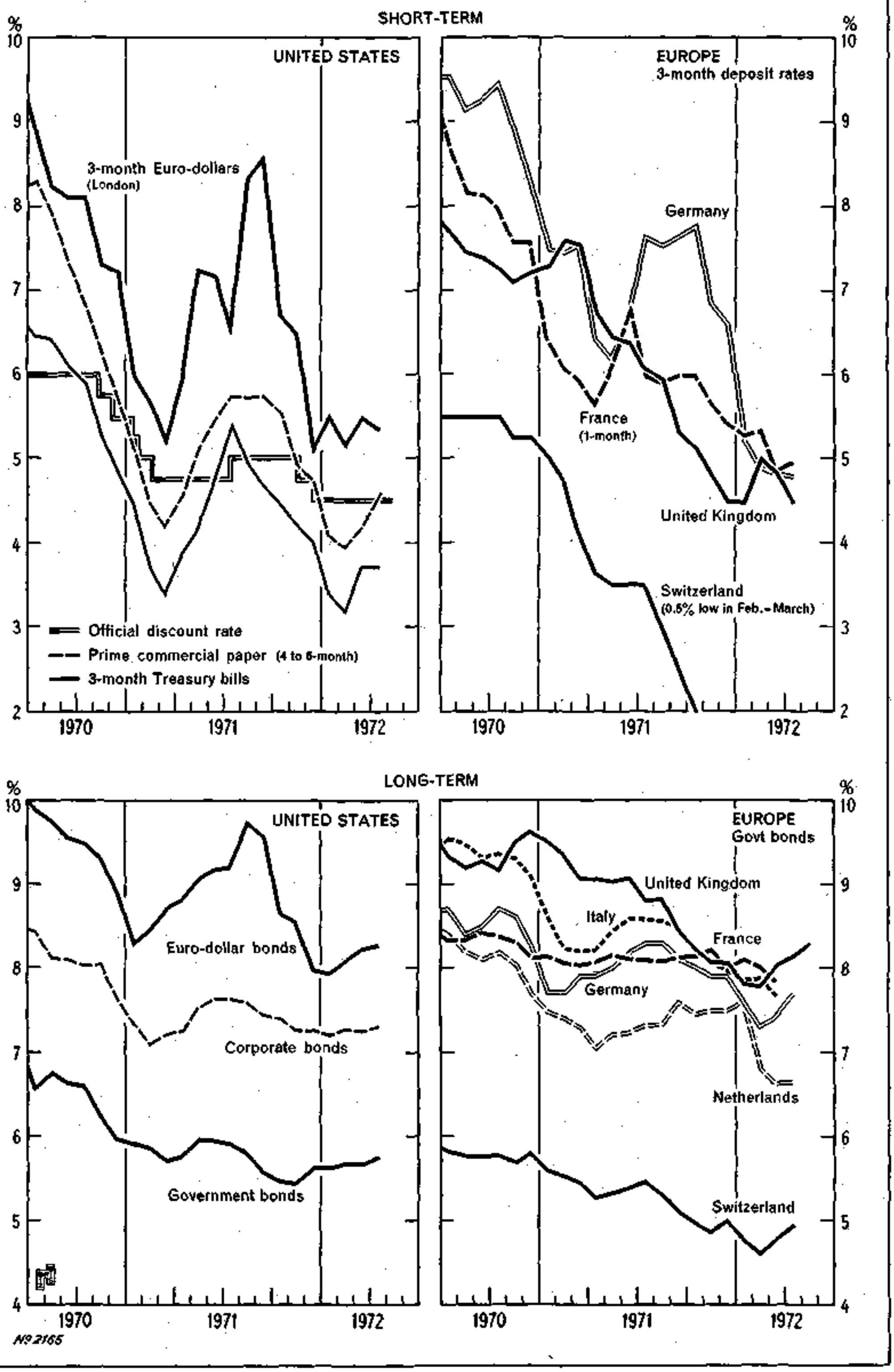
As for bank credit to the public sector, the position has varied considerably from country to country. In Canada, Japan, Spain, Sweden, the United Kingdom and the United States active steps had been taken to ease fiscal policy. Fairly generally, too, the slower pace of activity tended to cause the revenue of both central and local governments to lag, while expenditure was boosted by rising wages and prices. On the other hand, the receptiveness of the bond market enabled many governments to increase considerably their fund-raising at long term and to limit their recourse to short-term borrowing. But, whereas this resulted in a reduction in total bank lending to the public sector in Canada, the Netherlands and the United Kingdom, an offsetting factor — bank purchases of public-sector securities — brought about a substantial overall rise in Belgium, Sweden and the United States. In Italy another large increase in the budget deficit was financed mainly by short-term borrowing from the banks. In Germany the cash position of the public authorities deteriorated further last year; but against the rise in indebtedness to the banking system in 1970 and 1971 must be set the accumulation in each of those years of over DM 4 milliard of public-authority deposits with the central bank, consisting mainly of blocked anticyclical funds. There was also some overall increase in the government's recourse to the commercial banks in Austria, France and Switzerland. In Denmark and Finland, on the other hand, tight budgetary policies were maintained and there was a net improvement in the government's position vis-à-vis the banking system. In Japan, where the budget deficit rose, the deposit banks substantially increased their lending to the government, largely in the form of security purchases; a large decrease in credit from the central bank was achieved only with the help of a notable expansion in borrowing from the postal savings system.

The expansive monetary conditions last year were in general accompanied by a boom in security issues on domestic capital markets. Strong demand for bonds came from the banks and from other financial institutions, which in most cases also benefited from a record flow of deposits. Foreign demand, too, was often quite strong, though many countries adopted exchange control devices to restrain foreign purchasing. Expectations of falling interest rates may have given some stimulus to buying by the public, but this does not appear to have been the only factor.

With the corporate sector continuing to rebuild liquidity and to consolidate short-term debt, private bond issues in the United States were maintained almost at the very high level reached in 1970 and share issues soared. In a number of countries, including Denmark, Germany, Sweden, Switzerland and the United Kingdom, private bond and share issues both increased considerably. Elsewhere, though share issues were often held down by the slower recovery of stock markets, this was much more than offset by a rise in corporate bond flotations. In Germany and the Netherlands issues of mortgage bonds also rose sharply.

In the conditions prevailing, governments and public-sector borrowers in many countries also increased their recourse to the bond market, often raising amounts in excess of current financing requirements. The proceeds were used to improve cash positions or, as in Belgium, to repay foreign indebtedness. In Italy, to help prevent

Short and long-term interest rates.



inflows from swelling domestic liquidity, nationalised industries were encouraged to make domestic issues and to repay Euro-currency borrowings, while in Canada long-term interest rates were brought down to US levels so as to encourage domestic borrowers to rely more on Canadian sources of funds.

In the United States the decline in short-term interest rates early in 1971 was reversed between the early spring and August; but thereafter rates fell to levels below those recorded at the beginning of the year. Elsewhere, the decline over the year was even more pronounced, and the differentials vis-à-vis the United States narrowed further. In early 1972, with the anticipated reflux of funds to the United States still not of large proportions, the downward movement continued, particularly in Germany, while in Switzerland the over-supply of funds was so great that the rate on three-month interbank deposits remained for a time at about ½ per cent.

Over the year as a whole long-term interest rates generally continued to decline. But the fall was substantial only in the United Kingdom and Italy, where rates had been

Changes in official discount rates since 1970.

Country and date of change	Official discount rate in %
Austria	
11th September 1969	4¾
22nd January 1970	5
Belgium	
18th September 1969	7½
22nd October 1970	7
10th December 1970	6½
25th March 1971	*6*
23rd September 1971	*5½*
6th January 1972	*5*
3rd February 1972	*4½*
2nd March 1972	*4*
Canada	
16th July 1969	8
12th May 1970	7½
1st June 1970	7
1st September 1970	6½
12th November 1970	6
15th February 1971	*5¾*
24th February 1971	*5¼*
25th October 1971	*4¾*
Denmark	
12th May 1969	9
20th January 1971	*8*
15th April 1971	*7½*
10th January 1972	*7*
Finland	
28th April 1962	7
1st June 1971	*8½*
1st January 1972	*7¾*
France	
9th October 1969	8
27th August 1970	7½
20th October 1970	7
8th January 1971	*6½*
13th May 1971	*6¾*
28th October 1971	*6½*
13th January 1972	*6*
6th April 1972	*5¾*

Country and date of change	Official discount rate in %
Germany	
11th September 1969	6
9th March 1970	7½
16th July 1970	7
18th November 1970	6½
3rd December 1970	6
1st April 1971	*5*
14th October 1971	*4½*
23rd December 1971	*4*
25th February 1972	*3*
Italy	
14th August 1969	4
9th March 1970	5½
8th April 1971	*5*
14th October 1971	*4½*
7th April 1972	*4*
Japan	
1st September 1969	6¼
28th October 1970	6
20th January 1971	*5¾*
8th May 1971	*5½*
28th July 1971	*5¼*
29th December 1971	*4¾*
Netherlands	
4th August 1969	6
5th April 1971	*5½*
15th September 1971	*5*
6th January 1972	*4½*
2nd March 1972	*4*
Portugal	
1st September 1965	3
25th April 1970	3½
6th February 1971	*3¾*

Country and date of change	Official discount rate in %
South Africa	
27th August 1968	5½
31st March 1971	*6½*
Spain	
22nd July 1969	5½
23rd March 1970	6½
22nd January 1971	*6¼*
5th April 1971	*6*
22nd October 1971	*5*
Sweden	
11th July 1969	7
19th March 1971	*6½*
23rd April 1971	*6*
10th September 1971	*5½*
12th November 1971	*5*
Turkey	
1st July 1961	7½
1st September 1970	9
United Kingdom	
27th February 1969	8
5th March 1970	7½
15th April 1970	7
1st April 1971	*6*
2nd September 1971	*5*
United States	
4th April 1969	6
13th November 1970	5¾
4th December 1970	5½
8th January 1971	*5¼*
22nd January 1971	*5*
19th February 1971	*4¾*
16th July 1971	*5*
19th November 1971	*4¾*
17th December 1971	*4½*

particularly high, and in Switzerland, where the inflow of funds was particularly large. In general, there was a tendency for long-term rates to converge at levels very high in relation to short-term rates. In early 1972 long-term rates tended to flatten out in the United States despite the dip in short-term rates, but in Europe they continued to descend until the spring and then edged upwards.

On the international capital market, total foreign and international ("Euro") bond issues rose sharply, from $4.8 milliard in 1970 to $6.5 milliard last year. With regard to conventional foreign issues on individual markets, the rise from $2.0 to 2.8 milliard consisted almost entirely of higher flotations in Europe, particularly in Switzerland, and reflected a geographically-widespread increase in demand for funds, notable exceptions being Canada and Japan. International issues rose from $2.8 to 3.7 milliard, with flotations by European borrowers making up nearly half the total and those by US corporations more than a quarter. Partly reflecting currency considerations, issue activity was brisk in the first quarter of 1971, but then dropped off substantially before recovering to a more normal level in the final quarter and in early 1972. For 1971 as a whole, issues in US dollars and Deutsche Mark accounted respectively for about three-fifths and nearly one-quarter of the total, i.e. about the same proportions as in 1970. Yields on international dollar bonds, after rising from about 8¼ per cent. in January 1971 to a crisis peak of 9¾ per cent. in August, later receded to as low as 8 per cent. Those on DM bonds fluctuated around 8 per cent. throughout 1971, but subsequently fell markedly, to reach 7 per cent. by early spring 1972. Yields on both dollar and DM issues thereafter firmed up somewhat.

Developments and policies in individual countries.

United States. President Nixon's programme of 15th August divides the past year into a "before and after" story. The actions of that day met head on the dilemma of achieving economic recovery under conditions of persistent rises in prices and wages. Even the external measures showed concern over the impact of the balance of payments on the domestic economy, as may be seen in the imposition of the 10 per cent. import surcharge.

This concern had been building up for some time. Although output in the first quarter of 1971 rebounded after the autumn strike at General Motors, the basic weakness of demand soon became apparent. The only buoyant element was residential building, which benefited from somewhat lower interest rates and a plentiful supply of mortgage funds. Consumers appeared to lack confidence in the economic outlook; their spending, which had been forecast to recover strongly, rose very slowly after March, and the ratio of savings to disposable personal income remained high at over 8 per cent. Business fixed investment was stationary in real terms, while inventory accumulation, which had held up in 1970, showed a small decrease instead of the upsurge normally associated with cyclical recovery. Federal Government purchases of non-military goods and services expanded but not by enough to outweigh the cutbacks on defence and aerospace. The increased Federal-sector deficit of $23.1 milliard on a national-accounts basis in the calendar year 1971, compared with $13.6 milliard in 1970, was thus due to higher transfer payments and to a shortfall in tax receipts associated with the sluggish performance of the economy. In addition, the merchandise trade balance deteriorated sharply, recording deficits from the spring onwards.

The outcome was that the real gross national product showed only a slight increase during the spring and summer, and in the third quarter of 1971 was but 2.4 per cent. above the level of twelve months before. The economy's margin of idle resources remained substantial, with unemployment at a steady 6 per cent. In spite of this, trade unions continued to make substantial pay demands, and the new wage contracts negotiated provided for first-year increases averaging almost 12 per cent. The retail-price index rose less in the first eight months of 1971, but wholesale prices went up at an annual rate of about 5 per cent.

As the wage/price spiral continued, together with rapid expansion of the money stock, the authorities became concerned about a resurgence of inflationary expectations. While they did not wish to jeopardise the recovery of output, they felt that some measure of restraint had become necessary, especially in view of the flow of dollars abroad. Besides, the total volume of credit was sharply accelerating, reflecting both heavy new security issues and also "re-intermediation", whereby the private non-bank sector switched its financial assets back from market instruments into time and savings deposits. As the following table shows, this began on a large scale in the second half

United States: Total net funds raised in the credit and equity markets.

Credit instrument or sector	1968	1969	1970[1] 1st half	1970[1] 2nd half	1971[1] 1st half	1971[1] 2nd half
	in milliards of dollars					
Demand for funds						
US Government securities	13.4	− 3.6	9.5	16.1	22.5	28.6
Corporate equities	− 0.7	4.8	6.0	7.6	12.3	14.8
Corporate and foreign bonds	14.0	13.1	18.7	23.5	24.6	14.8
State and local-government securities	9.6	8.1	9.6	14.1	21.0	16.2
Mortgages	27.3	27.9	21.8	29.8	38.4	52.0
Consumer credit	11.1	9.3	5.5	3.2	6.6	14.2
Bank loans	13.4	15.7	8.3	− 2.9	8.8	14.5
Other	8.9	15.1	13.1	11.2	9.0	3.8
Total	96.9	90.4	92.5	102.6	143.2	158.9
Met directly by						
Federal Government	4.7	2.7	4.2	4.6	2.4	2.0
Banking system	43.2	18.4	15.5	57.0	57.2	55.5
Other financial intermediaries	34.2	30.1	33.8	43.9	76.6	60.8
Private non-financial sector[2]	12.3	39.8	29.5	− 15.2	− 21.7	12.7
Foreign	2.5	1.3	9.5	12.3	28.8	28.0
Total	96.9	90.4	92.5	102.6	143.2	158.9
Sources of funds						
Money (M_1)	14.8	7.1	4.5	7.8	19.3	7.9
Time and savings deposits	33.7	− 2.4	29.5	80.4	90.4	68.4
Other financial claims	48.4	85.7	58.5	14.4	33.5	82.6
Total	96.9	90.4	92.5	102.6	143.2	158.9

[1] Adjusted annual rates. [2] Including State and local governments.

of 1970, when time deposits again offered a yield competitive with that on money-market paper, and continued strongly in the first half of 1971.

Action was taken from April 1971 onwards to produce somewhat firmer conditions in the money market. The yield on three-month Treasury bills rose from a low of 3.3 per cent. in March to 5.4 per cent. in July, when the official discount rate was raised to 5 per cent. Long-term yields hardened, too, influenced by the substantial volume of new issues of corporate and State and local-government securities. The money stock (currency plus demand deposits), which in the second quarter of 1971 rose at an annual rate of 10 per cent., slowed down considerably in the following months.

The main significance for domestic policy of the mid-August programme was its new approach to incomes and price control. While some steps had been taken earlier — notably the introduction in March 1971 of wage guide-lines for the construction industry — the measures now adopted were far more comprehensive. Prices and incomes were frozen for ninety days and a Cost-of-Living Council was established to take charge of incomes policy on a more permanent basis. Later, other bodies were set up to execute particular aspects of incomes policy, the most important being the Pay Board, the Price Commission and the Committee on Interest and Dividends.

During November each of these bodies issued guide-lines: the general limit on annual wage increases was fixed at 5½ per cent. (despite union representatives' opposition), the target for annual price rises at a maximum of 2½ per cent. and the ceiling on company dividend increases in 1972 at 4 per cent. of the highest payment in the last three years. Exemption from control was announced for prices of agricultural products, exports and international shipping rates, as well as, in January 1972, for wages of low-paid workers, constituting about 15 per cent. of the labour force.

The three-month freeze was clearly effective in postponing wage and price increases, but the real test of the new policy will be whether it can check the spiral in the longer term. The Pay Board was obliged in January and February to authorise a number of pay rises much higher than 5½ per cent., and concern was also expressed about sizable price increases, partly seasonal in character, of exempted agricultural products. However, consumer prices increased more slowly from August 1971 to March 1972 than over the preceding seven months; and the Administration was confident that with post-freeze adjustments out of the way, the annual rate of inflation would show a considerable further reduction in the months ahead.

The budget side of the August measures confirmed the expansionary stance of fiscal policy, but without adding significantly to it in the short run. Income-tax reductions, the abolition of the 7 per cent. excise tax on cars and the introduction of new tax credits for investment in industrial plant were offset by cuts in government spending.

For monetary policy the direct attack on cost inflation meant relief from a task which it was ill-suited to perform, and the authorities felt able gradually to resume an easier policy. In this they were helped by market expectations that the August package would spur faster recovery of output and slow up inflation. Interest rates turned down; at end-October the Treasury bill rate had fallen to 4.4 per cent. and corporate bond yields to 7.8 per cent. Thereafter long-term rates levelled off, but short-term rates

United States: Saving, investment and changes in financial assets and liabilities.

Items	Years	Households	Business	State and local government	Federal Government	Banking sector	Non-bank financial intermediaries	Rest of the world*
		in milliards of dollars						
Gross saving	1969	147.0	78.9	— 4.5	5.8	3.5	— 0.2	
	1970	163.5	82.0	— 6.0	— 16.0	3.5	1.5	
	1971	183.1	93.3	— 4.0	— 26.2	3.6	2.9	
Capital outlays (—)	1969	—116.7	—109.2			— 1.0	— 0.8	
	1970	—112.9	—109.1			— 1.1	— 0.9	
	1971	—130.6	—118.9			— 0.8	— 1.0	
Financial surplus or deficit (—).	1969	30.3	— 30.3	— 4.5	5.8	2.5	— 1.0	0.9
	1970	50.6	— 27.1	— 6.0	— 16.0	2.4	0.6	— 0.4
	1971	52.5	— 25.6	— 4.0	— 26.2	2.8	1.9	2.7
Corresponding changes in:								
Financial assets	1969	55.2	29.6	2.7	12.2	23.5	49.4	10.3
	1970	70.6	21.2	6.5	11.4	40.5	51.4	5.2
	1971	95.7	23.4	13.4	7.7	60.7	76.4	21.7
Financial liabilities (—) . .	1969	— 30.7	— 65.3	— 9.0	— 6.8	— 21.7	— 50.5	— 6.6
	1970	— 20.6	— 50.1	— 12.7	— 26.6	— 38.5	— 51.7	— 4.5
	1971	— 43.1	— 61.5	— 19.3	— 33.4	— 59.0	— 73.3	— 8.3
Discrepancy	1969	5.8	5.4	1.8	0.4	0.7	1.1	— 2.8
	1970	0.6	1.8	0.2	— 0.8	0.4	0.9	— 1.1
	1971	— 0.1	12.5	1.9	— 0.5	1.1	— 1.2	— 10.7

* A negative figure indicates an increase in US claims (or a decrease in US liabilities) vis-à-vis the rest of the world.

continued to decline. The official discount rate was lowered in November and again in December to stand at 4½ per cent. By mid-February 1972 the Treasury bill yield was down to almost 3 per cent. and the prime lending rate of several majors banks was at 4½ per cent. Moreover, the banks' net free reserves had become positive and the money supply in the first quarter of 1972 increased at an annual rate of about 10 per cent.

However, with demand for credit remaining strong and with the dollar still weak in the exchange markets, the authorities decided to lessen somewhat the stimulus from monetary policy. Short-term interest rates began to move up in March, and by mid-April three-month Treasury bills were yielding about 3.8 per cent., while the banks' prime lending rate had gone up to 5¼ per cent.

While monetary policy thus followed a varying course, the expansion of credit was rapid throughout 1971. The total of $150 milliard raised in the credit markets was 50 per cent. greater than that in any previous year, despite the weak performance of the economy. Corporations and municipal governments concentrated on funding debt and strengthening their liquidity positions — including corporate liquidity positions overseas, which were hastily built up in anticipation of the dollar devaluation. This is reflected in the table on above, where the business sector appears with an "unexplained" accumulation of liquid assets in 1971 totalling $12.5 milliard.

The upswing phase of the business cycle showed itself from November on, though it was only in the spring of 1972 that it began to gather momentum. While employment rose rather markedly, unemployment showed only a slight decrease, averaging just over 5.8 per cent. of the labour force in the first quarter of 1972. Business surveys suggested that industrial investment would recover strongly later in the year, however, and the first-quarter increase in corporate profits was encouraging.

A continuing stimulus to expansion was also expected from the Federal budget. On a national-accounts basis the budget estimates presented in January showed a revised deficit of $35 milliard for the fiscal year ending June 1972 (compared with $18.4 milliard in fiscal 1971) and a deficit of $28 milliard for 1972–73. The corresponding budget balances at full employment were calculated as a deficit of $8 milliard for 1971–72 and a small surplus for 1972–73. Altogether, official projections were for a GNP increase of 9.4 per cent. in nominal terms and 6 per cent. in real terms in 1972. Private forecasts have been somewhat less optimistic, but all see 1972 as a good recovery year.

Canada. With both fiscal and monetary policy set for expansion from early 1970 onwards, Canada enjoyed a fairly vigorous upswing over the past year. As in the United States, there was a sharp increase in residential construction but, in contrast to its large neighbour, Canada also showed substantial gains in consumption, government expenditure and exports. Throughout 1971 real gross national product rose at a rate of 6 per cent., i.e. by more than its long-term average. However, with sizable productivity gains and large growth in the labour force, adjusted unemployment was slow to decline, falling from its summer peak of 6.9 per cent. to 6.2 per cent. at the start of 1972. At the same time, consumer prices moved up markedly in 1971, owing partly to higher food prices and partly to a restoration of profit margins as demand strengthened. In addition, wages went on rising rapidly, with manufacturing wage settlements in the fourth quarter of 1971 providing for increases averaging 9.8 per cent.

A series of stimulatory measures was introduced first in a supplementary budget in December 1970, then in the 1971–72 budget (presented in June) and again in a further supplementary budget in October 1971. These measures included reductions in personal and corporate income taxes, higher depreciation allowances, new public-works programmes, more funds for housing and higher unemployment benefits. In consequence, the budget shifted over a two-year period from a surplus of $605 million in the calendar year 1969 to a deficit of $690 million in 1971. Moreover, as the government accelerated its loans and advances last year and had again to finance a rise (smaller than in 1970) in its foreign exchange holdings, the total financing requirement came to $2,160 million, compared with $1,905 million in 1970 and a negative figure of $395 million in 1969. In the event, its total borrowing — mainly through sales of savings bonds — was $2,985 million, the difference being used to increase its cash balances.

As credit demand by all other sectors also showed large increases, total net credit raised amounted to nearly $14.8 milliard — a growth of more than 50 per cent. over the year. This expansion, though comparable in relative terms with that in the United States, took place against the background of an increase in official reserves and a strong rise in real gross national product. On the supply side, borrowing from non-residents showed a further significant decline, in line with the aims of policy, while credit flows via the banks, non-bank financial institutions and the markets rose substantially. All in all, the proportion of total credit supplied from domestic sources rose to 94 per cent., compared with 87 and 75 per cent. in 1970 and 1969 respectively.

Canada: Total net funds raised on credit and equity markets.

Items	1969	1970	1971
	in millions of Canadian dollars		
Demand for funds			
Non-financial business	3,790	2,875	5,010
Consumers	1,265	670	1,310
Mortgage borrowers	1,610	1,460	2,355
Provinces and municipalities	2,360	2,615	3,100
Federal Government	280	1,995	2,985
Total	9,305	9,615	14,760
Met by			
Domestic financial institutions			
Loans	4,360	2,375	5,910
Acquisitions of securities[1]	870	3,510	4,375
Direct borrowing from the public	1,775	2,470	3,615
Borrowing from non-residents[2]	2,300	1,260	860
Total	9,305	9,615	14,760

[1] Includes the Bank of Canada's purchases of government securities. [2] Includes both foreign currency and Canadian dollar securities acquired by non-residents as well as net direct investment from abroad.

The unemployment problem and exchange rate considerations caused the monetary authorities to continue to stimulate the economy throughout 1971. Bank rate, which had already been brought down from 8 to 6 per cent. in 1970, was reduced in three stages to 4.75 per cent. by October 1971. The commercial banks' assets and liabilities rose by 19 per cent. during 1971, with their residential mortgage loans increasing by nearly three-fifths. Loans to the business sector, which had edged up by only 3 per cent. in 1970, advanced by almost 25 per cent. However, in view of the rapid growth of the monetary aggregates, the authorities sought after mid-year to exert some moderating influence, and the banks' liquid-assets ratio — which had increased from 27 per cent. in December 1969 to 31 per cent. in January 1971 — declined to 29 per cent. by the end of the year.

Net security issues (including Canadian savings bonds) came to $8.2 milliard, over one-quarter more than in 1970 and nearly two-thirds more than in 1969. Compared with two years earlier, there were marked changes in the components of lending and borrowing. Foreign currency issues fell from $1.7 to 0.4 milliard, while those in Canadian dollars soared from $3.3 to 7.8 milliard; this marks a major success of the authorities' efforts to shift borrowing from the foreign to the domestic market. Nearly all the increase since 1969 was due to the government sector, while market borrowing by the corporate sector showed only a minor gain.

Interest rate relationships with the United States have changed significantly over the past year or two. Canadian short-term rates, after reaching a low in April 1971, rose with, but remained below, those in the United States up to August. They showed a relative rise in the following weeks, but after the late-October reduction in Bank rate they tended to fall into line with those in the United States, which were undergoing a renewed decline. With regard to long-term rates, the differentials in favour of Canada had narrowed or disappeared by early 1971, and the new relationship persisted thereafter. These changes in relative interest rates helped the authorities to slow down capital inflows and moderate the appreciation of the Canadian dollar.

Fiscal policy is to remain moderately expansive. The 1972–73 budget, presented in May 1972, provides for slightly higher pensions, increased depreciation allowances and, as from 1973, a reduction in the corporate income tax. With a cyclical rise in revenues, the budget deficit is estimated to narrow from $600 to 450 million.

Japan. While for most economies an annual growth of 6.1 per cent. would be very satisfactory, or even distinctly enviable, for Japan in 1971 it marked a cyclical trough, with expansion down to half speed. Within the increase of only 7.5 per cent. in total fixed investment — compared with a longer-term average of about twice that rate — private equipment investment showed a relatively small rise, while additions to stocks were only about half as much as usual. However, the growth of private consumption, at 7.9 per cent., was not greatly changed, and the volume of exports of goods and services continued its phenomenal expansion, notching up a further 18.3 per cent. In contrast, imports were only 3 per cent. higher.

The 1971 slow-down was notable as resulting more from endogenous forces of the investment cycle than from deliberate policies of restraint, though efforts had been made to check the pace of inflation. By the end of 1971 wages were 13.8 per cent. higher than a year earlier — the smallest increase since 1967. Consumer prices also went up slightly less fast, while wholesale prices actually declined somewhat. The rise in the GNP price deflator, at 4.4 per cent., was close to its longer-term average.

The economy responded only slowly to the progressive easing of policy from October 1970 onwards. The 1971–72 budget was relatively expansionary from the outset, and in June and again in October additional doses of fiscal stimulus were administered — principally through public investment — so that government bond flotations for the fiscal year ended March 1972 finally totalled Yen 1,220 milliard — almost treble the initial estimate. Nevertheless, economic growth still fell a long way short of the 10 per cent. originally forecast. Although the cyclical inventory adjustment seemed to have been completed by the autumn of 1971 and fixed-investment prospects appeared to be turning more bullish, the floating of the yen and associated uncertainties caused some anxiety in the business world. And the revaluation itself, by promising to weaken aggregate demand, cast a shadow over recovery prospects. In the event, however, the continuing strength of the trade surplus has become an embarrassing problem, raising fresh questions concerning the speed at which domestic demand is being adapted so as to reduce the external overflow.

In the budget for the year to March 1973, therefore, expenditure programmes were again increased substantially, requiring estimated bond sales of Yen 1,950 milliard. With expectations — and hopes — of reduced growth in exports and with only slow expansion forecast for private equipment investment as existing slack is taken up, the opportunity was seized to plan a much-needed acceleration of expenditure on social infrastructure and welfare — an emphasis that is to be maintained in subsequent years. However, such measures take time to produce their desired effects, and in the early months of 1972 there were few signs of any definite acceleration of activity; it will probably be the third quarter before an upturn takes firmer hold, by which time the period of slack will be almost two years old, though Japan has not been alone in experiencing prolonged stagnation.

The official discount rate was reduced in five stages from October 1970 to the end of 1971, by a total of 1½ percentage points, to stand at 4¾ per cent. The preferential rate for export-related finance was phased out by August. These steps were consistent with the need to stimulate domestic activity and to reduce the external payments surplus. From a peak of 8½ per cent. in 1970, the call-money rate reached a low of 5 per cent. in January 1972.

The enormous external surplus was directly associated with almost one-fifth of the 30 per cent. increase in the money supply during 1971 — the sharpest rise since 1955. It also brought about a huge increase in bank liquidity, and outstanding bank lending rose by one-quarter during the year. And, comparing 1971 with 1970, total net credit of all kinds raised by the non-financial sectors was 41 per cent. higher, corporate businesses and the public sector accounting for most of the increase, the former chiefly through bank loans and the latter by bond flotations.

The easier conditions enabled the commercial banks virtually to end at a stroke their long history of heavy indebtedness to the Bank of Japan. The authorities effected,

Japan: Changes in financial assets and liabilities.

Items	Years	Corporate sector	Personal sector	Central government	Public enterprises and local authorities	Banking system	Other financial institutions	Rest of the world[1]
		in milliards of yen						
Financial surplus or deficit (—)	1969	— 3,455	5,180	380	—1,340			— 765
	1970	— 4,510	5,750	1,050	—1,580			— 710
	1971	— 4,090	7,530	830	—2,235			—2,035
Corresponding changes in financial assets and liabilities[2]								
Money and time deposits	1969	3,065	6,525	—1,190	220	— 5,235	—3,385	
	1970	3,670	6,715	—1,400	210	— 5,685	—3,510	
	1971	8,225	8,185	—1,820	255	— 10,755	—4,065	
Insurance and trust claims	1969	165	1,815	— 280	5	10	—1,705	
	1970	185	2,175	— 360	10	25	—2,035	
	1971	375	2,590	— 475	5	5	—2,505	
Securities (net)	1969	— 445	1.045	— 75	— 880	255	335	
	1970	— 770	1,420	340	— 820	125	— 65	
	1971	— 500	1,745	410	—1,355	— 785	815	
Loans	1969	— 7,865	—2,715	1,705	— 650	4,650	4,875	
	1970	— 9,420	—3,240	2,115	— 965	5,700	5,810	
	1971	— 13,620	—3,825	2,490	—1,135	9,530	6,555	
Official reserves	1969							— 220
	1970							— 280
	1971							—3,775
Other foreign claims (net)	1969	— 210	—	165	— 20	525	—	— 595
	1970	— 85	—	170	15	220	10	— 525
	1971	— 1,130	20	185	— 5	— 760	25	1,740
Miscellaneous transactions[3]	1969	1,830	—1,465	55	— 20	— 200	— 120	50
	1970	1.910	—1,320	165	— 30	— 385	— 210	100
	1971	2,560	—1,185	45	—	2,765	— 810	—

[1] A negative figure indicates an increase in Japan's claims (or a decrease in Japan's liabilities) vis-à-vis the rest of the world. [2] A minus sign represents a decrease in assets or an increase in liabilities. [3] Including trade credit and statistical discrepancies.

Source: Bank of Japan.

in addition, considerable net sales of government securities, without reversing the general direction of policy. In fact, the liquidity glut was so great that the Bank of Japan ran short of eligible securities with which to absorb excesses, and in August it introduced a new instrument, viz. bills for which the Bank itself was both drawer and payee, to fill this gap.

In December an advisory committee to the Minister of Finance concluded a reappraisal of the system of reserve deposit requirements. Its recommendations were subsequently adopted. In addition to extending coverage to certain financial institutions which were formerly outside the system, and raising the maximum limits for the reserve ratios, the changes included an alternative formula, applicable to the growth of deposits rather than to the levels outstanding, and provision for a separate special ratio, of up to 100 per cent., which could be applied to non-resident yen accounts. This latter step was another example of the necessary adaptation of monetary policy to take account of potentially undesirable external influences, such as had been experienced for the first time in 1971.

With the cyclical depression of activity, business profits were severely squeezed in 1971 but, on account of the accompanying cutback of investment expenditures, the corporate sector had a financial deficit which, at Yen 4,090 milliard, was a little smaller than in 1970, though still large by historical standards. As indicated above, companies made heavy borrowings from banks and other financial institutions, and this helped them add Yen 8,225 milliard to their bank deposits, thereby amply restoring their liquidity, which had been squeezed in the earlier phase of monetary restraint. The corporate sector's financial position was also aided directly by inflows from abroad — probably reflecting a net build-up of advance payments for exports despite steps taken to limit them. Meanwhile, the sector raised only a modest Yen 500 milliard net through securities. In contrast, Yen 1,355 milliard was raised in this way by public enterprises and local authorities, against Yen 820 milliard in the previous year. Finally, there was an unusually steep rise in the personal sector's surplus, largely reflected in an expansion of bank deposits.

In late May 1972 a wide-ranging programme aiming at better external and internal balance was adumbrated.

United Kingdom. Early in 1971 the relaxation of monetary and fiscal policy was still rather cautious. There was considerable slack in the economy, and the balance of payments was heavily in surplus; but wages and prices were spiralling at rates of over 10 per cent. per annum, and the authorities were anxious not to aggravate this movement by an over-hasty expansion of demand. Moreover, a continuing recovery in consumer outlays was expected.

The budget at the end of March included cuts in direct and indirect taxation amounting to £550 million; and the guide-lines for bank credit were relaxed to permit an expansion of 2½ per cent. per quarter in the banks' sterling loans. Bank rate was reduced by a full point to 6 per cent., chiefly to stem the inflow of funds from overseas, but also in keeping with the budget's domestic strategy.

With the help of these measures, total final expenditure was expected to increase by 4 per cent. in real terms between the first halves of 1971 and 1972. Partly, however, because the compilation of economic indicators had been delayed by the postal strike in the first quarter, the weakness of demand at the time of the budget was underestimated. Real consumer expenditure in the first half of 1971, which had been expected to show an increase of more than 1 per cent. over the previous six months, in fact declined by ¼ per cent. and, with private investment also decreasing, the gross domestic product went down by 1 per cent. Besides pruning investment outlays, companies were shedding surplus labour and raising prices, which meant that total personal incomes were held back by a sudden acceleration in unemployment and reduced in purchasing power by price increases.

At the same time as this picture was emerging, prospects for a slow-down of the wage/price spiral became somewhat brighter. The failure of the postal strike in March was a success for the government's policy of resisting massive pay claims in the public sector, and in mid-year the Confederation of British Industry (CBI) took the initiative of asking two hundred of its largest member firms to commit themselves to a 5 per cent. ceiling on price increases over the next twelve months.

The government therefore decided to give some further stimulus to demand. As from 20th July all restrictions on consumer credit terms were removed and all rates of purchase tax were reduced by about 18 per cent. In addition, to encourage investment, the permitted rate of first-year depreciation was raised from 60 to 80 per cent. in respect of projects undertaken before August 1973; and a rate of 100 per cent. ("free depreciation"), which already applied to manufacturing in the development areas, was extended to service industries in those areas. Additional public-works programmes were also announced. As regards prices, the government welcomed the CBI's initiative and asked the nationalised industries to follow suit by holding price increases in the next twelve months to 5 per cent.

Other measures were introduced during the autumn. After 15th August sterling was allowed to appreciate somewhat, controls were imposed to check speculative inflows and at the start of September Bank rate was lowered from 6 to 5 per cent. Later that month new arrangements for the control of bank credit came into force, involving a new system of reserve-asset ratios for all banks and finance houses. While the changes were of a longer-term character, aimed at freer competition within the banking sector and greater reliance on the price mechanism for allocating credit, their introduction also contributed to easing monetary policy. Quantitative limits on bank and finance-house lending were abolished; although the repayment of all outstanding special deposits was outweighed by the banks' subscribing some £750 million to an issue of short-dated government bonds, the banks entered the new regime with comfortable reserve ratios. In November further increases in public expenditure were announced, notably an extra £185 million to be spent over the next two years, mainly by the nationalised industries.

These measures, together with the strong balance-of-payments position, contributed to a major monetary expansion. The broadly-defined money stock, rising by 5.7 per cent. in the fourth quarter, increased over the year as a whole by 13.3 per cent., against 9.7 and 3.1 per cent. in 1970 and 1969 respectively. However, the acceleration last year largely reflected the impact of the external surplus, because domestic credit expansion showed only a moderate rise from £1,035 to 1,160 million. The public-sector

United Kingdom: Saving, investment and changes in financial assets and liabilities.

Items	Years	Public sector	Overseas sector[1]	Persons	Industrial and commercial companies	Banks	Other financial institutions
		in millions of £ sterling					
Saving plus net capital transfers	1969	4,107		2,058	3,526	218	
	1970	4,971		2,443	3,274	271	
	1971	4,209		2,664	4,043	303	
Gross domestic capital formation (—)	1969	—3,754		—1,165	—3,883	— 554	
	1970	—4,109		—1,265	—4,261	— 596	
	1971	—4,636		—1,588	—3,952	— 565	
Financial surplus or deficit (—)	1969	353	— 443[2]	893	— 357	— 336	
	1970	862	— 611[2]	1,178	— 987	— 325	
	1971	— 427	— 952[2]	1,076	91	— 262	
Corresponding changes in financial assets and liabilities[3]							
Bank lending	1969	155	—4,859	77	— 684	5,271	20
	1970	— 402	—2,539	— 59	—1,125	4,206	— 81
	1971	445	—2,255	— 576	— 731	3,535	— 418
Notes and coin and bank deposits	1969	— 130	4,734	381	— 130	—5,040	185
	1970	— 187	3,328	937	333	—4,683	272
	1971	— 205	3,358	1,151	1,096	—5,507	107
Total currency flow[4]	1969	743	— 743				
	1970	1,287	—1,287				
	1971	3,228	—3,228				
Overseas loans and investments	1969	30	— 214		202		— 18
	1970	297	— 144		— 112		— 41
	1971	358	33		— 358		— 33
Marketable government debt	1969	203	42	78	— 12	— 592	281
	1970	— 280	44	— 227	9	140	314
	1971	—3,700	473	454	— 1	1,383	1,391
Non-marketable government debt	1969	— 211	59	— 235	375	14	— 2
	1970	326	— 32	— 50	— 231	— 21	8
	1971	— 172	— 28	396	— 184	— 16	4
Local-authority debt	1969	— 601	29	230	— 84	312	114
	1970	— 538	— 38	— 75	— 119	483	287
	1971	— 657	81	— 217	26	772	— 4
Claims on other financial institutions[5]	1969		— 2	2,534	56		—2,588
	1970		51	3,414	— 10		—3,455
	1971		57	4,219	— 22		—4,254
Shares and securities[6] . . .	1969	13	114	— 352	— 175	26	374
	1970	6	— 108	— 753	125	67	663
	1971	85	128	—1,184	— 130	180	921
Other domestic loans[7] . . .	1969	146		— 953	— 241	— 8	1,056
	1970	154		—1,335	— 288	39	1,430
	1971	65		—1,946	25	91	1,765
Unidentified	1969	5	397	— 867	316	259	
	1970	199	114	— 674	431	47	
	1971	126	429	—1,221	371	— 179	

[1] A negative figure indicates an increase in UK claims (or a decrease in UK liabilities) vis-à-vis the overseas sector. [2] Balance of goods and services. [3] A minus sign represents a decrease in assets or an increase in liabilities. [4] Equals total official financing with overseas sector. [5] Net inflow to life assurance and pension funds and deposits with other financial institutions. [6] Including transactions in unit trust units. [7] Mainly loans for house purchase.

Source: Bank of England.

United Kingdom: Domestic credit expansion.

Items	1967	1968	1969	1970	1971
	In millions of £ sterling				
Public-sector borrowing requirement*	1,830	1,315	— 475	—	1,370
Net sales of public-sector debt to non-bank private sector (—)	— 630	— 20	— 345	— 115	—2,105
Bank lending to private sector	575	570	520	1,125	1,600
Bank lending in sterling overseas	25	140	150	25	295
Domestic credit expansion	1,800	2,005	— 150	1,035	1,160

* The difference between the public sector's financial deficit (see previous table) and its net borrowing requirement is accounted for by loans of various kinds, refinancing of export credits and transactions in import deposits.

borrowing requirement, it is true, jumped from nil in 1970 to £1,370 million last year, but the monetary effects of this were more than offset by a huge expansion in net sales of public-sector debt, mainly in the form of gilt-edged securities, to the non-bank private sector. The strong demand for gilt-edged, it should be added, facilitated the transition in May to a new official approach to market management. Thenceforward the authorities would no longer stand ready as before to make outright purchases of bonds with more than one year to run to maturity. Finally, bank lending to the private sector rose substantially, mainly in the second half of the year, even though borrowing by manufacturing industry remained sluggish.

Increased borrowing by the personal sector helped to lift real consumption in the second half of 1971 to a level 3¼ per cent. above its low point in the first half, and private residential construction continued to rise buoyantly. On the other hand, public expenditure and exports tapered off, and private industrial investment remained weak, as companies continued to hold back on fixed capital outlays and ran down inventories. Among the factors holding down total output were the relatively heavy taxation of consumer durables, on which much of the increase in demand was concentrated, and the rising propensity to import consumer goods, especially cars.

Altogether, therefore, the gross domestic product in the second half of 1971, despite the tax cuts and easier credit, was barely 1½ per cent. higher than a year earlier — an increase substantially below the economy's potential for the third year running. By January 1972 registered unemployment had risen seasonally to over a million, or about 4.3 per cent. of the working population. These developments imply a substantial rise in productivity; gross domestic product per person employed rose by around 4 per cent. It remains to be seen whether this indicates a permanent productivity gain or simply the temporary reaction of industry to recent large wage increases.

As regards inflation, price increases decelerated, partly in response to the CBI's initiative, and public-sector wage awards were generally held in the 7–8 per cent. bracket. In the private sector, however, settlements running well into double figures remained frequent. This fact undoubtedly strengthened the determination of the miners to obtain a massive pay increase from the strike they began on 9th January 1972. The stoppage lasted until the end of February, and the resulting award of about 16 per cent. on an annual basis was an obvious breach in the government's anti-inflationary strategy.

The disruption of power supplies associated with the strike also made a dent in the first quarter's gross domestic product.

The government decided that the prospects of considerable under-utilisation of resources, both labour and capital, required a further substantial boost to demand. The need to revive production and employment outweighed the possible risk of worsening inflation or the balance of payments. In the budget, which was presented on 21st March, sweeping tax cuts were announced totalling £1,200 million in 1972–73 and about £1,800 million in a full operating year. The main changes were a substantial increase in income-tax allowances and a lowering of the 45 per cent. and 30 per cent. rates of purchase tax to 25 per cent. Retirement pensions and other social-security benefits are to go up by 12½ per cent. in autumn 1972, though much of this will be financed by higher contributions. Company tax allowances were also increased, notably the first-year depreciation allowance, which went up to 100 per cent. for all investment in plant and machinery (other than cars), and which for industrial building was extended to 40 per cent. for the whole country. Provisional rates announced for the value added tax and the reformed income tax to be introduced in April 1973 suggested that taxation might be further reduced at that time.

Together with higher public expenditure, the budget changes were calculated to raise the central government's overall borrowing requirement to £3,116 million in 1972–73, an increase of about £2,400 million over the previous financial year. The national-income forecast, after adjustment for the effects of the miners' strike, was for an expansion of about 6 per cent. in total final expenditure between the first halves of 1972 and 1973. With the volume of imports expected to rise faster than this, the projected growth of gross domestic product came to about 5½ per cent.

No further action was taken to lower interest rates. In fact, the yield on long-term government bonds, which had declined from 9.7 per cent. at the end of 1970 to about 7.7 per cent. in January 1972, moved back to over 8 per cent. in the following months. Sufficient stimulus to the economy was obviously judged to have been provided by the fiscal measures and by the considerable expansion in the money supply that was already taking place. The Chancellor laid down no numerical targets for monetary policy in his budget speech, but indicated that it would be used with suitable flexibility as an integral part of general demand management.

Germany. The economic situation in the Federal Republic has improved over the past twelve months. Excess demand pressure has been eliminated, and the rate of inflation somewhat lowered, without a serious recession in output and with a substantial narrowing of the external surplus on current account.

Early in 1971 economic expansion, which had been gradually tapering off since the spring of 1970, temporarily regained momentum. Business capital outlays were stimulated by the restoration of more generous depreciation allowances and the cut in investment tax in January. Public and private consumption and exports also expanded strongly, and industrial production in the first quarter rose at an annual rate of some 13 per cent.

The Bundesbank responded to this situation by continuing with monetary restraint. For external reasons it reduced the discount rate in April, but at the same time cut the banks' rediscount quotas by 10 per cent. These efforts were swamped by borrowing abroad on the part of German firms, together with speculation in favour of the Deutsche Mark. In the first five months of 1971 net inflows of short-term funds (including unrecorded items) totalled about DM 17 milliard, and under the impact of this inflow the stock of money and quasi-money (excluding savings deposits and long-term time deposits) increased at an annual rate of 20 per cent., while the banks' liquid-assets ratio went up to over 10 per cent.

The turning-point came in May with the decision to allow the Deutsche Mark to float upwards. The inflow of funds ceased, enabling the authorities to regain control of domestic liquidity. Corporate borrowing abroad was also discouraged by expectations that new legislation would shortly be introduced requiring part of such borrowing to be placed on non-interest-bearing accounts at the central bank. With business now seeking new funds at home rather than abroad, bank credit to the private sector accelerated sharply, and the banks' liquidity ratio fell to around 6 per cent.

The decision to float was accompanied by measures of fiscal restraint, notably a cut of DM 1.8 milliard in the Federal and Länder governments' planned outlays for 1971 and an increase of DM 1.7 milliard in their anticyclical cash reserves at the Bundesbank. In addition, floating appears to have had some direct impact in dampening aggregate demand, especially exports (where expansion earlier in the year may have included a speculative element) and business investment. Thus, economic activity levelled off and output, chiefly manufacturing, declined from the second quarter onwards. Tension on the labour market also eased. The seasonally adjusted unemployment rate, which had been steady at around 0.7 per cent. for some eighteen months, rose gradually to 1.0 per cent. in the fourth quarter, and the number of unfilled vacancies fell.

As this easing continued, a mood of pessimism about economic prospects began to build up in German business circles. The combination of rapidly rising labour costs with a continuing currency appreciation, barely two years after the revaluation of 1969, seemed to pose a serious threat to German industrial competitiveness. Although this pessimism turned out to be excessive, it probably had some influence both on wage negotiations and on the timing of fiscal and monetary relaxation.

As regards wages, a four-week strike by metal workers in November–December ended with a pay award of 7.5 per cent., and other settlements in the early part of 1972 gave similar or somewhat smaller increases — a significant reduction from the figure of about 14 per cent. that was prevalent during the boom. The annual rate of increase of industrial wholesale prices also slowed down, from 5 per cent. in the first half of 1971 to less than 3 per cent. in the first quarter of 1972. Consumer prices, however, from the autumn on were nearly 6 per cent. above the level of a year earlier, despite a 5 per cent. drop in import prices resulting from the currency appreciation.

Monetary restraint was eased in November 1971, when the banks' reserve requirements against domestic liabilities were cut by 10 per cent. Despite a further rise in bank lending to both the private and, even more, the public sector, the banks' liquidity ratio rose to some 7½ per cent. in the early months of 1972. The Bundesbank's discount rate, following the trend of interest rates abroad, was lowered in October and again in December, bringing it to 4 per cent.

Germany: Saving, investment and changes in financial assets and liabilities.

Items	Years	Private house-holds	Housing	Enter-prises	Public sector	Foreign coun-tries[1]	Credit insti-tutions[2]	Other financial insti-tutions[3]
		In milliards of Deutsche Mark						
Net saving plus capital transfers	1969	42.05	5.25	23.00	27.20		− 0.20	0.35
	1970	46.60	6.50	30.25	30.05		5.85	0.30
	1971	53.35	8.10	21.40	29.75		− 0.50	1.00
Net investment (−)	1969		−22.40	−51.00	−20.25		− 1.25	− 0.75
	1970		−26.20	−64.00	−25.90		− 1.55	− 0.70
	1971		−31.80	−59.95	−26.95		− 1.65	− 0.85
Financial surplus or deficit	1969	42.05	−17.15	−28.00	6.95	− 1.95[4]	− 1.45[5]	− 0.40
	1970	46.60	−19.70	−33.75	4.15	− 1.15[4]	4.30	− 0.40
	1971	53.35	−23.70	−38.55	2.80	8.15[4]	− 2.15[5]	0.15
Corresponding changes in financial assets and liabilities[6]								
Money, time and savings deposits	1969	26.15	0.10	11.75	7.85	7.25	−54.65	1.55
	1970	26.75	0.15	17.15	7.45	11.55	−64.75	1.75
	1971	35.65	0.15	22.90	9.00	3.85	−75.75	4.15
Claims on non-bank financial institutions	1969	11.05	—	1.35	0.05	0.05	0.10	−12.60
	1970	12.70	—	1.35	0.15	—	0.10	−14.30
	1971	15.20	—	1.75	0.20	0.05	0.10	−17.25
Money-market paper	1969	—	—	− 1.15	6.25	0.10	− 5.20	—
	1970	—	—	0.30	1.85	1.45	− 3.50	—
	1971	—	—	0.55	− 0.55	− 0.50	0.50	—
Bonds and shares: Purchases	1969	8.80	—	4.10	0.40	− 0.75	11.10	3.05
	1970	11.10	—	3.55	0.70	1.10	3.40	2.20
	1971	8.65	—	2.70	2.65	3.00	6.80	3.40
Sales	1969	—	− 0.05	− 3.05	0.45	−10.80	−13.10	− 0.10
	1970	—	− 0.05	− 4.70	− 0.75	− 3.55	−12.80	− 0.20
	1971	—	− 0.05	− 8.50	− 1.95	− 0.50	−16.15	− 0.10
Bank credit	1969	− 3.75	−11.00	−37.60	− 8.60	−13.45	74.65	− 0.25
	1970	− 3.10	−11.05	−31.00	− 8.15	− 4.10	57.85	− 0.45
	1971	− 5.25	−16.15	−39.15	−10.60	− 0.30	71.85	− 0.45
Other loans	1969	− 0.10	− 5.65	− 1.55	− 0.65	—	—	7.95
	1970	− 0.35	− 8.15	− 1.55	− 0.55	—	—	10.60
	1971	− 0.45	− 6.75	− 2.65	− 0.55	—	—	10.40
Other claims and liabilities	1969	− 0.10	− 0.55	− 1.90	1.20	1.35	—	—
	1970	− 0.55	− 0.55	−18.80	3.50	16.45	—	—
	1971	− 0.50	− 0.90	−16.15	4.60	12.90	—	—
Gold and foreign exchange	1969					14.40	−14.40[5]	
	1970					−24.05	24.05	
	1971					−10.45	10.45[5]	

[1] A negative figure signifies an increase in Germany's claims (or a decrease in Germany's liabilities) vis-à-vis foreign countries. [2] Including the central bank. [3] Building and loan associations and insurance sector. [4] Net foreign investment (i.e. balance of goods and services) after revaluation adjustments in 1969 and 1971. [5] After Bundesbank balance-sheet adjustments resulting from DM revaluation (counterpart changes appear under "Foreign countries"). [6] A minus sign represents a decrease in assets or an increase in liabilities.

Besides the monetary relaxation, the government indicated in January 1972 that fiscal measures would be used if necessary to check any serious fall in economic activity. The measures in question included: (i) the activation of contingency budgets of the Federal and Länder governments, together with the release of their anticyclical cash reserves amounting to DM 4.2 milliard; and (ii) the repayment of receipts from the anticyclical income-tax surcharge, totalling DM 5.9 milliard.

This commitment, together with the lower wage settlements and the Washington agreement in December, helped to put industry in a more optimistic frame of mind. Consumer outlays and house-building had expanded steadily all along, and the early part of 1972 saw a revival of orders both for export and for home investment. Industrial production, after a dip in November–December because of the metal workers' strike, recovered strongly in January–February, to regain its level of twelve months earlier. On the labour market, the increase in unemployment and the fall in job vacancies levelled off.

The early months of 1972 also witnessed new large capital inflows, long-term as well as short-term, reflecting both the relatively high level of interest rates in Germany and renewed weakness of the dollar. Measures to curb the inflows and to reduce bank liquidity somewhat were announced in late February. The discount rate was lowered to 3 per cent., banks' rediscount quotas were cut by 10 per cent. and their reserve requirements on the growth of foreign liabilities increased from 30 to 40 per cent. In addition, the cash-deposit requirement on foreign borrowing by German firms (passed by Parliament in December) was activated as from 1st March, the deposit ratio being fixed at 40 per cent. Credits contracted before 1st January 1972 and most of those connected with foreign commercial transactions were exempted. The requirement was designed to apply, on the other hand, to long-term borrowing (at terms of four years or more) by the banks, which was not previously subject to reserve requirements and which the banks were increasingly exploiting as a means of maintaining their liquidity.

In mid-March the Federal Minister for Economic and Financial Affairs announced that, in view of the signs of renewed expansion, he foresaw no short-term need to activate public-sector contingency budgets. The income-tax surcharge of DM 5.9 milliard is, however, to be repaid during June and July 1972, with the monetary impact to be offset by higher reserve requirements and lower rediscount quotas. By the spring the scope for non-inflationary expansion seemed suddenly to be narrowing. Rising export orders, advances in residential and industrial construction and growing personal incomes, coming on top of an already high rate of price inflation, suggested that new strains might emerge more quickly than had earlier been anticipated.

France. Despite a moderate slow-down last year, the increase of real output was not far short of the comparatively high average growth rate achieved over recent years. Credit restrictions had been eased in late 1970 and the discount rate brought down from 8 to 6½ per cent. by January 1971. After some initial hesitancy consumption recovered last year, and a further deceleration in private investment was partly offset by a rise in public-sector investment. In addition, the continuing effects of the 1969 devaluation, together with the exchange policies adopted last year, helped to maintain exports. Recently, with unemployment higher but price pressures still strong, mild further easing of fiscal and monetary policies has been combined with increased reliance on direct price restraints.

High rates of expansion of money and credit in early 1971 were partly a normal reaction to the termination in October 1970 of quantitative credit ceilings. But, to limit the added monetary expansion caused by capital inflows, the Bank of France saw to it that the bulk of its credit to the banks was provided at money-market intervention rates calculated to avoid any incentive to borrowing abroad. On the other hand, the discount rate, which still influenced certain domestic lending rates, was maintained at 6½ per cent. and then raised to 6¾ per cent. in May. In April the banks' franc liabilities to correspondents abroad were made subject to reserve ratios, and for domestic reasons a reserve requirement against the increase in total credit granted by banks and certain other financial institutions was introduced. To absorb most of the liquidity coming from abroad, the various reserve requirements were raised substantially between May and early August. In addition, during the international currency crisis of August new exchange measures were taken.

In September, after making determined efforts to check wage and price rises by using existing regulatory arrangements, the government concluded national contracts with industry that were designed to keep the overall price increase for manufactured products to 1½ per cent. between mid-September and mid-March. In addition, percentage trading margins were stabilised and service prices frozen. For its part, the government undertook for six months not to raise public-sector prices or firms' production costs.

The risk of capital inflows diminished following the exchange measures adopted in August. Towards the end of the year the authorities took steps to ease domestic credit conditions in order to stimulate aggregate demand. In October the discount rate was brought down to 6½ per cent. and in December banks' compulsory reserve requirements were lowered. First steps were also taken towards lowering long-term interest rates, which had hardly come down at all since the beginning of the year. Other measures, designed mainly to promote investment credit, included a special issue by the Crédit National of medium-term bonds to banks and a substantial rise in the ceiling for medium-term bank borrowing by nationalised enterprises in 1972. During the year, it may be added, there were extensive changes in the system of central-bank credit-granting to the banks in connection with the shift away from rediscounting towards reliance on techniques of open-market intervention.

France: Changes in reserve requirements.

Date of change	Cash reserves required against French franc liabilities to domestic non-banks		to banks abroad		against credits to non-banks[1]
	Sight deposits	Other deposits	Sight deposits	Other deposits	
	In percentages				
1970 10th July	7½	2½	0	0	—
1971 1st April	7¼	2¼	2¼	2¼	¼
6th May	8¼	3¼	3¼	3¼	¼
21st May	9¼	4¼	9¼	9¼	½
21st July	10¼	5¼	10¼	10¼	1½
5th August	12¼	6½	12¼	12¼	3
21st December	10	4	10	4	2
1972 21st March	8	3	10	4	2
10th June	8	3	10	4	4
Legal maxima	15	15	100[2]	100[2]	10

[1] In excess of base, viz.: prior to 21st July 1971, 80 per cent. of the level as at 5th January 1971; thereafter, 90 per cent. of the level as at 31st March 1971. [2] Since 18th May 1971 (previously 15 per cent.).

The government's budget became moderately expansionary in 1971, following two years of severe expenditure restraint, and an overall deficit of Fr.fr. 3.5 milliard emerged, compared with a surplus of about the same size in 1970. However, mainly because there was a large increase in funds accruing to the Treasury from the postal and savings-bank systems, the government was able to reduce further its calls on the banking system.

For the year as a whole, the growth of money and quasi-money came to 17.3 per cent., compared with 15.1 per cent. in 1970. But, as interest rates on savings instruments were kept relatively attractive, quasi-money alone grew by 30.6 per cent., compared with 24.8 per cent. in 1970. The banking system's credit-granting to enterprises and individuals advanced by 20 per cent., the sharpest acceleration being shown by short-term credits, especially for consumer instalment purchases, and by longer-term non-rediscountable credits, which have been assuming more importance in recent years. On the capital market, total issues expanded strongly. The government continued to refrain from long-term borrowing and share issues were slightly down from the high levels of the preceding year, but bond issues by the private sector and by financial institutions increased sharply.

A number of fiscal measures to stimulate investment were introduced in January 1972, but without at this stage departing from the aim of budgetary balance for the year as a whole. The government eased the conditions applying to refunds of value added tax and announced that certain government and nationalised industries' equipment expenditure was to be brought forward from the second to the first half of the year, while various expenditure projects previously under consideration were definitely to be undertaken. In addition, facilities for housing loans were improved.

In early 1972, when money-market rates were being reduced further in view of developments abroad, the monetary authorities also took some steps to bring other domestic rates down. In January the official discount rate was cut to 6 per cent., and in March controlled rates on certain savings deposits, long-term loans and new public-sector security issues were lowered. In addition, banks' compulsory reserve requirements in respect of liabilities to residents were reduced and, to facilitate a lowering of lending rates, all remaining links between them and the discount rate were severed. In a symbolic move, the discount rate was brought down to 5¾ per cent. in April. In addition, the banks were permitted to include quoted securities towards satisfying their minimum coefficient for medium-term paper, and this coefficient was reduced from 14 to 12.5 per cent. in May so as to help ease the money market.

In view of the modest extent of the slow-down, these measures were deliberately limited in scope. Moreover, inflation was still a matter of major concern. Against this background, the system of price contracts with industry has been extended and only slight relaxations have been introduced, the aim now being to restrict the increase in prices for manufactured goods during the twelve-month period ending March 1973 to 3 per cent. In early June, with monetary expansion tending to accelerate, the reserve requirement against credit-granting was increased to 4 per cent.

In the event, France proved to be one of the most successful countries in Europe in avoiding domestic disturbances from the exchange rate upsets last year and in maintaining a good rate of expansion.

Italy. Last year the economy experienced its most serious setback since the war. The phase of stagnation that began in early 1970, characterised by labour unrest, slackening of aggregate demand and a widespread feeling of uncertainty, was followed in 1971 by a recession which lasted for most of the year. Real national income showed a very small increase and was sustained only by private and public-sector services and by agricultural production. Investment fell by 5 per cent. and employment in industry also decreased. Both fiscal and monetary policies were expansionary, but a number of factors impaired the efficacy of the measures taken.

More than half the fall in gross investment took the form of a curtailment of inventory accumulation after the large rise in 1970; this was partly ascribable to the failure to enact appropriate transitional measures called for by the delay in introducing the value added tax. Housing legislation, after previously providing incentives for building, acted as a deterrent to it from 1970 onwards, so that residential building contracted in 1971 by 12 per cent.; this accounted for one-third of the decline in total investment. Some measures aimed at stimulating private investment were taken in July, but they were ineffective because of low levels of plant utilisation, a continuing downward trend of profits and still strained labour relationships. Reliance had therefore to be placed mainly on substantial investment spending by public and semi-public enterprises; and, since their self-financing capacity had been seriously eroded, their financial deficits rose to record amounts. There was also a significant increase in the financial requirement of the public sector — the combined result of lower fiscal receipts and a sharp acceleration in current outlays. In fact, last year the public administration's current accounts (excluding capital transfers) closed with a deficit of nearly Lit. 500 milliard — which represented a Lit. 1,300 milliard swing from the surplus in 1970. The overall financial deficit recorded by the public sector, together with that of the public and semi-public enterprises, came to Lit. 6,200 milliard, compared with Lit. 3,800 milliard in 1970 and about Lit. 2,900 milliard in 1969.

Credit policy was kept easy so as to accommodate the increased financial needs of the economy. Net lending by the Bank of Italy to cover the public sector's cash requirement was reduced to Lit. 1,035 milliard, a figure far below the Lit. 2,740 milliard recorded in 1970. But a large expansion occurred in the sector's net bond issues, which rose from a negligible amount in 1970 to Lit. 1,555 milliard last year. The security market was, as usual, dominated by the issues of the public sector and public enterprises, which together accounted for 55 per cent. of total net bond issues, against 45 per cent. in 1970. This relative increase took place in the context of a sharp rise in total net security issues, which amounted to Lit. 6,200 milliard, compared with Lit. 4,650 milliard in 1970. Easy domestic monetary conditions contributed towards the substantial reduction in net recourse to foreign capital markets, which fell last year to Lit. 190 milliard from Lit. 1,030 milliard in 1970, when the authorities had encouraged such borrowing on balance-of-payments grounds. Thus, total net domestic security issues showed an increase of two-thirds on the 1970 figure.

A significant feature of 1971 was the absorption of a large volume of bond issues by the credit institutions (excluding the Bank of Italy). Whereas in 1970 the credit institutions had taken up only Lit. 800 milliard's worth of bonds, last year the amount came to Lit. 2,325 milliard. This helped to bring down long-term bond yields, in

Italy: Saving, investment and changes in financial assets and liabilities.

Items	Years	Public sector	Public and semi-public enterprises[1]	Other enterprises and housing	Households	Banks and financial institutions	Rest of the world[2]
		in milliards of lire					
Saving (including capital *transfers*)	*1970*	*– 550*	*700*	*6,025*	*6,955*	*550*	
	1971	–2,365	685	5,815	9,150	650	
Gross domestic capital formation (–)	1970	–1,725	–2,230	–9,010		– 240	
	1971	–1,685	–2,640	–7,945		– 280	
Financial surplus or deficit (–)	1970	–2,275	–1,530	–2,985	6,955	310	– 475
	1971	–4,250	–1,955	–2,130	9,150	370	–1,185
Corresponding changes in:							
Financial assets							
Liquid assets	1970	– 160	– 80	1,735	4,650	615	– 90
	1971	755	30	2,420	5,840	1,795	40
Bonds, shares and participations	1970	285	130	305	1,150	1,430	380
	1971	815	115	520	1,815	2,610	395
Other net lending	1970	395	35	295	1,295	8,100	2,875
	1971	310	80	405	1,635	8,200	2,015
Financial liabilities (–)[3]							
Short-term liabilities[4]	1970	–3,080	– 665	–1,610	– 140	–7,835	–2,425
	1971	–3,590	– 840	–1,030	– 140	–9,825	–2,545
Long-term liabilities							
Domestic	1970	– 775	– 110	–1,930	—	– 805	– 645
	1971	–1,030	– 320	–3,350	—	– 440	– 670
Foreign	1970	– 65	– 525	20	—	– 500	—
	1971	– 30	145	– 380	—	– 255	—
Bonds, shares and participations	1970	– 50	– 315	– 860	—	– 815	– 370
	1971	–1,525	–1,165	– 785	—	–1,675	– 390
Statistical discrepancy	1970	1,175	—	– 940	—	120	—
	1971	45	—	70	—	– 40	– 30

[1] Consists of firms with government equity participation and also the National Electricity Agency. [2] A negative figure indicates an increase in Italian claims (or a decrease in Italian liabilities) vis-à-vis the rest of the world. [3] The increase in the financial liabilities of "Other enterprises and housing" corresponds to the overall rise in liabilities of the enterprise sector, less the increase in indebtedness of public enterprises, plus the estimated amount of loans obtained by the household sector for capital expenditure on housing. [4] Includes purchases by the Bank of Italy and the Italian Exchange Office of long-term securities issued by the public sector.

line with developments abroad. Yields on bonds issued by the special credit institutions declined over the year from 8.9 to 7.9 per cent. The banking system's acquisition of fixed-interest assets was a major counterpart — equivalent to 36 per cent., against 6 per cent. in 1970 — of the marked rise in total bank deposits.

Given abundant bank liquidity, fed partly by the external surplus, the public's holdings of primary and secondary liquid assets rose last year by 17 per cent., compared with an increase of 13 per cent. in 1970. Sight deposits were again the most dynamic item, with a rise of 21 per cent. But, with banks progressively lowering rates on such deposits after the sharp rises in early 1970, there was a reflux of funds to savings accounts, which increased by 12½ per cent., after falling in 1970.

The expansionary effects of monetary policy were to some extent blunted up to April 1972 by the option left to the banks of depositing surplus funds with the central bank for periods of more than eight days at an interest rate of up to 2.75 per cent. This diminished the banks' incentive to lower lending and borrowing rates. Thus, when in April 1972 the Bank of Italy reduced the discount rate from 4.5 to 4 per cent. and the lombard rate from 4 to 3.5 per cent., it also abolished the banks' option to hold such deposits with the central bank. Following these measures the banks decided to cut deposit and lending rates by about 1 per cent.

The stage is therefore set for credit flows to expand further: efforts must now be made to provide an industrial relations framework in which the expansionary policy will be able to work on real — not nominal — magnitudes.

Belgium. The slow-down that began in early 1971 with a weakening of exports and private investment became more marked during the year, as spending on durable consumer goods and then residential construction also eased off. This development contrasted with the still buoyant outlook at the beginning of the year. At that time the government's 1971 budget envisaged a larger financing requirement and, moreover, with the newly-introduced value added tax system causing prices to rise faster despite tighter direct controls, the monetary authorities were still concerned to avoid a speculative upsurge in spending.

The National Bank's discount rate was lowered from 6½ to 6 per cent. in March 1971, mainly because of developments abroad. On the domestic side, investment credits had been exempted from quantitative limitations at the start of 1971, but the ceilings on short-term bank credit, together with the special restrictions on lending for consumption, were extended until the end of September. In March, with capital inflows beginning to swell bank liquidity, the banks' net foreign liabilities were made subject to guide-lines and their rediscount and visa ceilings were lowered. Then, during the international currency crisis in May, steps were taken to limit non-resident franc deposits convertible in the official market.

By the autumn rising unemployment was a source of concern. Moreover, the foreign exchange situation had changed sharply when the franc, linked with the guilder, appreciated against other currencies. In September the limitations on banks' net foreign liabilities were terminated, and shortly afterwards the official discount rate was lowered to 5½ per cent., this time largely in consideration of domestic factors. The ceilings on bank credit were removed at end-September, and in early October the hire-purchase regulations were eased. In addition, banks' rediscount and visa ceilings were raised at the end of December, generally so as to restore the coefficients in force prior to the reduction in March.

For its part, the government accelerated expenditure on public works and took measures in September to stimulate social house-building. For the year as a whole its net financing requirement came to B.fr. 33.8 milliard, compared with B.fr. 23.8 milliard in 1970. At the same time, in order to help lessen the external payments surplus, the government continued to reduce its indebtedness abroad — to the extent of B.fr. 29 milliard. This, and also a reduction of its short-term domestic indebtedness, was made possible by the buoyancy of the domestic capital market, where, even at declining interest rates, the government was able to raise B.fr. 63 milliard, compared with B.fr. 34 milliard in 1970. The strength of demand for securities from the non-bank sector led the authorities, in the early autumn, to free the banks and certain other financial institutions from their undertaking, obtained earlier in the year, to invest at least 50 per cent. of their new resources in government securities.

The private sector's domestic financial assets expanded very sharply. The growth of the money supply increased, but there was an even bigger rise in ordinary savings deposits, on which interest rates were kept relatively high. On the other hand, the growth of long-term time deposits slackened appreciably. Net capital issues recorded a large gain, with the proportion taken up by financial institutions rising from less than one-third in 1970 to over one-half last year.

As inflows of funds from abroad provided the economy with liquidity, credit granted by the banking system to the private sector remained well within the ceilings up to September. But a subsequent spurt brought the increase for the year to B.fr. 37.5 milliard, or 16 per cent., compared with 13 per cent. in 1970. Credits granted by other financial institutions, mainly at longer term, grew fairly moderately, but enterprises increased their borrowing on the capital market.

Last January the government launched a vigorous programme of stimulatory measures, including B.fr. 17 milliard of additional public spending on infrastructural development for 1972. The temporary tax on exports, imposed when the value added tax was introduced a year earlier, was abolished. Steps were also taken to encourage housing construction and private investment, including a lowering of the value added tax in respect of investment goods and a refunding of taxes paid on stocks. Largely as a result of these measures, the government's net financing requirement will amount to some B.fr. 66 milliard in 1972, approximately double that for 1971. As to monetary policy, a lowering of the National Bank's basic discount rate from 5½ to 4 per cent. in three stages in the first quarter was considered to be appropriate on both domestic and external grounds. Interest rates on bank credit came down, and in March the authorities lowered the rates on longer-term credit granted by public credit institutions.

By the spring, somewhat unexpectedly, signs of renewed advance, led by exports and consumption, had become evident. This development, coming at a time when cost/price pressures were still strong, could soon lead to a new dilemma for policy.

Netherlands. From the spring of 1971 onwards demand eased and unemployment gradually increased. The main reasons were a slow-down of demand from abroad and a downswing in business investment stemming partly from a squeeze on profits. The expansion in public and private consumption slowed down too, whereas government capital expenditure and residential construction showed a substantial recovery from their low 1970 levels.

None the less, the wage/price spiral intensified. After rising by 12 per cent. during 1970, wages went up by another 13½ per cent. last year, and consumer prices increased from December to December by about 8½ per cent., as against 5½ per cent. the year before. Initially, the government sought to place limits on price and wage increases.

When this proved of little avail — since wage rises temporarily prohibited were granted on a more generous scale afterwards — price and wage limitations were suspended in August, and the authorities fell back to reliance on voluntary co-operation. But the upward movement continued. In view of this inflationary pressure, the September budget proposals for 1972 leaned towards restraint by providing for more moderate growth of public expenditure and for increases in certain taxes.

Ceiling limitations on bank credit were maintained throughout 1971, with the permissible growth of short-term credit to the private sector being fixed at 9 per cent. It was not difficult, however, for the banks to keep within the ceilings, because the economy's liquidity needs were being accommodated by the inflow of funds from abroad, which occurred through channels not covered by exchange controls.

These capital inflows prompted the authorities to make some policy adaptations in 1971 and early 1972. The discount rate was cut in stages over the twelve months to April 1972 from 6 to 4 per cent., although this was initially contrary to domestic requirements. Subsequent to the floating of the guilder, exchange control measures were taken to counter inflows of short-term funds. Then in September, to limit long-term capital inflows, which had risen steeply over the past three years, a separate market was established for non-resident transactions in Dutch securities. As a further help in diverting inflows, international issues of guilder notes for sale to non-residents, with the proceeds to be used abroad, were authorised in the amount of Fl. 900 million. As the currency realignment in December curbed inflows only temporarily, new measures relating to non-resident deposits were taken in March 1972.

The public sector's financial deficit in 1971 came to about Fl. 4.5 milliard, against Fl. 3.9 milliard in 1970. However, since the sector's capital-market borrowing went up to Fl. 4.7 milliard from Fl. 3.6 milliard in 1970, it was able to reduce its credit from the banks and to improve its net position vis-à-vis the Nederlandsche Bank.

The financial deficit of the personal and business sector increased from Fl. 7.3 to 8.7 milliard. But here again, greater recourse to the capital market, together with a somewhat smaller accumulation of liquid assets, left the sector's borrowing from banks almost the same. On the supply side, both banks and institutional investors substantially increased their capital-market investments.

Total net funds raised on the capital market, including private placements and mortgage loans, rose by over 20 per cent. — to Fl. 11.4 milliard from Fl. 9.4 milliard in 1970. A rise of this magnitude, while helping to restrain liquid-asset formation, tended to keep long-term interest rates at about 7 ½ per cent. over the year, whereas short-term rates came down sharply. Despite large inflows from abroad and an acceleration in the growth of nominal gross national product, the public's holdings of liquid assets (including Treasury paper but excluding the bulk of savings deposits) increased by only about 9 per cent. in 1971, slightly less than in 1970. Bank liquidity rose substantially during the year and was reflected in a large increase in net foreign assets.

In early 1972 aggregate demand eased further and unemployment rose to about 3 per cent. In January the government began to provide funds to deal with this problem on a regional basis. Monetary policy, too, was relaxed in March by a suspension of the ceilings on bank credit and a cut in the discount rate. But, with credit demand weaker, the growth of bank credit was expected to remain moderate. In April it was announced that the counter-cyclical tax surcharge, which had been increased from 3 to 5 per cent. in January 1972, would be put back again to 3 per cent. with effect as from July. A decisive turn-round in the economy is not forecast to occur before late 1972. However, in view of long-term balance-of-payments aims and of continuing cost inflation, the monetary authorities intend to go on pursuing a cautious liquidity policy.

Switzerland. Although it was hit in 1971 by external disturbances and experienced a sharp turn of the wage/price spiral, Switzerland was, to some extent at least, spared excessive demand pressures. The easing of tension was mainly ascribable to a slowing-down of exports and a weakening of industrial investment. Even so, the building sector remained over-burdened, local-authority expenditure rose steeply and consumption was fairly buoyant. The labour market did not ease until late 1971, and then not much.

Capital inflows were already significant in late 1970 and early 1971, as the previously high Euro-market interest rates came down to levels comparable with rates in Switzerland. Then, as exchange-market uncertainty arose, both foreign and repatriated Swiss funds poured onto domestic financial markets. In these circumstances, with non-bank funds more readily available and bank credits being repaid, the credit ceilings that had been laid down earlier became less meaningful. None the less, overall demand was still strong, and it was decided in early April to prolong the ceilings until end-July 1972, so as to continue limiting the increase in lending to an annual rate of 8.25 per cent., though special concessions were made in the case of mortgage loans and advances to public authorities.

Domestically, the dampening effect of the Swiss franc's revaluation in early May was reinforced in June by a Federal decree temporarily banning certain categories of new building. And in July, though the direction of the speculative flows had been reversed and exchange markets were calmer, the authorities negotiated a new agreement with the banks to provide safeguards against any new speculative wave.

The need for action was not long in coming. Faced with massive new inflows in the first half of August, the Swiss authorities ceased buying dollars and introduced measures designed to counteract a build-up of non-resident deposits, to limit conversions into Swiss francs for non-commercial purposes and to ensure that authorised capital exports were immediately converted into foreign currency.

At the same time, the Swiss National Bank adopted a very liberal attitude in approving foreign issues and large bank loans to borrowers abroad. Net foreign bond issues increased from Sw.fr. 450 million in 1970 to Sw.fr. 1,620 million in 1971, authorised credits to non-residents from Sw.fr. 2,260 to 3,745 million and private placings of foreigners' medium-term notes in Swiss francs from Sw.fr. 1,770 to 4,740 million. Further capital exports totalling Sw.fr. 2.2 milliard were approved between late December 1971 and mid-February 1972. As time went on, however, it became increasingly evident that the new foreign loans were themselves instrumental in attracting new inflows of foreign funds. To meet this situation, additional exchange measures were taken between February and May 1972.

Bank credit to residents increased during 1971 by only 7 per cent., against nearly 10 per cent. in 1970 and 13 per cent. in 1969. At the same time, the growth of the banks' liabilities dropped off relatively little, from almost 20 per cent. in 1970 to 17 per cent. last year. As a result, the banks' cash holdings rose by about one-quarter, and their net positive foreign position also increased sharply. On the capital market, despite a rise in net issues to Sw.fr. 6.5 milliard from Sw.fr. 3.6 milliard in 1970, interest rates steadily declined. During the year the National Bank sold off its entire securities portfolio of some Sw.fr. 150 million.

Following the currency realignment in December, there was no substantial reflow of capital abroad. In the spring of 1972, when signs of an acceleration in consumption and construction appeared, the enormous liquidity overhang became an increasing source of concern. It was therefore decided, in accordance with the September 1969 gentleman's agreement with the banks, to introduce minimum reserve requirements against the growth in domestic liabilities since end-July 1971. The ratios were fixed at half the maximum rates envisaged in the agreement, and by end-April about Sw.fr. 1.1 milliard had been absorbed. In addition, a more restrictive interpretation of the reserve requirement against the increase in non-resident funds led to a substantial sterilisation of funds and to further capital outflows.

Austria. Growth continued in 1971 at a satisfactory pace, a slow-down in external demand being largely compensated for by a more rapid increase in domestic expenditure. Against the background of increasing strain on the labour market, wage earnings rose much faster during 1971. With import prices rising as well, the increase in consumer prices accelerated noticeably, despite measures to hold down certain supervised prices.

Designed to be somewhat restrictive, the government's budget, excluding debt redemption, closed with a surplus of Sch. 1.8 milliard, against a slight deficit the year before. This shift was due to the buoyancy of revenue and to restraint in public investment, which made it possible for funds to be sterilised with the National Bank. Debt-management operations, which took account of balance-of-payments considerations, involved net domestic borrowing of Sch. 1.1 milliard and a reduction of Sch. 1.4 milliard in external liabilities.

Monetary policy aimed at being restrictive, though only moderately so and without marked success. From the spring onwards the main concern was to ward off speculative capital inflows. Towards this end some selective measures — including the sterilisation of 40 per cent. of increases in the banks' schilling liabilities vis-à-vis foreigners — were taken in conjunction with the revaluation of the schilling in May. However, residents raised funds abroad on a substantial scale, partly for hedging purposes, and official reserves went up sharply. After the August crisis inflows involving non-commercial transactions were restricted and provision was made for the sterilisation of 75 per cent. of any increase in schilling liabilities vis-à-vis non-residents. In addition, the National Bank issued in the late summer some Sch. 5 milliard of special three-month certificates in order temporarily to mop up excess liquidity.

As banks found no difficulty in meeting a sharp expansion in credit demand, their domestic lending (including net security purchases) increased by Sch. 37.9 milliard in 1971, against Sch. 27.0 milliard in 1970. Medium and long-term bank liabilities also rose, but somewhat less sharply. The volume of money increased by about 17 per cent., as compared with roughly 7 per cent. on average during the period 1967–70. Over the year as a whole the banks' holdings of primary and secondary domestic liquid assets (including unused central-bank credit facilities) were built up by Sch. 7.7 milliard, while their short-term foreign position deteriorated by Sch. 7.1 milliard to show net liabilities of Sch. 8.3 milliard.

As *the December currency realignment* did not bring about a reflux of funds abroad, new liquidity measures were taken at the end of January 1972. Minimum reserve ratios were increased by one percentage point and another issue of National Bank certificates was made, this time in the amount of Sch. 1 milliard; it was supplemented by a special government issue of Sch. 1 milliard's worth of ten-year bonds, the proceeds of which were sterilised. In addition, the banks' credit ceilings (fixed in relation to their capital) were reduced by two percentage points and the 75 per cent. sterilisation ruling referred to above was prolonged until the end of June. Furthermore, the government blocked certain expenditure appropriations and decided not to activate the contingency part of the 1972 budget.

In the spring of 1972 economic growth continued at a fairly brisk rate, but the outlook is for some slowing-down during the year, although with a high rate of wage and price increases.

Denmark. With the upswing at an end by mid-1970, economic activity grew slowly last year under the continuing influence of restrictive policies aimed at narrowing the large external current-account deficit. After a period of intense activity, residential construction eased up considerably, though it recovered somewhat towards the end of 1971. Moreover, industrial investment in plant and equipment, excluding ships and aircraft, fell slightly in real terms, and consumption expanded at a slow pace. Unemployment edged upwards. The volume of imports tapered off, so that the trade account showed somewhat better results from the early summer onwards.

A *tightening of fiscal policy* in 1970 resulted in a budget surplus of D.kr. 2.9 milliard in the fiscal year 1970–71 (April–March) and was expected to produce a higher surplus of D.kr. 3.5 milliard, equivalent to nearly 3 per cent. of gross national product, in 1971-72. These surpluses were intended to bring about a sustained liquidity squeeze, which was to be tempered, however, by a slight relaxation in the freeze on bank lending (other than for social housing) which had been in force since the spring of 1970. Accordingly, in the spring of 1971 the Nationalbank suspended the requirement, introduced in 1965, that banks should block part of the growth in their deposits, and thereafter existing blocked deposits were gradually released. In addition, the banks — already heavily in debt to the Nationalbank — were granted fresh borrowing facilities. Of more importance for bank liquidity, however, was the stepping-up of the Nationalbank's open-market bond purchases. Declines in interest rates abroad were followed by two cuts in the discount rate — from 9 to 7½ per cent. — in the early part of 1971, and a further cut to 7 per cent. in January 1972.

The price freeze introduced in the autumn of 1970 was terminated in the spring of 1971 after it had failed to serve its purpose of helping to abolish index-linking in the new national wage agreements. The previous price controls were then reintroduced and strengthened so as to prevent the passing-on of wage drift in prices, and limitations were placed on dividend payments for one year. Prices went on rising, however, and wage increases, escalating for the second year running, came to 15 per cent. during 1971. From the autumn, to sustain the improvement in the trade account, a temporary 10 per cent. import surcharge, principally on manufactured goods, was imposed — to be reduced in stages and abolished by the spring of 1973.

The growth of lending by the commercial and savings banks slackened last year to D.kr. 2.1 milliard, or 4½ per cent., and thus remained well within the ceiling. Credits from abroad also grew less fast, reflecting the slow-down of imports. On the other hand, net bond issues (mainly mortgage bonds) resumed the vigorous trend interrupted temporarily in 1970 and shot up from D.kr. 6.7 to 10.2 milliard. Bank deposits increased by D.kr. 5.2 milliard, or 10 per cent., nearly half of which was placed by the banks in bonds, reflecting both weaker loan demand and less strain on bank reserves than had been expected.

The squeeze on liquidity, in fact, was less severe than had been envisaged because fiscal policy turned out to be much less stringent than was planned. This became fully apparent only after the 1971–72 budget outturn showed that the projected surplus had not materialised. The 1972–73 budget provides for a surplus of D.kr. 2.3 milliard. Measures have been announced to improve budgetary control and speed up income-tax payments, which were found to be considerably in arrears as a consequence of the changeover to the PAYE system in 1970. Moreover, the ceiling on bank lending was prolonged, though with a marginal increase, until the end of the year; and the Nationalbank introduced deposit certificates, with longer maturities and higher interest rates than the ordinary three-month certificates, so as to mop up bank liquidity that might otherwise be channelled to the bond market.

Norway. The economy continued to show considerable stability last year. Thanks to buoyant consumption and extensive industrial and residential investment, domestic demand remained brisk, with weak export demand being largely offset by stock accumulation, so that the gross national product recorded a 5 per cent. increase in real terms. A further moderate deterioration of the trade account, together with a big increase in imports of ships, resulted in a substantially larger current-account deficit.

After a short-lived relaxation of fiscal policy at the beginning of 1970, restrictive measures taken later in the year heralded a return to a tighter stance. The government budget for 1971 provided for a surplus of N.kr. 200 million (prior to loan transactions), against an actual deficit of N.kr. 346 million in the previous year.

With a view to checking demand the credit targets for 1971 aimed at keeping the growth of domestic credit to about the same amount as in 1970. Priority was given to long-term financing through the state banks and the bond market, and this was to be accompanied by a slow-down in commercial-bank lending. However, as the growing need for funds to finance stockpiling made itself felt, the targets were revised so as to allow a substantial rise in commercial-bank lending and a small expansion of savings-bank lending. But even so, lending rose faster than intended owing to unexpectedly large capital inflows, and by early summer, when the guide-lines were exceeded, primary-liquidity reserve requirements were imposed, first on savings banks and shortly afterwards also on commercial banks. In the latter case they replaced the supplementary reserve requirements applied since late 1970. The primary-liquidity reserve requirements took effect gradually and did not prevent continual overstepping of the guide-lines. But as this was mostly a reflection of large-scale inventory financing, no further restrictive measures were taken, and towards the end of the year a selective relaxation of the reserve and bond-investment requirements permitted banks in the northern part of the country to step up their lending.

Total new credit to the private sector and the municipalities in 1971 amounted to N.kr. 11.8 milliard — a rise of N.kr. 2.4 milliard, N.kr. 1.3 milliard of which represented foreign funds. New credit from domestic sources thus expanded by N.kr. 1.1 milliard, with commercial banks accounting for N.kr. 0.6 milliard and the state banks for most of the remainder. The growth of commercial-bank lending came to 12½ per cent. over the year. This was close to the increase in deposits, but the banks' free reserves were run down and their liquidity position became very tight from the autumn onwards.

According to the national budget, new credit should rise only marginally in 1972 and some slowing-down of the pace of commercial-bank lending is required, as priority is again given to long-term financing. With lending by savings banks slackening off, their obligation to hold primary liquidity reserves was first reduced and then cancelled as from 1st April. Moreover, to improve enterprise liquidity in the face of less buoyant demand, it was decided in the spring to bring forward by two years the release of firms' blocked investment funds. Although government spending is to be stepped up, the overall budget is expected to result in a surplus of N.kr. 400 million in 1972. It is also intended that the surplus of the social-security system should be increased, and to help bring this about employers' contributions have been raised substantially. It is estimated that this, together with the wage increases provided for in the new two-year national wage settlements concluded in the spring of 1972, will raise wage costs by 15 per cent. and prices by 8–10 per cent. over the next two years, assuming some reduction in wage drift. Moreover, since the one-year price freeze which ended last November had only moderate success in slowing down the rate of price increases — from about 7 per cent. in 1970 to just under 5 per cent. in 1971, excluding rises in indirect taxes — the prospects for curbing inflation do not appear to be very bright.

Sweden. Last year, for the first time since the war, Swedish economic growth came to a virtual halt. To dampen inflationary pressures, a credit squeeze and a tightening of fiscal policy had been imposed in the course of 1970. Their effects continued to be felt last year and this coincided with a gradual weakening of foreign demand. The resulting marked slackening of overall demand was characterised by a steep rise in the household saving ratio, a rapid deceleration of stock-building, a sharp decline in local authorities' investment and a fall in housing construction. The strength of the depressive forces, however, was not apparent until well into 1971, partly because consumption was speeded up in late 1970 in anticipation of the rise in value added tax at the beginning of 1971. The spread of industrial unrest (hitherto almost unknown in Sweden) in the spring, and prolonged uncertainty about the new national wage settlements, may well have intensified the recession. Unemployment went on rising until the final months of the year, when it approached a high point of 2½ per cent.

At the beginning of 1971 policy was based on a projected real growth rate of nearly 3 per cent.; fiscal policy was to be kept tight in order to permit relaxation of monetary restraint. Bank liquidity had built up in late 1970 but commercial-bank lending was held back by the ceiling on credit other than loans for housing construction. This ceiling was abolished as from the beginning of 1971, on the understanding that the banks would continue to assist the government's housing programme and would direct other lending mainly towards industrial investment and not increase consumer credit. The abolition of the credit ceiling was accompanied by a relaxation of the rules for the banks' borrowing from the Riksbank, and in the spring the discount rate was lowered, in two steps, from 7 to 6 per cent.

By then a shift to a surplus on external current account had become apparent, but so had signs of recession. Government support for local-authority orders to industry and a speeding-up of the housing-construction programme initiated a series of counter-cyclical measures. During the summer blocked investment funds were released for firms in all parts of the country, whereas this had hitherto been done only for selected regions. The temporary 10 per cent. tax allowance for investment in machinery, introduced at the beginning of the year, was doubled after the temporary 25 per cent. tax on non-priority building, introduced in the spring of 1970, was terminated at the end of June. From the summer onwards, central-government building projects and orders to industry were expanded, while the housing-construction programme and

Sweden: Net credit flows.

Lenders	Years	Borrowers				
		Government	Local authorities	Housing sector	Business sector	Total
		in millions of Swedish kronor				
Riksbank	1969	1,510	—	— 10	— 20	1,480
	1970	1,600	—	30	—	1,630
	1971	1,520	—	— 30	30	1,520
Commercial banks	1969	1,530	220	1,180	650	3,580
	1970	— 840	300	1,990	— 140	1,310
	1971	1,360	430	600	2,820	5,210
Other banks	1969	— 10	350	2,560	680	3,580
	1970	1,090	220	1,640	1,010	3,960
	1971	— 700	350	1,680	1,170	2,500
Public insurance institutions	1969	590	600	2,810	1,610	5,610
	1970	760	690	3,270	2,040	6,760
	1971	950	820	4,140	3,270	9,180
Private insurance institutions	1969	— 280	160	1,340	630	1,850
	1970	370	60	750	710	1,890
	1971	— 90	140	1,740	910	2,700
Others	1969	460	— 10	—	690	1,140
	1970	230	10	10	230	490
	1971	— 410	10	40	510	150
Total	1969	3,800	1,320	7,880	4,240	17,240
	1970	3,210	1,280	7,690	3,850	16,030
	1971	2,630	1,750	8,160	8,720	21,260

government support for local-authority orders to industry were further stepped up; these moves were followed by substantial appropriations for relief work. New measures in the late autumn included government grants for firms' anti-pollution investment and government support for the financing of stock-building in 1972. The cost of counter-cyclical stimuli in the fiscal year 1971–72 (July–June) is expected to result in a deficit of S.kr. 3.7 milliard, against the original estimate of near-balance.

The continued improvement in external reserves gave scope for a further easing of monetary policy in the autumn. Two further cuts brought the discount rate down to 5 per cent. and the last remaining restriction on bank lending — that on consumer credit — was lifted. Moreover, industry's access to long-term credit was substantially increased. To widen the market for bonds, the investment ratios for the National Pension Fund and the private insurance institutions were relaxed and the margin between the discount rate and the bond rate was deliberately increased; whereas the discount rate was cut four times in all, the bond rate was adjusted downwards only once and then only by a quarter of a percentage point.

The net total credit flow last year showed a rise of S.kr. 5.2 milliard, or 33 per cent., after decreases of 7 and 14 per cent. in 1970 and 1969 respectively. Of the rise, commercial banks alone accounted for S.kr. 3.9 milliard, but this increase was counterbalanced to some extent by a fall in other bank lending. The National Pension Fund and to a lesser extent private insurance institutions also expanded their lending. Credit from other domestic sources fell, reflecting the re-intermediation of lending, and net private capital inflows from abroad were halved from about S.kr. 2 to 1 milliard. The greater part of the increase in the flow of funds went to the business sector, whose borrowing jumped from S.kr. 3.9 milliard in 1970 to S.kr. 8.7 milliard in 1971. In spite of the decline in housing construction and local-authority investment, the flow of funds to these sectors also rose. There was thus a considerable build-up of liquidity in all sectors. The rise in commercial-bank lending to the government was to a large extent counterbalanced by a shift in the financing of the housing sector from commercial banks to the insurance institutions.

In conjunction with the large external surplus and the strong demand for liquid assets, bank deposits rose over the year by 10 per cent. The banks complied with cash and liquidity ratios without difficulty and improved their position vis-à-vis the Riksbank. The government, besides stepping up its long-term borrowing in the second half of 1971, placed a short-term loan, the first since 1968, with the banks to mop up excess liquidity. All the same, the banks were independent of Riksbank credit from the summer onwards.

The price freeze, introduced in the autumn of 1970 and relaxed last summer, was replaced by price surveillance from the beginning of 1972. Leaving aside increases in indirect taxes, the rate of price increase had by then slowed down to 3½ per cent.

A gradual recovery of economic activity, led by a pick-up of investment, appears to have begun around the turn of the year.

Finland. In 1971, after two years of rapid growth, the economy entered a phase of recession. The weakening of international markets hit Finnish exports exceptionally hard, but policies aimed at correcting the worsening trade balance contributed to a slight contraction in the volume of imports. After rising sharply in the two previous years, investment in both residential construction and machinery and equipment levelled off. Since consumption also slowed down, the real growth rate plummeted from 8 per cent. to about 1 per cent., and unemployment edged upwards.

As strong wage pressures had been building up, it was clear at the outset of 1971 that national price and income arrangements would have to be relaxed considerably. In these circumstances fiscal and monetary policies were kept tight, with some further accumulation of anticyclical funds, and price and rent controls were maintained. The new national wage settlements, which, though providing for rather high average increases, also involved a substantial narrowing of wage differentials, led to protracted strikes in the building and metal industries. These disputes resulted in even larger wage increases, which in turn sparked off wage drift.

Aggravated by the strikes, the trade deficit widened rapidly, and in late spring a package of measures was introduced aimed at curbing imports and boosting investment. Following a very short period of quantitative import restrictions, a 15 per cent. turnover-tax surcharge (supplemented by an import equalisation tax) was imposed on durable consumer goods until the end of the year. The discount rate, which had been at 7 per cent. since 1962, was raised to 8½ per cent., with a rise also in the banks' time-deposit and lending rates. Moreover, the banks were requested to reduce consumer credits, and steps were initiated to increase the flow of funds to industry, including the announcement of a forthcoming release of enterprises' anticyclical funds. During the summer the Bank of Finland stepped up its export and other direct credits to industry. Then, in the autumn, a decision to release anticyclical funds over a one-year period starting in September 1971 was accompanied by an increase in the banks' borrowing quotas at the central bank from F.mk. 900 to 1,225 million. In December a lowering of the discount rate to 7¾ per cent. was announced with effect from 1st January 1972. The banks' rates were reduced correspondingly, except for those on consumer and import credits, which remained unchanged.

By the end of 1971 the accrual of anticyclical funds earlier in the year had been largely offset by outpayments. Moreover, a continuing inflow of funds from abroad helped to ease liquidity, so that the banks, without additional recourse to the central bank, could increase their lending slightly faster than the growth of deposits. Over the year as a whole bank lending rose by a good 15 per cent. and deposits by nearly 14 per cent. — the same annual growth rates as those registered in 1970.

In 1971, after three years of comparative price stability, the annual increase in consumer prices leapt from 3 to more than 8½ per cent. In the spring of 1972 price and rent controls and wage settlements were extended for another year, entailing estimated consumer-price increases of about 6 per cent. Most of the government's own anticyclical funds are to be used in 1972, mainly for the financing of housing construction, while private investment is expected to pick up.

Spain. The marked slow-down in the growth of output last year was largely a consequence of previous restraint measures designed to improve the balance of payments. By the beginning of 1971, however, monetary policy had already been eased again. But, while exports advanced well and a large external surplus emerged, a planned acceleration of government spending was somewhat slow to materialise, productive investment fell, and housing and durable consumer goods demand weakened. Moreover, partly in reaction to a relaxation under existing control arrangements, the rise in wages and prices accelerated.

In January 1971 larger credit lines for capital-goods industries and exports were provided, facilities for housing credits were improved and hire-purchase controls were eased. In two stages, in January and April, the Bank of Spain's rediscount rate was lowered from 6½ to 6 per cent., and rates applied by banks and public financial institutions were adjusted correspondingly. When in October speculative capital inflows became a problem, measures were taken to limit the growth of non-residents' convertible peseta deposits. Shortly afterwards, on both domestic and external grounds, the official rediscount rate was lowered by a full percentage point to 5 per cent. Moreover, in November, the government announced a new programme of public spending on investment and housing, together with a 7 per cent. tax concession for corporate fixed investment begun prior to June 1972.

Reflecting principally the larger external surplus, the growth of money and quasi-money, at 24 per cent., was rapid even by Spanish standards, but this followed a relatively low rate of 15 per cent. in 1970. At the same time, bank credit to the private sector accelerated, growing by 18 per cent., compared with 15 per cent. in 1970. With its budget moving moderately into deficit, the government increased its borrowing on the domestic capital market, thus helping to keep down bank liquidity. In addition, a reduction in bank liquidity was brought about by transactions of the official credit institutions, which in a context of weak demand for loans improved their position vis-à-vis the Bank of Spain. However, the impact on liquidity of the external payments surplus and of the reduction in January, followed by the termination in July, of the import deposit requirement imposed in 1969, was much stronger. The Bank of Spain's offsetting action, consisting principally of cuts in late 1971 in the banks' rediscount lines, was deliberately limited, so that the commercial banks were able at the end of the year to meet the 7 per cent. liquidity coefficient (introduced in December 1970) and to have a margin of free liquidity of over 4 per cent.

On the security markets, issues by the private sector came to Pesetas 117 milliard, virtually the same high level as in 1970. Moreover, with support coming from the banks, net issues by the public sector increased strongly, those of the Treasury reaching Pesetas 62 milliard, against only Pesetas 11 milliard in 1970. In this connection, interest rates on new issues — previously very low — were raised to levels better adapted to the public sector's borrowing requirements.

In the spring of 1972 there were signs that a recovery was already under way, but, with under-utilisation of resources likely to continue for some time, monetary policy was designed to permit moderate growth of bank liquidity.

Portugal. The overall pace of expansion slackened a little in 1971. Exports advanced well, as did consumption and current government expenditure, but there are signs that investment weakened. Partly reflecting structural changes associated with economic development, inflation became more acute, and imports rose somewhat more than exports. Thanks, however, to a sharp rise in tourist receipts and inward remittances, the overall balance-of-payments surplus increased substantially.

In conjunction with the increase in the Bank of Portugal's net purchases of foreign exchange, the private sector's money and quasi-money holdings went up by 21 per cent., compared with only 13 per cent. in 1970. Whereas the growth of the money supply had about levelled off in 1970, it amounted to 13 per cent. last year, while the growth of quasi-money came to 32 per cent. The public sector further improved its net position vis-à-vis the banking system. Though the government's investment spending under the development plan accelerated and tax receipts slowed down, Treasury accounts were again in overall surplus. Bank credit to the private sector, on the other hand, went up by nearly 22 per cent., against about 18 per cent. in 1970. At the same time the banks reduced their indebtedness to the Bank of Portugal and were able to meet their minimum reserve requirement with a comfortable margin at the end of the year. A new requirement, effective as from the end of March 1972, is that banks hold at least 40 per cent. of their liquid assets at the Bank of Portugal.

The authorities continued their efforts to increase the availability of long-term funds for productive investment. Besides a general upward adjustment of interest rates at the beginning of 1971, steps were taken to facilitate share transactions and the issue of convertible bonds. In addition, certain special government lending funds were reorganised. In November restrictions on consumer instalment credit were introduced. Further measures aimed at selectively promoting long-term credit-granting and the capital market were foreshadowed in the government's 1972 budget statement, indicating the generally increased concern with fostering the development of the economy.

Yugoslavia. An intensification of inflation and a growing external deficit gave rise to new policy initiatives in early 1971. The dinar was devalued by 16.7 per cent. in January, and at the same time credit ceilings were extended until March, the banks' liquidity ratios raised and rediscount facilities curtailed. Although certain taxes were reduced, it was stipulated that public authorities should sterilise increases in revenue beyond certain limits. In the second quarter, however, monetary restraint was relaxed somewhat, partly to accommodate institutional changes in the system of short-term credit, especially those relating to the decentralisation of rediscount facilities.

During the first half of 1971 continued high investment and a new upsurge in consumption intensified the pressure on resources and led to a further sharp increase in prices and another large trade deficit. Around mid-year, therefore, monetary policy was tightened again by raising liquidity ratios and reserve requirements, and by setting ceilings for overall bank credit and lending to consumers. In addition, a 30 per cent. cash-deposit requirement was prescribed for new investment, and certain projects of enterprises and public authorities were prohibited altogether. Furthermore, a 6 per cent. export subsidy, restrictions on certain imports and cuts in foreign exchange allocations were introduced in July.

After the middle of 1971 tensions eased somewhat and the trade deficit declined. But price and wage rises continued unabated. Prices were therefore frozen in November and arrangements subsequently made to limit the increase in wages. In December the dinar was again devalued — by 11.8 per cent. vis-à-vis the US dollar — and import licensing tightened further.

The growth of real social product came to about 9½ per cent. in 1971 (6 per cent. in 1970). As previously, industrial output expanded a little faster than this, while agricultural production lagged behind. Personal income rose by about one-quarter over the year, and consumer prices went up by some 16 per cent. Compared with these changes, increases in monetary variables appear to have been kept to some extent in check. Short-term credit went up by 15 per cent. during the year, or slightly less than in 1970, while the money supply expanded by 14 per cent., against 18 per cent. in the previous year. The trade deficit widened considerably in 1971, with exports increasing by 8 per cent. and imports by 13 per cent. However, a rise in remittances from abroad and in receipts from tourism helped to keep down the size of the current-account deficit.

In the first four months of 1972 the growth of the money supply accelerated sharply, partly as a result of inflows of funds following the second dinar devaluation. In May, therefore, the National Bank tightened monetary policy by changing minimum reserve requirements and curbing the availability of central-bank credit.

Australia. When in late 1969 balanced growth began to give way to overheating, monetary policy was tightened and from about mid-1970 onwards demand pressures eased. However, largely as a result of a decision by the national wage tribunal in December 1970, average wage earnings rose by 7 per cent. in the first quarter of 1971, to stand some 13 per cent. above the level a year earlier, and consumer prices began to accelerate. Against this background, restrictive monetary and fiscal policies were continued until clear signs of a recession emerged towards the end of the year. Externally, the current-account deficits in 1970 and 1971 were smaller than in the two previous years, with higher mineral exports more than compensating for the weakness of certain traditional exports, especially wool. More strikingly, private capital imports, which for some time had averaged about A$1 milliard per annum, ran at nearly twice that rate as from the beginning of 1971. Official reserve assets almost doubled, going up from US $1.7 to 3.3 milliard during the year.

Early in 1971 the government announced some budget economies and suspended a 20 per cent. tax allowance which previously applied for investment in manufacturing industry. With interest rates remaining high for most of the year, strong demand for government securities helped to keep bank liquidity under strain. To avoid too severe a squeeze, the coefficient for the banks' minimum reserves was lowered from 9.4 to 8.9 per cent. in April. In August the government announced a sharp tightening of fiscal policy, including an additional 2½ per cent. surcharge on income tax, a reduction in tax concessions to companies and increases in various indirect taxes, fees and charges designed to bring the budget close to overall balance in the financial year ending June 1972.

Investment and exports remained fairly strong until late in the year, but a weakening of consumption contributed to a progressive slow-down in overall activity and unemployment rose. In December, to promote an easing of credit conditions, the coefficient for the banks' minimum reserves was lowered again, to 7.1 per cent., part of the resources set free being transferred to special funds for financing term lending. In addition, the interest rates on commercial-bank loans and deposits of up to A$50,000 were lowered with effect from February 1972 and the banks were given increased freedom to set competitive rates on larger transactions.

Money and quasi-money grew by 9 per cent. following a rise of only 5 per cent. in 1970, with most of the increase taking the form of time and savings deposits. Commercial-bank liquidity went up towards the end of the year. With the demand for credit generally weak, the banks increased considerably their holdings of government securities.

In view of the higher level of unemployment, fiscal policy was decisively reversed early in 1972. Steps were taken to mitigate rural unemployment and in February the government announced the restoration of the tax allowance for investment, together with increases in its budget spending for 1971–72, especially in the form of grants to State governments for public-work programmes. With capital inflows continuing, monetary conditions eased further, but a recovery of overall demand was not yet evident.

South Africa. After two years of fairly balanced expansion, demand pressures became excessive in 1969 and 1970 and imports rose steeply. With exports declining, largely as a result of unfavourable trends in world-market prices, the external current account moved sharply into deficit. Under the influence of restrictive measures, output growth slowed down in 1971, but the rise in prices accelerated and imports remained at high levels. The current-account deficit increased and could not be fully offset by higher capital inflows. As a result, official exchange reserves declined by $300 million, following a fall of nearly $400 million in 1970. It was against this background that import controls were tightened in November and that the rand was devalued by 12.28 per cent. against gold in December.

Long-standing ceilings on most types of bank lending and on certain bank investments were extended in late 1970 to cover credit granted by other financial institutions as well and were administered quite severely last year. The ceilings were kept at the same levels (except for loans to agriculture), and as from March the banks were required to make non-interest-bearing deposits with the Reserve Bank in relation to credit-granting excesses. After an increase in Bank rate from 5½ to 6½ per cent. in March, the banks raised their lending and deposit rates. For its part, the government had introduced or increased various indirect taxes in October 1970 and hire-purchase restrictions had been tightened. This was followed in February and March 1971 by further increases in sales and excise taxes, together with a 5 per cent. increase in the surcharge on personal income tax and a raising of the rates for the temporary levies applying to individual and company income.

Though private fixed investment in manufacturing continued to increase, overall demand pressures eased progressively, as spending on consumer durables slowed down and exports remained weak. With a 27 per cent. rise in the government's expenditure and with revenue lagging, there was a budget deficit of R. 845 million in the calendar year 1971, about double that recorded in 1970. Moreover, despite special measures to promote sales of government securities to the non-bank sector, including higher interest rates, tax privileges and an increase in the proportion of assets which pension, insurance and mortgage institutions must invest in prescribed securities, the government had to increase substantially its recourse to the central bank. On the other hand, credit from the banking system to the private sector increased by less than 8 per cent., against 10 per cent. in 1970 and 18 per cent. in 1969. Reflecting partly the external deficit, money and quasi-money expanded by only 7 per cent., compared with the very low rate of 5 per cent. in 1970 and one of over 10 per cent. in 1969.

Monetary policy was kept restrictive after devaluation. As from April 1972, as a stimulus to exports and investment, banks were permitted to exceed the existing ceilings to the extent of 5 per cent. for short-term credits and 10 per cent. for investment credits. The government's 1972–73 budget presented in March provided for certain selective tax concessions, notably in respect of investment and increases in exports, but envisaged limiting the rise in government expenditure during the year to 6 per cent.

Eastern Europe. In the *Soviet Union* slower growth last year was mainly attributable to a levelling-off of agricultural output following the sharp recovery of 1970. A slackening in investment, which included a growing number of unfinished investment projects, and the delay — regarded as excessive — in achieving full utilisation of installed capacity were reflected in a modest deceleration in the expansion of industrial production and construction and a slower rise in productivity. Smaller rises in nominal wages, although partially offset by higher social pensions, led to a slower growth in real income and retail sales. In the autumn, against a background of certain continuing maladjustments in the supply of consumer goods, the authorities provided new incentives to stimulate the production of mass consumption goods. The growth of external trade slackened appreciably over the year, reflecting in particular a tapering-off of imports after an increase of 13.6 per cent. in 1970. Targets for 1972 call for the output of consumer goods to rise at a relatively rapid rate, although some slowing-down in the growth of industrial production is expected. Some principal aims of policy are the further development of the services sector, an improvement in product quality and a faster overall rise in productivity.

In the *German Democratic Republic* structural adjustment took precedence last year over the objective of rapid growth. National income rose by only 4.5 per cent., against a 5.2 per cent. average for the preceding five years. Agricultural production was adversely affected by dry weather conditions, but construction activity rose substantially and industrial output slackened only a little in the face of energy and labour shortages. Investment levelled off, though efforts were made to rationalise production in order to help sustain productivity gains. Production of consumer goods was given particular encouragement, but some unevenness in supply could be overcome only by higher imports. Nevertheless, retail sales in money terms rose appreciably less than in previous years. The total external trade turnover increased by 6 per cent., against 14 per cent. in 1970. In view of the continuing structural imbalances, economic plans for 1972 provide for moderate growth similar to that achieved last year.

In *Poland* economic targets were changed early in 1971 with a view to improving the standard of living. Production of consumer goods was given greater emphasis,

Eastern European economies:
Sectoral output and national income produced.

Countries	Gross output: Industry 1970	Industry 1971	Agriculture 1970	Agriculture 1971	Construction 1970	Construction 1971	National income produced[1] 1970	1971
	real annual increases, in percentages							
Bulgaria	9.3	9.5	3.6	3.1	13.2	5.9	7.2	5.5[2]
Czechoslovakia	8.5	6.9	1.1	2.8	7.9	9.7	5.8	4.6
German Democratic Republic	6.5	5.5	3.7	. .	4.0	5.7	5.2	4.5
Hungary	7.3	5.0	− 5.0	9.0	12.2	9.5	4.9	7.5
Poland	8.5	8.0	2.2	3.7	4.6	8.7	5.2	7.5[2]
Rumania	11.9	11.5	− 5.2	18.2	14.0	10.6	6.6	12.5
USSR	8.5	7.8	10.3	—	11.4	9.0	9.0	6.0[2]

[1] Net material product. [2] Estimate.
Source: UN Economic Commission for Europe, *Economic Survey of Europe in 1971.*

wages and pensions were increased and previous rises in food prices reversed. Real wages consequently rose by 5.3 per cent. over the year — against a longer-term average of less than 2 per cent. — though productivity gains slowed down. Private consumption expanded by about 8 per cent. — the biggest increase in eastern Europe. The adjustment of production was, however, not rapid enough to meet growing demand, and imports of consumer goods — particularly foodstuffs — increased substantially, though other imports were kept down. In value terms overall imports expanded by 11.9 per cent. in 1971, against approximately 12½ per cent. in each of the previous two years. Exports, although encouraged by price and exchange rate adjustments, rose by only 9.2 per cent., against roughly 13 per cent. in 1970. As a result, the trade deficit increased appreciably, but it was more than covered by an increased surplus on invisibles. The net material product grew by about 7½ per cent., with a slight slackening in industrial production being offset by improved performance in agriculture and construction. Production targets for 1972 anticipate a slight deceleration of industrial growth and provide for a further shift towards consumer goods.

In *Czechoslovakia* construction activity accelerated further last year and agricultural results were better than in 1970. On the other hand, energy and labour shortages tended to limit the expansion of industrial production. Priority was therefore assigned to investment directed towards increasing the supply of fuel and electricity and improving productivity. Even last year, however, productivity in industry rose by 6.5 per cent. — the highest rate of increase in eastern Europe. This gain, together with a relaxation of the wage freeze and cuts in consumer prices, led to an acceleration in the growth of real income and a more rapid rise in private consumption. The expansion of imports slackened more than that of exports, so that the trade surplus — which had reappeared in 1970 — increased substantially. In view of the scarcity of unutilised resources, the economic plan for 1972 sets a comparatively low growth target, but emphasises structural improvements and gains in labour productivity.

In *Hungary* the continuing rapid growth of investment brought the economy under some strain last year. To ease the situation, large state investment projects were postponed, credit-granting was tightened and subsidies to industry were reduced.

Furthermore, price increases were allowed, particularly for construction, in order to dampen domestic demand. Although industrial production grew more slowly, a good recovery in agricultural output, together with a continuing strong uptrend in construction, led to an acceleration in the growth of national income. Productivity gains slackened and, with the cost of living increasing faster than before, the rise in real wages slowed down. As a result, the expansion of retail sales declined, despite an increased supply of consumer goods. Reflecting partly the high level of investment activity, imports rose by 19 per cent., after increasing by 30 per cent. in 1970. Exports, on the other hand, went up by only 8 per cent., mainly because of a weakening in demand from western Europe. The trade deficit widened considerably and efforts were made to curb the growth of imports. One feature of the year was the National Bank's placing on the international bond market in June of a ten-year $25 million loan at 8¾ per cent. The economic plan for 1972 aims at a more moderate growth rate, based on a stabilisation of investment at the present high level, and at bringing the trade accounts into better balance.

In *Rumania* the growth of national income produced was nearly double that recorded in 1970, thanks to favourable weather conditions and a consequent steep recovery in agricultural output, which had suffered severely from flood damage in 1970. Industrial production continued to expand strongly, helped by a rapid growth in the industrial labour force, but the increasing employment of unskilled labour tended to limit productivity gains. However, investment activity, particularly in the petro-chemical industries, continued strong. Special measures were taken to reduce discrepancies between agricultural and industrial money incomes but, in general, nominal and real wages increased a good deal less than in 1970. This slow-down was part of a policy designed to shift resources to exports. As at the same time imports were restrained, the trade balance swung into surplus and part of the external indebtedness incurred in 1969 and 1970 could be repaid. New legislation provided for some liberalisation of foreign trade and decentralisation of its management. In addition, steps were taken to allow foreign enterprises to participate in Rumanian firms and to establish sales agencies in Rumania. The new five-year plan envisages a continuation of the rapid overall growth, with the emphasis again on investment.

In *Bulgaria* measures taken in late 1970 provided for a greater concentration of management in industry and agriculture and for a faster rate of industrialisation, the effects of which will make themselves felt gradually. Meanwhile, the growth of national income slowed down last year, mainly as the result of output trends in construction and agriculture. The rise in industrial production was again satisfactory, though output in certain key investment-goods sectors fell short of expectations. The production of consumer goods was given special stimulus but continued to lag behind demand. A shortage of skilled labour and an increasing number of unfinished investment projects contributed to the slower growth recorded in productivity. Real wages showed a fairly good gain, partly because the price level was held virtually stable by reducing those of industrial goods to compensate for higher foodstuff prices. Imports increased by 14.7 per cent. in 1971, after a period of severe restraint over the two previous years. Exports expanded less, by only 8.8 per cent., but the trade balance remained in surplus. Although a scarcity of certain resources had emerged, the new five-year economic plan again provided for a high growth rate.

III. WORLD TRADE AND PAYMENTS.

In value terms the rate of increase in world trade last year — at 11½ per cent. — was again high, particularly considering the sluggishness of the recovery in North America, the slow-down in many other developed countries and the uncertainties arising from the currency crisis. The expansion was three percentage points less than in 1970, but it exceeded the average of some 9 per cent. for the decade 1960–69. It becomes less impressive, however, when allowance is made for the rise in average prices of internationally traded goods, which went up by about 5 per cent., slightly less than in 1970, compared with increases of only about 1 per cent. a year during the sixties. Moreover, comparing 1971 with 1967 — which was also a year of weak world demand — volume growth is seen to be approximately the same in both cases, i.e. about 5–6 per cent., against an average expansion during the sixties of 8 per cent. That the increase in dollar prices of international trade moderated only slightly last year is attributable largely to the continuing inflation in the industrial countries. However, a part was also played by special factors, particularly the depreciation of the dollar vis-à-vis many currencies, but also the oil-price agreements, which led to an increase of 20 per cent. in fuel export prices during the year.

International trade.

Areas	Exports (f.o.b.)		Imports (c.i.f.)		Rates of increase in exports		Rates of increase in imports	
	1970	1971	1970	1971	1970	1971	1970	1971
	in milliards of US dollars				in percentages			
Developed areas								
Western Europe								
EEC	88.7	101.1	88.7	100.0	*17.0*	*14.0*	*17.0*	*13.0*
EFTA[1]	43.3	48.5	51.2	56.0	*13.0*	*12.0*	*16.0*	*9.5*
Other countries	6.5	7.4	12.3	13.5	*18.0*	*14.0*	*18.5*	*10.0*
Total	138.5	157.0	152.2	169.5	*15.5*	*13.5*	*17.0*	*11.5*
United States	43.2	44.1	42.5	48.5	*13.5*	*2.0*	*11.0*	*14.0*
Canada	16.8	18.3	14.5	16.8	*16.5*	*9.0*	*2.0*	*15.5*
Japan	19.3	24.0	18.9	19.7	*21.0*	*24.5*	*25.5*	*4.5*
Other countries[2]	8.2	8.9	10.2	11.0	*7.0*	*9.0*	*16.0*	*7.5*
Total	226.0	252.3	238.3	265.5	*15.5*	*11.5*	*15.5*	*11.5*
Developing areas								
Latin America	13.8	.	14.0	. .	*11.5*	.	*13.0*	.
Other areas	40.3	.	41.6	.	*11.0*	.	*11.0*	.
Total	54.1	60.0	55.6	63.0	*11.5*	*11.0*	*11.5*	*13.5*
Grand total[3]	280.1	312.3	293.9	328.5	*14.5*	*11.5*	*14.5*	*11.5*

[1] Including Finland and Iceland. [2] Australia, New Zealand and South Africa. [3] Represents roughly 90 per cent. of world trade, as the exports and imports of centrally-planned economies are included only to the extent that they are reflected in trade with the rest of the world.

Expressed in US dollars, the terms of trade of both developed and developing areas showed no overall change last year, but there were widely differing trends inside the two areas. In the developing world there was a marked contrast between petroleum-producing and other countries. In fact, primary commodities other than fuels generally experienced a weak price trend, though there were exceptions in the case of certain important agricultural products. In the industrialised countries the deterioration in the terms of trade of North America was countered by opposite movements in Europe and Japan. Prices of manufactured goods went up by 6 per cent., but here again the figures are inflated by being expressed in dollar terms.

Both exports and imports of industrial countries increased by 11½ per cent., though this reflected large offsetting movements between North America and other countries, particularly Japan. The growth of exports from developing areas slowed down only marginally, while imports rose more quickly. The reverse was true of centrally-planned economies, where exports grew faster than imports, at rates averaging about 8 per cent., i.e. well below those in the rest of the world.

The most marked decline in import expansion was recorded by Japan: from 25½ per cent. in 1970 to 4½ per cent. last year. A significant contraction also took place in Australia and South Africa as a result of the weak demand conditions in those countries. It was only in North America that imports gathered momentum, reflecting both an incipient cyclical upswing and anticipations of a depreciation of the Canadian and the US dollar vis-à-vis other major currencies. The acceleration was particularly marked in Canada, where imports expanded by 15½ per cent. in 1971, compared with 2 per cent. in 1970. In Europe the slow-down was especially pronounced in the EFTA area, largely as a consequence of developments in Scandinavian countries.

As for exports, the slackening-off was most noticeable in North America: both the United States and Canada experienced an actual decline or near-stagnation in trade with Europe and Japan, though this was offset to some extent by an increase (of 14½ per cent.) in US exports to Canada and Canadian exports to the United States. At the

Growth of exports from main industrial areas.

Exports from	Years	Exports to: Western Europe EEC	Western Europe EFTA[1]	North America	Japan	Other developed countries[2]	Developing countries	Total
		in percentages over previous year, based on dollar values						
EEC	1969	26.0	14.0	4.5	16.0	12.5	11.5	18.0
	1970	18.5	17.0	10.5	33.0	15.0	15.5	17.0
	1971	14.5	12.5	18.0	− 4.5	10.5	12.5	14.0
EFTA[1]	1969	18.5	16.5	5.0	29.5	13.5	16.5	15.0
	1970	15.0	19.5	3.0	14.5	10.5	9.0	13.0
	1971	8.5	11.5	16.5	6.5	11.0	9.0	12.0
North America . .	1969	14.5	4.5	14.0	16.0	5.0	4.0	10.0
	1970	23.5	18.5	3.5	33.0	19.0	17.5	14.5
	1971	− 1.0	− 5.0	14.5	−10.5	3.0	3.5	4.0
Japan.	1969	41.0	− 3.0	23.0	—	36.5	22.0	23.5
	1970	34.5	46.5	19.5	—	33.0	13.5	21.0
	1971	25.5	21.5	29.0	—	10.0	25.5	24.5

[1] Including Finland and Iceland. [2] Including centrally-planned economies.

other extreme, Japan's exports accelerated further, particularly those to the United States and Canada. In Europe the EEC's export expansion moderated somewhat as a result both of intra-area developments and of the adverse trend in trade with Japan. In the EFTA, on the other hand, the rate of growth was well maintained, especially because of the good results achieved by the United Kingdom.

Balances of payments.

One of the side-effects of last year's exchange rate adjustments is the difficulty of obtaining comparable balance-of-payments data for 1971 when the US dollar is taken as the common denominator for the presentation of data for all countries. There are two basic problems. Firstly, countries' official dollar-conversion procedures have not been uniform; in fact, a few countries continued to apply their old dollar parities for conversion purposes right up to the end of 1971. Secondly, the overall balances in terms of US dollars as given in the official national data were affected by valuation adjustments relating to the external monetary position.

As to the latter problem, changes in the overall balances due to valuation adjustments in 1971 have been netted out, so far as the available statistics allow. While limitations in the data still remain, the margins of error should not be so great as to prevent last year's developments in trade and payments from being examined in broad perspective.

Turning to the current accounts of Group of Ten countries last year, the United States was the only one to show a large deficit. All the other countries were in surplus, with the exception of the Netherlands, which had a small deficit, and France, whose deficit vis-à-vis non-franc-area countries is estimated to have been offset by a surplus in relation to the franc area. Excluding the United States, the combined surplus came to some $11 milliard — or roughly 1 per cent. of the other countries' aggregate gross national product. Japan, the United Kingdom and Italy accounted for the bulk of it.

The strength of the Japanese current account lies in merchandise trade, the surplus on which grew progressively during the sixties and shot up last year to $8 milliard. In the United Kingdom and Italy, where historically the main source of earnings has been invisibles, the trade surplus last year was substantial too. Germany stands out both for its huge trade surplus and for its deficit on invisibles — the largest in the world. This climbed to $6 milliard last year, practically offsetting net earnings from trade. As regards the United States, the sharp deterioration in its current balance was wholly due to merchandise trade, while services and transfers yielded a small surplus, thus reversing the usual relative position of these groups.

On capital account, the outstanding feature was the US deficit of $20 milliard, representing as much as 2 per cent. of gross national product; otherwise net outflows were recorded only in Italy, Canada and (on a cash basis) the BLEU. Italy's capital account is in any case generally in deficit, and last year's result was greatly influenced by the official encouragement given to residents to repay in advance loans taken up abroad in 1970. The unusual Canadian net outflow was also largely a reflection of deliberate monetary action taken in view of the surplus on current account. The largest net inflow on capital account — about $3.5 milliard — was registered in

Balances of payments of the Group of Ten countries.[1]

Countries	Periods	Trade balance (f.o.b.)	Services and transfers	Current balance	Net capital movements[2]	Overall balance[3]
		in millions of US dollars				
Belgium-Luxemburg[4] . . .	1961–65	—	+ 35	+ 35	+ 25	+ 60
	1966–70	+ 185	+ 10	+ 195	— 170	+ 25
	1971	+ 850	+ 20	+ 870	— 685	+ 185
France[5]	1961–65	+ 330	+ 290	+ 620	+ 230	+ 850
	1966–70	— 110	— 360	— 470	— 175	— 645
	1971	— 15	— 590	— 605	+ 2,635	+ 2,030
Germany	1961–65	+ 2,005	— 2,215	— 210	+ 270	+ 60
	1966–70	+ 4,985	— 3,455	+ 1,530	— 1,040	+ 490
	1971	+ 6,330	— 6,210	+ 120	+ 3,555	+ 3,675
Italy	1961–65	— 660	+ 1,240	+ 580	— 290	+ 290
	1966–70	+ 315	+ 1,590	+ 1,905	— 1,755	+ 150
	1971	+ 420	+ 1,480	+ 1,900	— 1,115	+ 785
Netherlands	1961–65	— 465	+ 540	+ 75	— 30	+ 45
	1966–70	— 565	+ 435	— 130	+ 235	+ 105
	1971	— 700	+ 525	— 175	+ 715	+ 540
Total EEC	1961–65	+ 1,210	— 110	+ 1,100	+ 205	+ 1,305
	1966–70	+ 4,810	— 1,780	+ 3,030	— 2,905	+ 125
	1971	(+ 6,885)	(— 4,775)	(+ 2,110)	(+ 5,105)	(+ 7,215)
Sweden[6]	1961–65	— 200	+ 215	+ 15	+ 75	+ 90
	1966–70	— 195	+ 30	— 165	+ 120	— 45
	1971	+ 380	— 195	+ 185	+ 90	+ 275
United Kingdom	1961–65	— 610	+ 510	— 100	— 450	— 550
	1966–70	— 715	+ 965	+ 250	— 245	+ 5
	1971	+ 730	+ 1,590	+ 2,320	+ 1,265	+ 3,585
Canada	1961–65	+ 455	— 1,175	— 720	+ 855	+ 135
	1966–70	+ 1,220	— 1,515	— 295	+ 930	+ 635
	1971	+ 2,260	— 2,040	+ 220	— 820	— 600
Japan	1961–65	+ 390	— 660	— 270	+ 195	— 75
	1966–70	+ 2,725	— 1,485	+ 1,240	— 340	+ 900
	1971	+ 7,900	— 2,000	+ 5,900	+ 1,775	+ 7,675
Total, including EEC	1961–65	+ 1,245	— 1,220	+ 25	+ 880	+ 905
	1966–70	+ 7,845	— 3,785	+ 4,060	— 2,440	+ 1,620
	1971	(+18,155)	(— 7,420)	(+10,735)	(+ 7,415)	(+18,150)
United States	1961–65	+ 5,435	— 1,630	+ 3,805	— 6,380	— 2,575
	1966–70	+ 2,235	— 1,495	+ 740	— 4,585	— 3,845
	1971	— 2,890	+ 105	— 2,775	—19,915	—22,690
Grand total	1961–65	+ 6,680	— 2,850	+ 3,830	— 5,500	— 1,670
	1966–70	+10,090	— 5,280	+ 4,800	— 7,025	— 2,225
	1971	(+15,275)	(— 7,315)	(+ 7,960)	(—12,500)	(— 4,540)
Memorandum item						
Switzerland[6, 7]	1967–70	— 760	+ 1,105	+ 345	+ 280	+ 625
	1971	— 1,465	+ 1,515	+ 50	(+ 2,380)	(+ 2,430)

[1] The figures for 1961–65 and 1966–70 are annual averages. The data for 1971 correspond to those given in the tables for the various countries (excluding SDR allocations) and are taken from official national sources. They are not strictly comparable inasmuch as the conversion procedures adopted by the various countries are not consistent. Except for Belgium-Luxemburg, all data are on a transactions basis. [2] Including errors and omissions. [3] Equal to changes in net official assets (excluding SDR allocations) and in the net foreign position of commercial banks, except for the United States, where it refers to the net liquidity balance (excluding SDR allocations), and the United Kingdom, where from 1963 onwards it excludes UK banks' net foreign currency borrowing for UK investment abroad and trade credit provided by UK banks. The figures are net of estimated revaluation gains or losses to the extent allowed by available data (see individual countries for details). [4] On a cash basis; exports and imports partly c.i.f. [5] Vis-à-vis non-franc- area countries. [6] Imports c.i.f. [7] Data for Switzerland are available on a roughly consistent basis as from 1967 only.

Germany: it was practically all concentrated in the first five months of the year. Substantial net gains on capital transactions were also recorded by France, Switzerland, Japan and the United Kingdom. However, the net inflows of all countries of the Group, excluding the United States but including Switzerland, totalled only $10 milliard. This points to significant outflows — both directly and, to some extent, indirectly via Group of Ten countries — from the United States to other areas.

As regards overall balances, the largest surplus — $7.5 milliard — was recorded by Japan. Germany, the United Kingdom, Switzerland and France followed, with net gains of between $3.5 and 2 milliard. All other countries were in surplus, apart from Canada, which showed a $0.5 milliard deficit, and, of course, the United States, which was faced with a huge deficit of $22.5 milliard on a net liquidity basis. Thus, taking the Group as a whole, there was a net overall deficit of around $2 milliard vis-à-vis the rest of the world: the combined surplus of the Group on current transactions was not sufficient to offset net capital outflows, chiefly from the United States.

United States. In 1971 the US balance of payments experienced an enormous and unprecedented deterioration.

The trade balance recorded its first annual deficit (on a balance-of-payments basis) since 1935, moving from a surplus of $2.1 milliard in 1970 to a deficit of $2.9 milliard — equal to 7 per cent. of gross exports.

Exports rose by only 2 per cent. in value and declined slightly in volume. Agricultural exports accounted for nearly 60 per cent. of the value increase, reflecting mainly higher prices but also a surge in the volume of cotton exports. In other categories, there was a sharp fall in shipments of semi-manufactures, centred on the strike-hit metal industries, and substantial increases in aircraft deliveries — chiefly jumbo jets — and, partly as an after-effect of the 1970 General Motors strike, in exports of automotive products. Imports were some 14½ per cent. higher in value than in 1970; a little over 5 percentage points of this gain reflected price rises. An unusually big increase of over 12 per cent. in imports of industrial supplies and materials was partly the result of domestic strikes. Imports of motor-industry products from Canada rose sharply, by 29 per cent., with the General Motors strike again an important influence, but those from other countries also went up steeply, by 43 per cent. Imports of other (non-food) consumer goods showed a substantial increase of over 13 per cent. One-third of the total rise in imports was accounted for by motor-industry products and another third by semi-manufactures. Of the $5 milliard deterioration in the trade balance, $2.1 milliard occurred vis-à-vis countries of western Europe, leaving the United States with a net surplus of $0.8 milliard in trade with them, while $2 milliard was vis-à-vis Japan, leaving the United States in a net deficit position of $3.2 milliard with that country.

One of the reasons why it is difficult to see the underlying position clearly is that trade in 1971 was affected by various strikes. Official estimates suggest that this factor accounted for perhaps $1 milliard of the $5 milliard shift in the trade balance.

But the dominant factor in this shift was undoubtedly the much slower growth than usual in overseas markets at a time when the US economy was beginning to

United States: Balance of payments.*

Items	1969	1970			1971		
		Year	1st half	2nd half	Year	1st half	2nd half
	in millions of dollars						
Merchandise trade (f.o.b.)							
Exports	36,490	41,960	20,825	21,155	42,770	21,720	21,050
Imports	35,830	39,870	19,560	20,310	45,650	22,535	23,115
Trade balance	+ 660	+ 2,110	+ 1,265	+ 845	− 2,880	− 815	− 2,065
Other current items							
Investment income	+ 5,975	+ 6,240	+ 3,045	+ 3,195	+ 7,950	+ 3,965	+ 3,985
Military transactions	− 3,340	− 3,370	− 1,715	− 1,655	− 2,855	− 1,330	− 1,525
Travel and transportation	− 1,780	− 1,980	− 950	− 1,030	− 2,245	− 1,050	− 1,195
Government grants	− 1,645	− 1,740	− 810	− 930	− 2,015	− 910	− 1,105
Other	− 770	− 815	− 420	− 395	− 730	− 310	− 420
Total	− 1,560	− 1,665	− 850	− 815	+ 105	+ 365	− 260
Current balance	− 900	+ 445	+ 415	+ 30	− 2,775	− 450	− 2,325
Long-term capital							
US Government	− 1,930	− 2,030	− 1,045	− 985	− 2,380	− 1,315	− 1,065
Direct investment	− 2,420	− 3,475	− 2,025	− 1,450	− 4,720	− 2,690	− 2,030
Other	+ 2,370	+ 2,020	+ 785	+ 1,235	+ 590	− 115	+ 705
Total	− 1,980	− 3,485	− 2,285	− 1,200	− 6,510	− 4,120	− 2,390
Basic balance	− 2,880	− 3,040	− 1,870	− 1,170	− 9,285	− 4,570	− 4,715
Non-liquid short-term private capital	− 600	− 545	− 255	− 290	− 2,530	− 790	− 1,740
Errors and omissions	− 2,605	− 1,100	− 430	− 670	−10,875	− 3,325	− 7,550
SDR allocations	—	+ 865	+ 435	+ 430	+ 715	+ 360	+ 355
Net liquidity balance	− 6,085	− 3,820	− 2,120	− 1,700	−21,975	− 8,325	−13,650
Liquid private capital							
Claims	+ 125	+ 240	+ 100	+ 140	− 1,090	− 225	− 865
Liabilities	+ 8,660	− 6,240	− 2,245	− 3,995	− 6,705	− 2,750	− 3,955
Total	+ 8,785	− 6,000	− 2,145	− 3,855	− 7,795	− 2,975	− 4,820
Official reserve transactions balance	+ 2,700	− 9,820	− 4,265	− 5,555	−29,770	−11,300	−18,470

* On a transactions basis, seasonally adjusted.

recover. To be sure, continuing domestic economic slack might have been expected to induce US business firms to push exports, and to have limited any expansion of imports. But, in fact, exports dropped slightly in volume terms while the import volume rose by 9 per cent. This was a worse result than past relationships between trade and economic activity would have indicated. All in all, it has been estimated that cyclical factors were responsible for about half of the deterioration in the trade balance.

Even if $1 milliard is deducted for strikes and about $2½ milliard for cyclical influences, $1½ milliard of the deterioration in the trade balance still has to be accounted for. Though there had been a marked downward trend for the previous six years, reflecting a weakening of US competitiveness, the trade balance was also unfavourably affected last year by commercial leads and lags associated with exchange uncertainties and speculation. Furthermore, such influences were probably at work before

15th August as well as during the subsequent period of floating rates. On the other hand, the 10 per cent. import surcharge may have had some restraining influence on imports.

The deterioration on trade account was not wholly reflected in the balance on current account, which declined by $3.2 milliard to a deficit of $2.8 milliard. Two components of the current account improved over the year: the surplus of net investment income rose from $6.2 to 8 milliard, reflecting to some extent revaluation effects on earnings denominated in foreign currencies, but mainly lower outpayments due to the decline in US interest rates; there was also a reduction of $0.5 milliard in net military outlays, chiefly as a result of increased sales of military equipment.

On the long-term capital account, the outflow of US direct investment, at $4.5 milliard, continued at the high level of 1970, even though it fell off in the face of the exchange rate uncertainty in the later months of the year. At the same time there was a small net outflow, the first for seven years, in respect of foreign direct investment in the United States. This, too, was due to exchange rate considerations. Adding to all this a large increase in other long-term net claims on foreigners — mostly through banks — and a small rise in outflows on government account, the deficit on long-term capital account was $6.5 milliard, compared with $3.5 milliard in 1970.

The bulk of the deficit, however, was on short-term capital account. The net outflow including errors and omissions and liquid capital, at $21.2 milliard, hardly needs comment in view of the great incentive for a flight of both residents and non-residents from the dollar.

The official reserve transactions balance showed a record $29.8 milliard deficit for the year, as against the 1970 deficit of $9.8 milliard, which itself was over $7 milliard higher than that in the preceding year.

In the first quarter of 1972 the (adjusted) trade deficit increased slightly to $1.6 milliard. In itself, this is hardly surprising, since in the short run the adverse terms-of-trade effects of devaluation outweigh the volume effects. Incomplete data suggest that a sizable deterioration took place on services account — mainly owing to a decline in investment-income receipts — causing the surplus to contract from about $1 milliard in the previous quarter to about $700 million. On the other hand, favourable shifts in long-term and non-liquid capital transactions contributed to a narrowing of the net liquidity deficit from $4.3 to 3.2 milliard, including the (seasonally adjusted) allocation of SDRs of $180 million. The most significant development, however, was the fall in the net private "liquid" capital outflow from $1.9 milliard to only $300 million. The official settlements deficit was therefore $3.5 milliard, compared with $6.3 milliard in the previous quarter.

Canada. In the past Canada used to run a deficit on current account — the net result of a trade surplus and a deficit on invisibles. In 1970, however, a swing of nearly $2 milliard from deficit to surplus took place. This seemed to reflect partly the slow-down in the Canadian economy and partly a number of special factors, notably distortions caused by strikes. But the change may have been more fundamental, since in 1971 the current account still showed a small surplus, although the economy had a much higher rate of expansion than its trading partners.

Last year's current-account surplus, concentrated mainly in the first half of the year, resulted from a trade surplus of almost $2.3 milliard and a deficit on services and transfers of approximately $2 milliard. The trade surplus was 22 per cent. smaller than in 1970, while the deficit on invisibles was 10 per cent. larger. These results were no doubt affected by the appreciation of the Canadian dollar in the second half of 1970.

In terms of Canadian dollars, merchandise imports expanded in 1971 by 12 per cent., accelerating gradually as the year progressed. The increase in volume was 9½ per cent. and in prices 2 per cent. Exports, on the other hand, rose by only 6 per cent., entirely accounted for by a growth in volume. The largest rise in imports was in automotive production, which shot up by 26 per cent. in 1971 after a fall of 8 per cent. in 1970. Export earnings were strongly affected by a 5 per cent. decline in sales of metals and minerals after a rise of 28 per cent. in 1970. This is largely ascribable to the fall in world prices of non-ferrous metals. Cyclical movements abroad help to explain why, whereas in 1970 exports to countries other than the United States had soared by 37 per cent., in 1971 they fell by 3½ per cent.; in contrast, exports to the United States rose by 10 per cent. in 1971, against 3 per cent. in 1970.

Canada: Balance of payments.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	in millions of US dollars[2]						
Merchandise trade (f.o.b.)							
Exports	13,820	16,115	7,925	8,190	17,665	8,670	8,995
Imports	12,955	13,225	6,705	6,520	15,405	7,450	7,955
Trade balance	+ 865	+ 2,890	+ 1,220	+ 1,670	+ 2,260	+ 1,220	+ 1,040
Services and transfers	− 1,745	− 1,860	− 1,050	− 810	− 2,040	− 1,060	− 980
Current balance	− 880	+ 1,030	+ 170	+ 860	+ 220	+ 160	+ 60
Long-term capital	+ 1,945	+ 690	+ 535	+ 155	+ 475	+ 290	+ 185
Basic balance	+ 1,065	+ 1,720	+ 705	+ 1,015	+ 695	+ 450	+ 245
Short-term capital[3]	− 515	− 25	+ 15	− 40	− 1,295	− 1,155	− 140
SDR allocations	−	+ 125	+ 125	−	+ 115	+ 115	−
Overall balance	+ 550	+ 1,820	+ 845	+ 975	− 485	− 590	+ 105[4]

[1] On a transactions basis. [2] Conversion since the second quarter of 1970 at quarterly average spot rates. [3] Including errors and omissions. [4] Gold and gold-guaranteed net official assets still valued at the parity of $35 per ounce.

In view of the current-account surpluses in 1970 and 1971, the authorities sought to reduce Canadian dependence on long-term capital inflows. Thus, in 1971 total net long-term capital inflows amounted to less than $0.5 milliard, against $0.7 milliard in 1970 and nearly $2 milliard in 1969. The major source of the overall decline was transactions with non-residents in securities issued by Canadians, which yielded only $0.2 milliard in 1971, compared with $0.5 milliard in 1970 and $1.6 milliard in 1969. Direct foreign investment in Canada reached a record net figure of about $0.9 milliard, against $0.7 milliard in 1970, with some two-thirds of the total coming from the United

States; Canadian direct investment abroad amounted to \$0.3 milliard, so that the net inflow came to \$0.6 milliard.

As a result of the contraction in the current-account surplus and in net long-term capital receipts, the basic balance showed a surplus of \$0.7 milliard in 1971, i.e. \$1 milliard less than in 1970.

Non-bank short-term capital movements (including errors and omissions) produced a very large net outflow of approximately \$1.3 milliard. This mainly represented shifts in inter-company accounts and unidentified transactions and must largely have been directed to European countries and Japan. The outflow was, in fact, attributable to interest rate differentials that arose in the course of 1971.

In the first quarter of 1972 the current account was in deficit to the extent of \$530 million (or \$390 million on an adjusted basis, compared with \$225 million in the fourth quarter of 1971), owing to a sharp contraction of the trade surplus. Net capital movements brought in \$70 million, so that, including the third SDR allocation, the overall balance registered a deficit of \$345 million.

Japan. A predominant feature of the international scene last year was Japan's overall external surplus, which, at \$7.8 milliard, was the largest in nominal terms ever recorded by any country. Over three-quarters of the surplus was on current account. This development reflected not only the growing competitiveness of Japanese goods but also the economic slow-down at home, which induced enterprises to step up their export efforts. It appears also that the prospect of a yen revaluation against the dollar was a strong spur to exports. At the same time, import growth dropped off considerably, and the resulting current surplus was equivalent to 2.7 per cent. of the gross national product, against 1.2 per cent. in 1970 and 1 per cent. on average for the period 1965–69.

On the basis of customs statistics, merchandise exports rose by 21 per cent., i.e. at the same rate as in 1970; 85 per cent. of this expansion was in volume. Efforts to maintain competitive prices, together with the practice of fixing export contracts in terms of US dollars, had the result that export unit values, after increasing at an annual rate of 7 per cent. from the beginning of 1970 to August 1971, fell thereafter, so that for 1971 as a whole they rose by only about 2½ per cent. Exports of machinery and equipment, the largest category, advanced by 22 per cent., to record a nearly threefold increase in the last five years. Imports, on the other hand, were practically stagnant last year, after a 26 per cent. rise in 1970. A deceleration in stock-building, after the big increase in 1970, caused raw-material imports to fall both in value and in volume; fuel imports continued to grow, but mostly because of price effects. The average unit value of imports did not change as compared with 1970, and the terms of trade improved by only 2½ per cent., suggesting that the price benefits of revaluation will be felt more this year.

Net payments on services, at \$1,750 million, were slightly down on the 1970 figure, but transfer outflows rose by about \$50 million to \$250 million, so that the net deficit in respect of non-merchandise transactions remained unchanged.

Long-term capital movements showed a sizable deficit of nearly \$1.2 milliard, but this was over 25 per cent. less than in 1970. The gross outflow went up to \$2.3 milliard, Japan: Balance of payments.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	In millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	15,680	18,970	8,620	10,350	23,650	10,700	12,950
Imports	11,980	15,005	7,195	7,810	15,750	7,850	7,900
Trade balance .	+ 3,700	+ 3,965	+ 1,425	+ 2,540	+ 7,900	+ 2,850	+ 5,050
Services and transfers	− 1,580	− 1,995	− 995	− 1,000	− 2,000	− 1,105	− 895
Current balance	+ 2,120	+ 1,970	+ 430	+ 1,540	+ 5,900	+ 1,745	+ 4,155
Long-term capital . . .	− 155	− 1,590	− 900	− 690	− 1,160	− 20	− 1,140
Basic balance .	+ 1,965	+ 380	− 470	+ 850	+ 4,740	+ 1,725	+ 3,015
Short-term capital[2] . .	+ 320	+ 995	+ 480	+ 515	+ 2,935	+ 1,170	+ 1,765
SDR allocations	—	+ 120	+ 120	—	+ 130	+ 130	—
Overall balance .	+ 2,285	+ 1,495	+ 130	+ 1,365	+ 7,805	+ 3,025	+ 4,780[3]

[1] On a transactions basis. [2] Including errors and omissions. [3] Gold and gold-guaranteed net official assets still valued at the parity of $35 per ounce.

compared with $2 milliard in 1970, but the gross inflow swelled to $1.2 milliard from $0.4 milliard in 1970. Last year's inflow mainly reflected foreign investment in Japanese securities, which in January–June 1971 reached nearly $1 milliard, or approximately four times as much as total foreign acquisitions in 1970. In May the granting of licences for non-residents' purchases of unlisted debentures was suspended. During the year other measures were also taken to step up capital outflows while restricting inflows. They included: (i) free authorisation for residents to purchase securities and real estate and to undertake direct investment abroad; (ii) yen loans to the IBRD by the Bank of Japan; (iii) tight controls on the issuing of bonds abroad by residents to raise funds for domestic purposes.

Short-term capital inflows were the second big factor contributing to last year's surplus: net receipts on non-bank account (including errors and omissions) amounted to nearly $3 milliard. Movements in leads and lags, the largest source of short-term inflows, mainly consisted of advance payments for Japanese exports and were especially concentrated in the latter two weeks of August before the floating of the yen, and before the introduction of exchange controls restricting such prepayments.

Because of both weak domestic demand and the terms-of-trade effects of the yen revaluation, trade transactions continued to yield a substantial surplus in the first quarter of 1972. At $1.8 milliard, the surplus was nearly two-thirds higher than in the corresponding period of 1971, thus pushing net receipts on current account to over $1 milliard, or more than twice the amount recorded a year earlier. Long-term capital outflows exceeded short-term inflows by about $50 million, thanks partly to the reimposition at the end of February of exchange controls restricting advance payment for Japanese exports, which had been lifted at the beginning of the year. Including the allocation of SDRs, the overall balance closed with a surplus of $1.1 milliard, against one of $735 million in the first quarter of last year.

United Kingdom. In 1971 the United Kingdom recorded a trade surplus for the second year in succession. The surplus — a rare thing in itself given the country's balance-of-payments structure — was particularly impressive in terms of size, having risen to $730 million. On closer examination, however, this performance loses some of its lustre. In volume terms imports rose by almost as much as exports — a disappointing result for a year in which home demand was weak and spare capacity abundant. Concentrated in the second half of the year, the trade surplus partly reflected special, non-recurring factors affecting exports, as well as a marked deceleration in imports, which on an adjusted basis actually declined in volume terms. Imports rose last year by 9 per cent. in value and by 4½ per cent. in volume, and the corresponding figures for exports were 12½ and 5 per cent. Altogether, the terms of trade improved over the past two years by some 8 per cent. and at end-1971 were again well above the pre-1967 levels.

Customs data show that the rise in exports was mainly due to increased sales of manufactured goods, which expanded by some 15 per cent. in value but by only 6½ per cent. in volume. Non-manufactured goods — representing 15 per cent. of total exports — rose by 7½ per cent., or half as much as in 1970. Exports to the sterling area and to North America showed an above-average expansion. Those to western Europe rose by approximately 10 per cent., with sales to the EEC going up more than those to the EFTA. Imports displayed very dissimilar trends. Purchases of industrial materials — 40 per cent. of the total — declined slightly. In contrast, imports of finished consumer goods rose by 42 per cent. and those of fuels by 32 per cent. The former reflected the revival of consumer spending in the second half of 1971, while the latter largely represented an increase in prices following the Teheran and Tripoli agreements. Imports

United Kingdom: Balance of payments.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	in millions of US dollars[2]						
Merchandise trade (f.o.b.)							
Exports	16,945	18,925	9,430	9,495	21,625	10,330	11,295
Imports[3]	17,280	18,910	9,440	9,470	20,895	10,335	10,560
Trade balance	− 335	+ 15	− 10	+ 25	+ 730	− 5	+ 735
Services and transfers	+ 1,400	+ 1,450	+ 875	+ 575	+ 1,590	+ 920	+ 670
Current balance	+ 1,065	+ 1,465	+ 865	+ 600	+ 2,320	+ 915	+ 1,405
Long-term capital	− 585	− 1,125	− 305	− 820	− 400	+ 125	− 525
Basic balance	+ 480	+ 340	+ 560	− 220	+ 1,920	+ 1,040	+ 880
Short-term capital	+ 105	+ 685	+ 430	+ 255	+ 865	+ 610	+ 255
Balancing item	+ 950	+ 275	+ 350	− 75	+ 800	+ 660	+ 140
SDR allocations	—	+ 410	+ 410	—	+ 300	+ 300	—
Overall balance	+ 1,535	+ 1,710	+ 1,750	− 40	+ 3,885	+ 2,610	+ 1,275[4]

[1] On a transactions basis. [2] Conversion effected at the old parity until mid-August 1971 inclusive, and thereafter at the average spot rates. [3] Including progress payments for US military aircraft and missiles. [4] Excluding estimated revaluation adjustments of the external monetary position.

from the sterling area, almost stationary in 1970, went up by 11 per cent. last year. Imports from western Europe maintained the 13 per cent. rate of increase shown in 1970, whereas those from North America actually declined — particularly if payments for US military aircraft are included, as these came to only $12 million in 1971, against twice that amount in 1970 and twelve times as much in 1969.

Net invisible receipts have been rising steeply and steadily since the second half of the sixties; in 1971 they came to $1.6 milliard, i.e. $140 million more than in 1970 and approaching four times as much as in 1966. The widening of the surplus last year occurred in spite of increased government service and transfer payments and a cut of nearly one-half in net earnings from travel; it was mainly due to a reduction in the deficit on shipping account, larger inflows from other service items, especially insurance, and greater net receipts in respect of interest, profits and dividends.

The overall surplus came to $3.9 milliard. On top of the current-account surplus, there were net identified capital inflows totalling $450 million (compared with a net outflow of about the same size in 1970) and, in particular, unidentified inflows, which shot up from $350 million in 1970 to $800 million last year. The rise in identified inflows was mainly concentrated in the period preceding the floating of the pound and the subsequent tightening of exchange control restrictions.

The net outflow of long-term capital shrank last year to $0.4 milliard, compared with $1.1 milliard in 1970. This change was attributable to a rise of about $1 milliard to $2.8 milliard in incoming investment capital; such inflows were especially large in the first half of the year, when both exchange rate considerations and anticipations of a fall in the still high UK yields gave rise to hopes of capital gains. Net outflows in respect of official capital transactions and long-term trade credit expanded by about $0.2 and 0.1 milliard respectively, while UK private long-term investment abroad remained at the same level as in 1970. Identified non-monetary short-term inflows were mainly related to residents' net foreign currency borrowing for investment abroad, which totalled $0.6 milliard.

In the first quarter of 1972 the adjusted trade balance showed a deficit of $305 million, against a surplus of $195 million in the fourth quarter of last year; the deterioration reflected to some extent the repercussions of the miners' strike. As to invisibles, the surplus shrank by $50 million to $385 million, mainly owing to an increase in foreign aid. Thus, the current account closed with a surplus of only about $80 million, compared with one of $630 million in the preceding quarter.

Germany. Practically the whole of Germany's large overall surplus last year was due to capital movements. Huge net inflows of $5.2 milliard in the first half of the year were followed in the second half by a net outflow of $1.6 milliard, so that for the year as a whole net receipts on capital account totalled $3.6 milliard.

The current balance was practically in equilibrium: the trade surplus increased, but net outpayments in respect of services and transfers expanded sharply, more than offsetting the gain in visible items. The trade figures on the basis of customs statistics show that merchandise exports rose by 8½ per cent., compared with 10½ per cent. in 1970 and 14 per cent. in 1969. The falling-off reflected both a moderate economic slow-down abroad and the average appreciation of the Deutsche Mark, which came to as much as 8 per cent. before the December realignments but subsequently worked out at 5½ per cent. relative to the pre-May parity. As German exporters managed to keep their prices down, 80 per cent. of the export expansion was in volume terms. Overall exports to other EEC countries rose at the same rate as total exports, a marked falling-off in those to Italy being largely offset by faster growth of sales to France. The growth of exports to EFTA countries slowed down from 10½ per cent. in 1970 to 7½ per cent. last year, even though exports to the United Kingdom rebounded sharply after declining somewhat in 1970. Germany achieved very favourable results in its exports to North America, while those to Japan went down by 7 per cent., after rising by more than one-quarter the year before.

Revaluation and the domestic slow-down also had an impact on imports, which in value terms expanded by only 9½ per cent., against 12 and 20½ per cent. in 1970 and 1969 respectively. The rise was concentrated in the first half of the year. In terms of volume, however, the growth of imports was more or less steady throughout the year, with revaluation contributing to a sharp decline in import prices during the second half. Over 1971 as a whole import prices decreased by 1 per cent., so that the terms of trade improved by nearly 3 per cent. Imports from other EEC countries rose more rapidly than in 1970 — by 15½ per cent., against 14 per cent. — while those from EFTA countries expanded much more slowly and those from North America stagnated after a rise of more than 20 per cent. in 1970.

The appreciation of the Deutsche Mark beginning with the revaluation in October 1969 has resulted in a substantial improvement in Germany's gains from trade. Real imports rose by about 50 per cent. between 1968 and 1971, while real

Germany: Balance of payments.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	in millions of US dollars[2]						
Merchandise trade (f.o.b.)							
Exports	29,100	34,135	16,320	17,815	38,835	19,095	19,740
Imports	23,960	28,245	13,865	14,380	32,505	16,200	16,305
Trade balance	+ 5,140	+ 5,890	+ 2,455	+ 3,435	+ 6,330	+ 2,895	+ 3,435
Services and transfers	− 3,530	− 5,160	− 2,245	− 2,915	− 6,210	− 2,755	− 3,455
Current balance	+ 1,610	+ 730	+ 210	+ 520	+ 120	+ 140	− 20
Long-term capital	− 6,040	− 825	− 1,325	+ 500	+ 1,800	+ 600	+ 1,200
Basic balance	− 4,430	− 95	− 1,115	+ 1,020	+ 1,920	+ 740	+ 1,180
Short-term capital	− 200	+ 1,645	+ 645	+ 1,000	− 280	+ 2,065	− 2,345
Errors and omissions	+ 405	+ 2,250	+ 1,385	+ 865	+ 2,035	+ 2,485	− 450
SDR allocations	—	+ 200	+ 200	—	+ 170	+ 170	—
Overall balance	− 4,225	+ 4,000	+ 1,115	+ 2,885	+ 3,845	+ 5,460	− 1,615[3]

[1] On a transactions basis. [2] Conversion at parity up to May 1971 and at average spot rates thereafter. [3] Gold and gold-guaranteed net official assets still valued at the parity of $35 per ounce.

exports went up by only 30 per cent. Yet, as a result of the favourable shift in the terms of trade, the merchandise account improved and offset a deterioration on services account.

The trade surplus in nominal terms and expressed in US dollars increased last year by 7½ per cent. The invisible account, however, closed with a deficit 20 per cent. higher than that recorded in 1970: a $0.3 milliard rise in receipts from foreign military agencies was more than offset by a $0.5 milliard widening of the deficit on net travel account and a similar increase in the deficit on unilateral transfers — mainly due to an expansion in workers' remittances.

In previous years Germany had been a large net exporter of long-term capital, but in 1971 receipts exceeded outflows by $1.8 milliard — a swing of more than $2½ milliard from the 1970 position. Partly to avoid reserve requirements, banks borrowed $0.9 milliard of long-term funds, compared with $0.1 milliard in 1970. As the banks also experienced a $0.2 milliard inflow on portfolio transactions, they accounted for net receipts of about $1.1 milliard. Enterprises and households were responsible for an even larger inflow — approximately $1.4 milliard. Direct advances and loans brought in about $0.8 milliard, and appreciable inflows also occurred through the sale of borrowers' notes abroad. Receipts from security transactions with non-residents were substantial, especially during the second half of the year, when yields were high compared with those abroad and a downward trend was in prospect. The public sector continued to export long-term capital on a considerable scale — around $0.7 milliard, of which more than 50 per cent. consisted of loans to developing countries and 30 per cent. of loans to the United States under the foreign exchange offset agreement.

As to short-term movements, businesses' recorded borrowing abroad during the first five months of 1971 amounted to about $2 milliard, while in the period June–December there was a net repayment of $2.7 milliard. In the three months after the Deutsche Mark was floated in May repayment took place despite a continuing covered-yield advantage on borrowing abroad; this was due both to the easier availability of credit domestically and to expectations of the introduction of a non-interest-bearing cash-deposit requirement to apply to foreign borrowing by non-banks. In the event, this measure was not introduced until the beginning of March this year. The bulk of short-term capital movements was related to shifts in the terms of payment recorded under "Errors and omissions". This item showed a surplus of $3.5 milliard for the period January–May and a deficit of $1.5 milliard for the rest of the year.

Huge capital inflows were the dominant feature of the first quarter of 1972. The overall balance recorded a surplus of about $3.3 milliard (including the SDR allocation of $170 million). Current transactions accounted for only $100 million of the surplus, against twice that amount in the first quarter of 1971, net receipts of $1.9 milliard in respect of trade transactions having been nearly offset by the $1.8 milliard deficit on invisibles.

France. Last year the combination of well-sustained growth of the French economy with weak economic activity abroad tended to have unfavourable

France: Balance of payments on current account vis-à-vis the franc area and the non-franc area.[1]

Items	Non-franc area		Franc area		Total	
	1970	1971	1970	1971[2]	1970	1971[2]
	in millions of US dollars					
Trade balance (f.o.b.)	+ 85	− 15	+ 235	+ 1,115	+ 320	+ 1,100
Services and transfers	− 260	− 590	− 210	− 510	− 470	− 1,100
Current balance	− 175	− 605	+ 25	+ 605	− 150	—

[1] On a transactions basis. [2] Preliminary estimates.

repercussions on the current-account balance of payments, but this was countered by the continuing benefits deriving from the parity changes of 1969.

The overall current account on a transactions basis seems to have been in approximate balance, whereas it had shown a deficit of $150 million in 1970. This overall balance was the result of an improvement in respect of trade (a surplus of $1.1 milliard, against one of $0.3 milliard in 1970), which was offset by the deficit on services and transfers ($1.1 milliard, against $0.5 milliard); the trade surplus was due exclusively to transactions with the franc area, while the deficit on invisibles was the combined result of deficits vis-à-vis the franc and the non-franc areas. The sharp improvement in the trade balance vis-à-vis the franc area was chiefly due to recourse to new sources of oil supplies as a result of the tensions between France and Algeria.

According to customs data (f.o.b.), exports rose by 15 per cent. in 1971, while imports went up by 11 per cent. In terms of volume, the respective gains were 8½ and 7½ per cent. Thus, it was mainly the improvement in the terms of trade — with export unit values increasing by 6 per cent. and import unit values by 3½ per cent. — that accounted for the rise in the average export/import cover ratio. The increase in total exports was significantly influenced by the rise in agricultural exports, which recorded an increase in value of 27 per cent. Exports of manufactured products were somewhat sluggish early in 1971 but accelerated sharply thereafter, so that they rose by 13 per cent. over the year. This was especially due to the well-sustained growth of exports to EEC partners.

As regards the balance of payments vis-à-vis the non-franc area (on a cash basis), the very large overall surplus was more or less equally attributable to the current-account balance, long-term capital receipts and short-term capital inflows, which amounted to $0.5, 0.8 and 0.7 milliard respectively. The first and third of these figures, however, are very significantly affected by leads and lags, so much so that the estimates on a f.o.b. transactions basis indicate that there was a deficit of $0.6 milliard on current account and a surplus of $2.6 milliard on total capital account. Reflecting the importance of leads and lags, the balance on a cash basis shows a trade surplus of $1.1 milliard, while that on a transactions basis is estimated to have been slightly in deficit. The build-up of these trade-related short-term capital inflows during the year was mainly concentrated in the final quarter.

The marked deterioration of the balance on services and transfers in 1971 was largely attributable to two factors. Firstly, shipping showed a deficit of more than

France: Balance of payments
vis-à-vis non-franc-area countries.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	in millions of US dollars[2]						
Merchandise trade							
Exports (f.o.b.)	13,285	16,580	8,110	8,470	20,160	9,490	10,670
Imports (c.i.f.)	14,845	16,095	7,825	8,270	19,025	9,045	9,980
Trade balance	− 1,560	+ 485	+ 285	+ 200	+ 1,135	+ 445	+ 690
Services and transfers	− 620	− 250	+ 10	− 260	− 590	− 415	− 175
Current balance	− 2,180	+ 235	+ 295	− 60	+ 545	+ 30	+ 515
Long-term capital	+ 325	+ 525	+ 325	+ 200	+ 765	+ 255	+ 510
Basic balance	− 1,855	+ 760	+ 620	+ 140	+ 1,310	+ 285	+ 1,025
Short-term capital[3]	+ 190	+ 610	+ 685	− 75	+ 720	+ 230	+ 490
SDR allocations	—	+ 165	+ 165	—	+ 160	+ 160	—
Overall balance	− 1,665	+ 1,535	+ 1,470	+ 65	+ 2,190	+ 675	+ 1,515

[1] On a cash basis. [2] Conversion at the old parity (of 10th August 1969). [3] Including multilateral settlements, adjustments and international brokerage.

$0.4 milliard, against one of $0.2 milliard in 1970, as a result of the significant change in the sources of oil supplies, involving longer routes for tankers, following the tensions in Franco-Algerian relations. Secondly, there was a time-lag between payments to and reimbursements by the European Agricultural Guidance and Guarantee Fund. Altogether, invisible transactions resulted in a deficit of $0.6 milliard in 1971, against one of $0.3 milliard in 1970.

Long-term capital movements again recorded a substantial surplus — nearly $0.8 milliard, against $0.5 milliard in 1970. Private foreign capital inflows, at $1.3 milliard, were $0.2 milliard less than in 1970, while residents' net lending abroad was about the same as in that year, i.e. $0.5 milliard. The overall surplus on private account (excluding banks) thus amounted to $0.8 milliard, against $1 milliard in 1970. Long-term capital outflows on public account were about the same in both years, at $0.2 milliard. The positive swing in total long-term capital flows was therefore the result of a shift in bank flows, which yielded a surplus of $0.2 milliard, against a deficit of $0.3 milliard in 1970.

Italy. Last year's results would seem to indicate a further consolidation of those recorded in 1970, when there was a turn-round from deficit to comfortable surplus. There are, however, difficulties in gauging the underlying position in view of the various cross-currents which influenced developments in 1971.

During the first half of last year the overall balance showed a surplus of $670 million; this represented a swing of well over $1 milliard from the deficit in the corresponding period of 1970. The surplus for the year as a whole came to $890 million, nearly twice that recorded in 1970. This further improvement put Italy's total external monetary position once again above the end-1968 level.

The strength of the balance of payments was concentrated in the current account, with trade, services and transfers each showing improvements on the 1970 results. On capital account the deficit of $1.1 milliard (including errors and omissions) recorded in 1971 — as against one of $415 million in 1970 — occurred mainly in the final quarter. In fact, during the first half of 1971 there had been net receipts of $340 million, owing to substantial long-term inflows.

The reversal on capital account was largely due to the shift from borrowing abroad to advance repayments of debt by both the public and the private sector; this followed suggestions made to that effect by the authorities, but may also have been prompted by exchange and interest rate considerations. Thus, in the case of foreign capital, loans and trade credit provided an inflow of $1.2 milliard in the first half of 1971, but showed an outflow of $0.7 milliard in the second half. On the other hand, as far as Italian capital is concerned, the outflow was fairly evenly distributed over the year. The biggest outflow was again that in respect of remittances of bank-notes, which totalled nearly $900 million, or only $60 million less than in 1970. Trade credits, too, gave rise to substantial recorded outflows, which amounted to $680 million, compared with $610 million in 1970. Portfolio investment, in contrast, declined sharply, from $520 million in 1970 to $200 million in 1971, reflecting, in particular, a reduction in outflows through investment funds.

As regards the trade balance, imports of goods and services remained the same in volume terms as in 1970, while exports went up almost in line with world demand. The income elasticity of imports was therefore about zero in 1971, against 3½ in 1970 — when domestic demand was still fairly strong but production growth was slowing down — and against an average of 2.2 for the period 1951–69. Thus, even after allowance is made for the slackness of demand last year, imports appear to have been unusually depressed. There has also recently been a narrowing of the profitability of

Italy: Balance of payments.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	in millions of US dollars[2]						
Merchandise trade (f.o.b.)							
Exports	11,640	13,105	6,335	6,770	14,830	7,060	7,770
Imports	11,100	13,445	6,615	6,830	14,410	7,105	7,305
Trade balance	+ 540	− 340	− 280	− 60	+ 420	− 45	+ 465
Services and transfers	+ 1,800	+ 1,155	+ 345	+ 810	+ 1,480	+ 270	+ 1,210
Current balance	+ 2,340	+ 815	+ 65	+ 750	+ 1,900	+ 225	+ 1,675
Long-term capital	− 3,230	+ 230	− 225	+ 455	− 170	+ 700	− 870
Basic balance	− 890	+ 1,045	− 160	+ 1,205	+ 1,730	+ 925	+ 805
Short-term capital[3]	− 285	− 645	− 375	− 270	− 945	− 360	− 585
SDR allocations	—	+ 105	+ 105	—	+ 105	+ 105	—
Overall balance	− 1,175	+ 505	− 430	+ 935	+ 890	+ 670	+ 220

[1] On a transactions basis. [2] Conversion at the old parity. [3] Including errors and omissions.

exports, as reflected in the steep rise in the ratio of wages per unit of output to export prices. Export prices went up by 6 per cent. in 1971, against 5 per cent. in 1970; unit labour costs increased by over 30 per cent. in these two years combined. At the same time import prices rose by 7½ per cent., against 4 per cent. in 1970, so that the terms of trade worsened by 2½ per cent.

The improved trade balance was associated with a decline in imports of raw materials and semi-finished goods, while the biggest increases in exports related to semi-finished and consumer goods. The surplus on services expanded in 1971 by some $200 million to $1.2 milliard, owing, in particular, to higher receipts from tourism. Together with some gain in unilateral transfers, the overall surplus in respect of services and transfers came to nearly $1.5 milliard.

In the first quarter of 1972, with the domestic economic trend still weak, the current account yielded a surplus of $280 million, against a deficit of $70 million a year earlier. But, as this was more than offset by net capital outflows of $560 million, the overall balance, including the SDR allocation of $105 million, recorded a deficit of $175 million, compared with a surplus of $475 million in the first quarter of last year.

Belgium–Luxemburg Economic Union. The external accounts closed last year with an overall surplus of $255 million, compared with one of $180 million in 1970. It is, however, difficult to ascertain exactly where the improvement lay, because the official data are presented on a cash basis and are consequently subject to considerable distortion by shifts in leads and lags at times of currency uncertainty and speculation. Furthermore, last year saw the introduction of an export tax (a transitional step in the changeover from a turnover tax to the value added tax), and this is likely to have led to under-recording of actual exports.

Thus, while balance-of-payments data point to a somewhat higher trade surplus of $850 million last year, customs data on an adjusted f.o.b. basis (plus the net surplus

Belgium-Luxemburg Economic Union: Balance of payments.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	in millions of US dollars[2]						
Merchandise trade[3]							
Exports	8,115	9,725	4,690	5,035	10,785	5,095	5,690
Imports	7,940	8,940	4,340	4,600	9,935	4,730	5,205
Trade balance	+ 175	+ 785	+ 350	+ 435	+ 850	+ 365	+ 485
Services and transfers	— 90	— 40	— 5	— 35	+ 20	+ 20	—
Current balance	+ 85	+ 745	+ 345	+ 400	+ 870	+ 385	+ 485
Net capital movements[4]	+ 205	— 635	— 210	— 425	— 685	— 95	— 590
SDR allocations	—	+ 70	+ 70	—	+ 70	+ 70	—
Overall balance	+ 290	+ 180	+ 205	— 25	+ 255	+ 360	— 105[5]

[1] On a cash basis. [2] Conversion at the old parity up to the third quarter of 1971; for the fourth quarter at the average rate on the regulated market. [3] Exports and imports partly c.i.f.; including processing and net arbitrage transactions abroad. [4] Including errors and omissions. [5] Excluding estimated revaluation adjustments of the external monetary position.

on trade arbitrage transactions abroad) show a fall in the surplus to $165 million (from $800 million in 1970). All in all, it is likely that the true trade results lie somewhere between these two sets of figures.

According to customs statistics (excluding arbitrage transactions), exports expanded by only 4 per cent., against 15 per cent. in 1970, while imports rose by 10 per cent., compared with 14 per cent. With revaluation in respect of current transactions temporarily averted by the use made of the two-tier market, the terms of trade shifted slightly against Belgium last year. Export prices showed a marginal decline and import prices remained virtually stationary. These developments were largely due to the decrease in world steel prices, which had a marked effect on BLEU exports, and to the fall in prices of certain raw materials — copper in particular — processed in the BLEU.

The balance on invisible items swung into surplus despite a worsening of the tourism account; the improvement was due to a reduction in official transfers and an increase in net freight receipts.

There was a modest increase in net total capital outflows last year; this was despite a marked fall in the first eight months of the year — mainly the result of inflows of non-resident capital and of a favourable movement in respect of errors and omissions; both these developments are ascribable to exchange rate considerations and interest rate differentials. However, many capital inflows were probably not recorded as such, as they were related to leads and lags working in favour of the BLEU.

Netherlands. The easing of domestic demand tensions in the course of 1971 brought a sharp improvement in the current balance. Thus, despite a reduction in net capital inflows, the overall balance closed with a larger surplus than in 1970.

According to customs figures, the whole of the improvement in the trade accounts occurred in the second half of the year, when import growth dropped sharply, partly because import prices fell after rising at an annual rate of about 8 per cent. from the beginning of 1970 until June 1971. The terms of trade worsened by about 4 per cent. in the first half of 1971, but this deterioration was almost reversed in the second half. And, with a revaluation of 2½ per cent. vis-à-vis the rest of the world following the Washington agreement, an improvement can be expected this year. The growth of exports in volume terms was about the same as in 1970, i.e. around 13 per cent., but it decelerated slightly in terms of value. With services and transfers also improving substantially in the latter part of 1971, the current balance showed a surplus of $150 million during the second half of the year — registering a swing of nearly $0.5 milliard from the deficit of the first six months.

The deficit on goods and services was equal to about ½ per cent. of gross national product. For a long time now the Dutch medium-term goal has been a current-account surplus of about ¾ per cent. of gross national product with which to finance development aid. Actual results have fallen short of this aim for some years, and this was commonly held to be due to cyclical rather than structural factors. Results this year may help to show whether this view is correct.

Netherlands: Balance of payments.[1]

Items	1969	1970 Year	1970 1st half	1970 2nd half	1971 Year	1971 1st half	1971 2nd half
	in millions of US dollars[2]						
Merchandise trade (f.o.b.)							
Exports	9,315	11,000	5,315	5,685	12,695	6,010	6,685
Imports	9,710	11,865	5,745	6,120	13,395	6,465	6,930
Trade balance	− 395	− 865	− 430	− 435	− 700	− 455	− 245
Services and transfers	+ 425	+ 420	+ 180	+ 240	+ 525	+ 130	+ 395
Current balance	+ 30	− 445	− 250	− 195	− 175	− 325	+ 150
Long-term capital	+ 10	+ 520	+ 280	+ 240	+ 340	+ 240	+ 100
Basic balance	+ 40	+ 75	+ 30	+ 45	+ 165	− 85	+ 250
Short-term capital	− 25	+ 30	− 70	+ 100	− 25	+ 35	− 60
Errors and omissions	+ 135	+ 350	+ 200	+ 150	+ 400	+ 355	+ 45
SDR allocations	—	+ 90	+ 90	—	+ 75	+ 75	—
Overall balance	+ 150	+ 545	+ 250	+ 295	+ 615	+ 380	+ 235[3]

[1] On a transactions basis. [2] Conversions at parity up to April 1971; thereafter at monthly average spot rates. [3] Excluding estimated revaluation adjustments of the external monetary position.

Despite the measures taken by the Dutch authorities in the course of 1971 to stem the capital inflow, it was still substantial last year, although slightly smaller than in 1970. The inflows were in fact motivated both by exchange rate considerations and by the attractive domestic yields, which remained firm throughout the year as a result of the still fairly tight credit policy pursued. Net receipts were concentrated in the first half of the year, before the floating of the guilder and before the introduction, in September, of the "closed bond circuit" for non-resident transactions in guilder bonds. Also in the first half of 1971, there was a large inflow of (unidentified) short-term capital related to favourable shifts in leads and lags.

Switzerland. Net capital inflows of some $2.4 milliard — gigantic for an economy the size of Switzerland's — were responsible for virtually the whole of the overall surplus in 1971. The current account remained more or less in balance, though movements in its component items had a significant influence on domestic developments.

The deceleration in export growth in the second half of 1970 contributed to a lessening of demand pressures, which, in turn, caused a deceleration in imports last year. Thus, while in 1970 (according to customs data) imports had shown a rise in value of nearly 23 per cent., the growth slowed down last year to about 6½ per cent.; four-fifths of this increase was due to volume expansion, compared with two-thirds the previous year. Exports also expanded less rapidly, with a growth rate only slightly above that of imports, compared with the gains of 10½ and 15½ per cent. recorded in 1970 and 1969 respectively; in terms of volume exports rose by 4 per cent., while prices went up by 2½ per cent. As a result, the terms of trade improved by less than

Switzerland: Balance of payments.[1]

Years	Merchandise trade: Exports (f.o.b.)	Merchandise trade: Imports (c.i.f.)	Merchandise trade: Balance	Services and transfers	Current balance	Net capital movements[2]	Overall balance[3]
	in millions of US dollars[4]						
1969	4,635	5,265	− 630	+ 1,155	+ 525	− 365	+ 160
1970	5,135	6,465	− 1,330	+ 1,400	+ 70	+ 1,010	+ 1,080
1971	5,740	7,205	− 1,465	+ 1,515	+ 50	(+ 2,380)	(+ 2,430)[5]

[1] On a transactions basis. [2] Including errors and omissions. [3] Owing to major changes in coverage for Swiss commercial banks' net foreign position, data for 1970 and 1971 are not comparable with each other or with the corresponding figures for earlier periods. [4] Conversion at average rates. [5] Excluding estimated revaluation adjustments of the external monetary position.

2 per cent. last year, not quite offsetting the deterioration of 1970. The turn-round came in the second half of the year, i.e. after the May revaluation. A further improvement is expected as a result of the Washington agreement, which involved an effective revaluation of the Swiss franc against the rest of the world by an estimated 4 per cent. compared with the pre-May parity.

Imports of raw materials and semi-finished goods actually declined, while imports of lubricants and fuels rose by 27 per cent.; the decline in the first group of goods was attributable to a price decrease not offset by a very limited volume growth, and the rise in the second group was due mainly to price increases. Exports of investment goods did best, with a rise of about 9 per cent., but this represented a marked deceleration compared with the gain of 15½ per cent. in 1970. As regards geographical distribution, the share of trade with Europe increased; imports from the EEC expanded by 7½ per cent. and those from the EFTA by 11 per cent., while an 11½ per cent. increase in exports to EFTA countries helped raise the share of exports to European countries by 1 percentage point, to 68½ per cent.

The slight deterioration in trade was largely offset by an 8 per cent. gain in the surplus on invisibles, which reached $1.5 milliard. An increase in net outflows in respect of unilateral transfers — mainly remittances by foreign workers — was more than compensated for by rises of 13½ per cent. ($100 million) in net capital earnings and 17 per cent. ($80 million) in net tourism receipts, the latter despite a significant slow-down — to only 2 per cent. — in the rate of expansion of overnight stays in hotels by foreign tourists.

The massive inflows of capital into Switzerland resulted to some extent from the relative decline in interest rates abroad from late 1970, but mainly from exchange rate considerations. Owing to the limited data available, the balance on capital transactions can only be calculated as the difference between the current-account balance and the change in official reserves and commercial banks' foreign positions. However, after allowing for recorded outflows of Swiss long and medium-term capital, which last year reached $1.1 milliard (against $0.5 milliard in 1970), inflows of at least $3.5 milliard must have taken place. This figure is the equivalent of nearly 15 per cent. of the Swiss gross national product in 1971. Although many measures were taken by the Swiss authorities to curb inflows (see Chapter IV), there was nothing to prevent a repatriation of Swiss capital, which evidently accounted for a large proportion of the total inflow.

Austria. The trade deficit continued to rise sharply last year, passing the $1 milliard mark, but the growth of nearly 40 per cent. in the surplus on services and transfers went a long way towards offsetting it. The improvement in invisibles, with net receipts advancing to a record $1 milliard, compared with $0.7 milliard in 1970, was chiefly due to the strong favourable trend in tourism. Despite the deterioration on both current and long-term capital account, Austria's overall surplus last year, at $135 million, was larger than in 1970. This was the result of short-term capital inflows, which largely preceded the revaluation of the schilling in May and for the most part represented unidentified receipts due to shifts in leads and lags.

On the basis of customs data, the growth of merchandise exports slowed down considerably last year, reaching only 6 per cent., compared with 18 per cent. in 1970. In particular, exports to eastern European countries remained practically unchanged, after recording a 13 per cent. rise in 1970, and the growth in those to the EEC decelerated to 5 per cent., against 13 per cent. in 1970. Exports to the EFTA countries, however, and especially those to the United Kingdom and Switzerland, expanded more rapidly than before. Exports of finished goods did not maintain their pace, and those of raw materials showed an actual decline, partly as a consequence of shortages of electric power.

The growth of imports slowed down appreciably, to 13 per cent. As a result, the income elasticity of imports, which had worked out at 1.9 in 1970, stood at 1.2 in 1971; this is approximately the same as the long-term average for the preceding ten years. A sharp deceleration in inventory accumulation last year particularly affected imports of raw materials and semi-finished goods. It is interesting to note that, despite the strengthening of the schilling during 1971 — its effective appreciation vis-à-vis the rest of the world is estimated at around 3½ per cent. — the terms of trade continued to be unfavourable to Austria; they deteriorated by approximately 7 per cent. from 1969 to 1971 and it was only in the second half of last year that a turn-round occurred. Import prices rose further in 1971, by approximately 4 per cent., while export prices underwent little change; the export expansion was therefore wholly in volume terms.

The overall balance was approximately in equilibrium in the first quarter of 1972, whereas there had been a slight surplus in the corresponding period of 1971. The deficit on current transactions of around $80 million — about the same as a year earlier — was offset by capital inflows, mainly short-term, and by a $30 million allocation of SDRs.

Austria: Balance of payments.[1]

Years	Merchandise trade			Services and transfers	Current balance	Net capital movements		SDR allocations	Overall balance
	Exports (f.o.b.)	Imports (c.i.f.)	Balance			Long-term	Short-term[2]		
	in millions of US dollars[3]								
1969	2,415	2,850	− 435	+ 535	+ 100	− 25	+ 30	—	+ 105
1970	2,860	3,580	− 720	+ 710	− 10	+ 15	+ 60	+ 30	+ 95
1971	3,175	4,245	−1,070	+ 980	− 90	− 20	+225	+ 20	+ 135[4]

[1] On a transactions basis. [2] Including errors and omissions. [3] Conversion at monthly average spot rates.
[4] Gold and gold-guaranteed net official assets valued at the parity of $35 per ounce.

Denmark. Increasingly large trade deficits in the late sixties have compelled the authorities to apply a broad line of fiscal and monetary restraint policies since 1969. These policies appear to have borne fruit last year, as the trade balance began to improve gradually from the summer onwards. In addition, the introduction in October of a 10 per cent. import surcharge helped to strengthen the final-quarter results. Thus, while the trade deficit had totalled \$425 million in the first half of last year, it shrank more than seasonally to \$245 million in the second half. With continuing net inflows in respect of invisibles and capital movements, the overall balance showed a surplus of \$165 million, compared with \$30 million in 1970.

According to customs statistics, exports rose in 1971 by 8 per cent., slightly less than in 1970. More than 60 per cent. of this increase was in volume terms. Imports rose by 3 per cent. in value but, since prices went up by 6 per cent., there was a sizable decline in volume. The deterioration in the terms of trade was largely due to the trend of prices for industrial products, but was also clearly influenced by the quite substantial increase in fuel prices.

The surplus on invisibles remained the same as in 1970: the sharp widening of the deficit on investment income — a consequence of the large-scale borrowing in 1969 and 1970 — was offset by an equivalent improvement in net receipts from tourism.

Net capital inflows were again substantial last year. Net private capital imports declined by about \$0.1 milliard to \$0.3 milliard, but this was more than compensated for by increased public-sector borrowing.

Norway. With domestic consumption buoyant, world demand for Norwegian goods weak and developments in the shipping sector unfavourable, the current balance-of-payments deficit rose to a record level in 1971. However, substantial capital inflows — both long and short-term — caused the overall balance to show a slight improvement over the year.

According to customs statistics, merchandise imports, excluding ships, rose by nearly 6½ per cent., as opposed to 21 per cent. in 1970. This was despite near-stagnation in imports for industrial purposes (which, having risen in 1970 by about 28 per cent., had in that year accounted for nearly 60 per cent. of total imports) due to the deceleration in stock-building. An 18 per cent. expansion in consumer-goods imports was largely ascribable to a huge 40 per cent. increase in imports of passenger cars. In terms of volume, overall import growth was only about 2 per cent., as 70 per cent. of the expansion in value was accounted for by price increases. Commodity exports (excluding ships) went up by 5 per cent. in value, compared with 14½ per cent. in 1970, chiefly owing to the negative results recorded by traditional export items — notably metals and wood-pulp. Since export prices also rose by 5 per cent., there was no gain in terms of volume. The visible trade balance was particularly affected by results in the shipping sector: imports of ships went up by 27 per cent., whereas exports fell by almost 15 per cent.

Mainly because of an increase in net freight earnings to a record level of \$1.1 milliard, the surplus in respect of services and transfers was somewhat greater than in 1970.

Total net capital receipts amounted to \$0.5 milliard. As regards long-term capital movements, the turn-round from net repayments in 1969 to a substantial net inflow in 1971 was the result of a sharp expansion in private external borrowing by both the shipping sector and the rest of the private sector. With foreign financing having become easier to obtain and more attractive, it proved necessary in certain cases last year to refuse permission for such borrowing. The short-term inflow was clearly influenced by exchange considerations, with shipping companies and other enterprises converting short-term dollar assets into kroner.

Sweden. The balance-of-payments surplus last year clearly reflected the domestic cyclical downturn. In addition, however, the basic external situation seems to have been gradually improving. And some further marginal improvement may be expected following the exchange rate realignment of December 1971. The overall surplus in 1971, which worked out at \$310 million, compared with one of \$115 million in the previous year and a deficit of \$330 million in 1969, was the result of surpluses on both current and capital account.

After being consistently in deficit since 1965, with a particularly marked deterioration in 1970 to \$305 million, the current balance last year swung round by approximately \$0.5 milliard, so that net receipts of \$185 million were recorded. This was due exclusively to the improvement in merchandise trade, which showed a surplus of \$380 million, against a deficit of \$185 million in 1970. In fact, the net outflow on invisibles rose by \$75 million to a record level of \$195 million, largely owing to the widening of the travel deficit and a deterioration in the net balance of interest and dividend payments.

On the basis of customs data, the value of exports increased last year by nearly 9 per cent., while their volume expanded by about 3½ per cent. Imports, in contrast,

Northern countries: Balances of payments.[1]

Countries	Years	Merchandise trade: Exports (f.o.b.)	Merchandise trade: Imports (c.i.f.)	Merchandise trade: Balance	Services and transfers	Current balance	Net capital move-ments[2]	SDR alloca-tions	Overall balance[3]
		In millions of US dollars[4]							
Denmark	1969	2,985	3,615[5]	– 630	+ 220	– 410	+ 330	–	– 80
	1970	3,320	4,080[5]	– 760	+ 220	– 540	+ 545	+ 25	+ 30
	1971	3,645	4,315[5]	– 670	+ 220	– 450	+ 585	+ 30	+ 165
Finland	1969	1,975	2,030	– 55	+ 75	+ 20	+ 30	–	+ 50
	1970	2,295	2,645	– 350	+ 110	– 240	+ 300	+ 20	+ 80
	1971	2,350	2,810	– 460	+ 115	– 345	+ 510	+ 20	+ 185
Norway	1969	2,230	2,995	– 765	+ 920	+ 155	– 210	–	– 55
	1970	2,475	3,720	–1,245	+1,065	– 180	+ 305	+ 25	+ 150
	1971	2,575	4,100	–1,525	+1,160	– 365	+ 510	+ 25	+ 170
Sweden	1969	5,725[6]	5,910	– 185	– 25	– 210	– 120	–	– 330
	1970	6,820[6]	7,005	– 185	– 120	– 305	+ 385	+ 35	+ 115
	1971	7,455[6]	7,075	+ 380	– 195	+ 185	+ 90	+ 35	+ 310

[1] On a transactions basis. [2] Including errors and omissions. [3] Gold and gold-guaranteed net official assets valued at the parity of \$35 per ounce. [4] Conversion at parity up to the third quarter of 1971; for the fourth quarter at the average spot rate. [5] Imports f.o.b. [6] Including adjustment for net trade not recorded in customs statistics.

did not change in value terms but fell by 5 per cent. in volume. The terms of trade therefore remained the same, and the increase in the export/import cover ratio from 97 per cent. in 1970 to 105 per cent. in 1971 is largely explained by changes in volume. Exports of iron and steel and wood-pulp actually declined, while those of other raw materials and staple commodities showed little change. The overall gain was thus due mainly to engineering products; among these, exports of machinery went up by 13 per cent. and those of transport equipment by 19 per cent. Exports of motor vehicles, in particular, recorded a strong rise of 24 per cent., as weak demand at home made it possible to step up car sales to the United States (passenger cars account for more than 30 per cent. of all US purchases from Sweden). Whereas imports had been boosted in 1970 by stock-building of raw materials and manufactures — a large part of which Sweden has to import — they were depressed last year both because stock-building decelerated sharply and because domestic consumer demand was weak.

Net capital inflows declined by more than three-quarters: net receipts, at $90 million, were nearly $300 million less than in 1970. This was the result partly of a relaxation of exchange restrictions, which enabled Swedish direct investment abroad to increase substantially, and partly of the easing of domestic credit conditions last year.

In the first quarter of 1972 the overall balance (including the allocation of $35 million's worth of SDRs) showed a surplus of $215 million, compared with one of $85 million in the first quarter of 1971. The surplus was almost entirely attributable to long and short-term capital inflows. The current account recorded a net deficit of $85 million, compared with a surplus of $40 million in the first quarter of 1971, as a result of a contraction in the trade surplus and an increase in the deficit on invisibles.

Finland. The weakness of Finland's export markets, together with a policy-induced slow-down in the domestic economy, had a marked impact on the external accounts last year. With both exports and imports of goods and services falling in terms of volume, and with the terms of trade turning against Finland, the current deficit rose to a record $345 million. On the other hand, tight domestic liquidity conditions contributed to substantial capital inflows of over $0.5 milliard. As a result, the overall balance closed with a surplus of $185 million, compared with one of $80 million in 1970.

According to customs statistics, merchandise exports expanded by 2 per cent. last year (after rising by 16 and 21 per cent. in 1970 and 1969 respectively), a decline in volume being more than offset by the rise in unit values. Following substantial increases for two years running, imports went up by only 6 per cent. in value terms, a 7½ per cent. rise in prices being accompanied by a small decline in volume. Exports suffered from a series of unfavourable developments: strikes in the metal and engineering industries, a temporary fall in deliveries to eastern Europe, and a very weak trend in world demand for timber-processing products, which hit Finland with particular severity. As to imports, the substantial rise in fuel and lubricant prices — as much as 32 per cent. — accounted for most of the small overall change in value. A sharp expansion in imports towards the year-end partly reflected a speeding-up of stock-building, especially of consumer goods, based on expectations that the supplementary turnover tax would be abolished.

The adverse trade results were offset to only a limited extent by the surplus on invisibles. Net receipts from tourism increased appreciably but so did net dividend and interest payments. All in all, the current-account deficit rose by nearly 50 per cent. In view of these developments, the appreciation of the markka vis-à-vis the US dollar at the time of the December realignment was kept very small, the result being an effective devaluation vis-à-vis the rest of the world of about 4 per cent.

Capital inflows were mainly at long term, reflecting the high yields offered to foreign investors and the easy availability of funds on international markets.

Spain. A weakening of domestic economic activity contributed to an impressive balance-of-payments performance in 1971. Large surpluses on both current and capital account produced an overall surplus (including the SDR allocation) of \$1.3 milliard, against one of \$0.9 milliard in 1970 and a deficit of \$0.2 milliard in 1969.

Merchandise exports, the economy's main dynamic force last year, went up by 23 per cent. in value terms. Imports, on the other hand, expanded by only 4½ per cent., so that the trade deficit shrank from nearly \$1.9 milliard in 1970 to \$1.5 milliard in 1971. Net receipts from services went up by \$0.4 milliard to \$1.7 milliard, with earnings from tourism, at \$1.9 milliard, by far the most important item. Together, imports of goods and services expanded by 10 per cent. over the year; the income elasticity of imports therefore worked out at 0.7 in value terms, as against an average for the period 1966–70 of 1.2; this fall certainly reflects cyclical factors, but it also suggests that an improvement occurred in the underlying position. Among other invisibles, net transfer receipts, mainly remittances from Spanish workers abroad, rose to \$785 million from \$660 million in 1970. The surplus on current account thus came to nearly \$1 milliard, compared with less than \$100 million in 1970 and an average deficit for the period 1965–69 of more than \$400 million.

Spain: Balance of payments.[1]

Years	Merchandise trade (f.o.b.)			Services and transfers	Current balance	Net capital movements		SDR allocations	Overall balance
	Exports	Imports	Balance			Long-term	Short-term[2]		
	in millions of US dollars[3]								
1969	1,995	3,865	−1,870	+1,475	− 395	+ 505	− 330	—	− 220
1970	2,455	4,335	−1,880	+1,955	+ 75	+ 675	+ 70	+ 40	+ 860
1971	3,025	4,535	−1,510	+2,460	+ 950	+ 520	− 265	+ 45	+1,250

[1] On a transactions basis. [2] Including errors and omissions. [3] Conversion at the old parity.

The overall increase in exports was attributable mainly to a 31 per cent. expansion in non-agricultural products. Among these, consumer and capital goods were the most dynamic components, with respective growth rates of 40 and 33 per cent. These two groups of exports earned \$110 million in 1961; in 1971 they brought in \$1,290 million. On the import side, the slack in domestic investment helps to explain the stagnation or actual fall in imports of capital and intermediate goods.

On capital account, the total inflow of \$255 million was the result of a net inflow of long-term capital (\$520 million) and a net short-term outflow (\$265 million).

IV. GOLD, RESERVES AND FOREIGN EXCHANGE.

Gold production, markets and reserves.

World gold production (excluding that of the USSR, other eastern European countries, mainland China and North Korea) has now been on a plateau for about seven years, having oscillated between just over 40 and just under 41.5 million ounces. After a 0.8 million ounce increase in 1970 output contracted by 1.3 million ounces, or about 3 per cent., in 1971. This brought it back to the 40.1 million ounce level at which it had already stood in 1964. The 1971 decline was essentially accounted for by the three major producing countries, while elsewhere production showed on balance very little change. South Africa's output, after an expansion of 0.9 million ounces in 1970, fell by 0.7 to 31.4 million ounces; apart from a 0.3 million ounce decline in 1967, this was the first decrease of any size since 1947. A contraction of 0.2 million ounces in Canada's production continued the steady downward trend which had begun as far back as 1960. In relative terms the largest decline was recorded by the United States, whose production fell by 0.3 million ounces, or 17 per cent.

World gold production.

Countries	1929	1940	1946	1953	1967	1968	1969	1970	1971
	weight, in thousands of fine ounces								
South Africa	10,412	14,046	11,927	11,941	30,535	31,169	31,276	32,146	31,398
Canada	1,928	5,333	2,849	4,056	2,986	2,743	2,545	2,409	2,208
United States	2,057	4,863	1,462	1,971	1,526	1,539	1,717	1,790	1,492
Japan	335	867	40	259	678	614	677	729	711
Ghana	208	886	586	731	767	727	707	704	698
Australia	427	1,644	824	1,075	805	786	699	622	635
Philippines	163	1,121	1	481	491	527	571	582	635
Rhodesia	561	826	545	501	515	515	515	500	500
Mexico	655	883	420	483	165	177	181	198	200
Colombia	137	632	437	437	258	240	219	202	190
Zaïre	158	562	332	371	153	172	177	181	175
Total listed	17,041	31,663	19,423	22,305	38,879	39,209	39,284	40,063	38,842
Other countries	1,299	5,797	2,007	1,955	1,281	1,361	1,296	1,347	1,278
Estimated world total[1]	18,340	37,460	21,430	24,260	40,160	40,570	40,580	41,410	40,120
	in millions of US dollars								
Value of estimated world total at $35 per fine ounce	640[2]	1,310	750	850	1,405	1,420	1,420	1,450	1,405

[1] Excluding the USSR, eastern Europe, mainland China and North Korea. [2] At the official price of $20.67 per fine ounce then in effect, $380 million.

The 2.3 per cent. drop in South Africa's gold output was the result of a 1.1 per cent. contraction in the amount of ore treated and a 1.3 per cent. decrease in the average gold content of the ore. This latter decline was probably related to the increase, from \$36.20 to \$40.40 per fine ounce, in the average price obtained by the industry, which must have encouraged the mining of lower-yielding ore. The higher price of gold seems also to have affected working costs per ton of ore milled, which went up by about 7.5 per cent., the highest rate of increase since the early sixties. Average profits per ounce of gold rose by 14.3 per cent., from \$12.40 to \$14.17.

Valued at \$35 per fine ounce, western gold production dropped from \$1,450 million in 1970 to \$1,405 million in 1971. On the other hand, for the first time since 1965, there seem to have been significant sales by communist countries, which may be estimated at about \$100 million. Thus, total new supplies of gold edged up from \$1,450 to about 1,500 million. Since at the same time western official gold reserves — which had expanded by \$280 million in 1970 — declined by \$70 million, the net amount of gold sold on the free market appears to have gone up from \$1,170 million in 1970 to \$1,575 million in 1971.

Estimated sources and uses of gold.

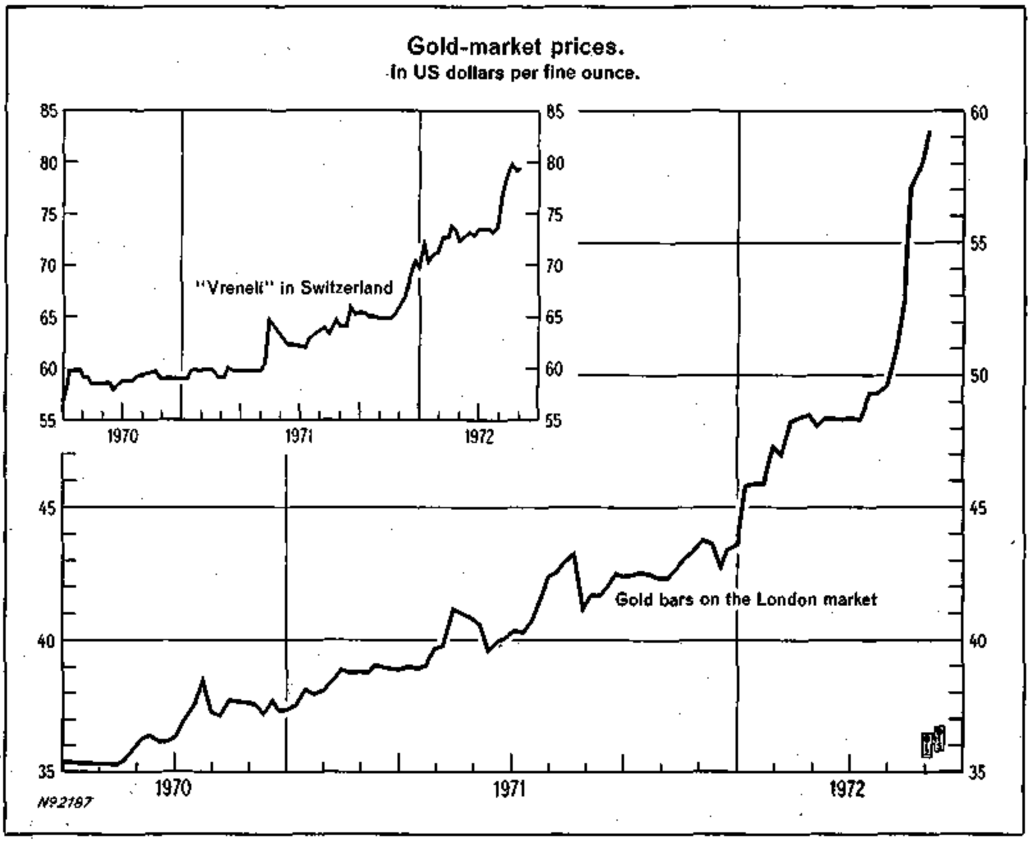
Items	1968 April–December	1969	1970	1971
	in millions of US dollars, at \$35 per ounce			
Production	1,060	1,420	1,450	1,405
Estimated sales by communist countries	—	—	—	100
Total	1,060	1,420	1,450	1,505
Change in western official gold stocks	670	100	280	— 70
Sales on the free market*	390	1,320	1,170	1,575

* Residual figures.

This \$405 million increase in private purchases (again calculated at \$35 per ounce), which occurred despite a rise in the average market price of gold from about \$36 per ounce in 1970 to \$40 in 1971, was entirely due to speculative demand resulting from the international currency unrest. Other non-monetary purchases, for industrial and traditional hoarding purposes, seem actually to have decreased by between \$150 and 200 million, largely reflecting a decline in demand from the Middle and Far East and reduced purchases for the jewellery trade.

With regard to the development of the gold price on the free market, there was throughout 1971 a fairly steady upward trend despite the considerable increase in the total of gold marketed. This was followed by a very sharp upward movement of the price during the first five months of 1972, which carried quotations from under \$44 at the beginning of the year to nearly \$60 per ounce at the end of May. While during 1971 the course of the gold price was determined chiefly by movements in demand, the recent very steep rise in quotations has also resulted from a reduction in supplies.

During the last two months of 1970 the gold price had fluctuated around a level of \$37.5. In early 1971, however, a revival of industrial demand and Middle and Far Eastern purchases led to a firming of quotations. The London fixing price rose to \$39 by the middle of February and remained close to that level until, in late April,



the increasing tensions in the exchange markets began to push quotations up again. They reached a peak of $41.75 on 14th May, but fell back to below $40 around the middle of June, when exchange-market conditions quietened down again.

The upward movement was, however, soon resumed and, with the dollar coming under increasing pressure in the exchange markets, it steepened in the second half of July. When it became known that the US Congressional Sub-Committee on International Trade and Payments had come to the conclusion that the dollar was overvalued, the gold price rose to a peak of nearly $44 on 9th August. Following US denials that there would be any change in the official dollar price of gold, market quotations dropped to about $41 at the end of August. They recovered to $42.5 in the course of September and stayed close to that level until the second week of November. By that time the increasing political tension between Pakistan and India, together with the real indications that there might, after all, be a change in the dollar's gold parity, had led to a renewed firming of the market. Quotations reached nearly $44 on 6th December, shortly after the meeting of the Group of Ten in Rome, and fluctuated around $43.5 throughout the rest of the month. The relatively high price throughout the fourth quarter was maintained despite a substantial increase in the supply of new gold resulting from the sale by South Africa on the market of gold from its reserves, in addition to its current production.

At the beginning of 1972 expectations that the effects of the devaluation of the rand on South Africa's balance of payments might lead to a reduction in that country's gold sales — in fact sales out of South Africa's gold reserves virtually ceased after the turn of the year — contributed, together with the renewed weakness of the dollar on the exchange markets, to a further sharp rise in the market price of gold. The London fixing price rose from \$43.85 at the beginning of the year to a new peak of \$49.25 in early February. Subsequently it fluctuated around \$48.25 until the second week of April. At that point a further and still steeper rise began that by 17th May had carried the price to \$57.75 per ounce. By the end of May it had gone even higher, to nearly \$60, at which level it stood well over 50 per cent. above the new official dollar price of gold.

A number of factors combined to bring about the most recent, very rapid, rise in the market price of gold. On the supply side, not only was South Africa (for the first time in three years) marketing a little less than its full current gold output, but in addition South African output was itself running some 8 per cent. below the level of a year earlier. On the demand side, purchases appear to have been stimulated by the realisation of this change in the supply situation — and also of the fact that so far this year South Africa has taken very little of its payments surplus in gold — as well as by developments in Vietnam.

Valued in current dollars, western official gold stocks increased by \$3.5 milliard in 1971, to a total of \$44.8 milliard at the end of the year. This was, however, more than accounted for by the revaluation of gold in dollar terms. Valued at \$35 per ounce, western official gold stocks actually contracted by \$70 million in 1971, following a \$280 million gain in 1970. This decline — the first since the suspension of the gold pool arrangements in 1968 — came about because South Africa, being obliged to draw \$255 million on its gold reserves, sold or transferred only \$165 million to the IMF, and disposed of the rest on the market. Under the agreement which it had reached at the end of 1969 with the IMF, South Africa was entitled to offer to the Fund (at \$35 per ounce) any gold in excess of its current production which it might have to sell in order to finance a balance-of-payments deficit. During the first seven months of the year sales out of South Africa's gold reserve totalled \$155 million; but despite the substantial premium at which gold stood on the free market, \$135 million of this was sold to the IMF and only \$20 million (calculated at \$35 per ounce) on the market. In the last five months of the year, however, with the dollar formally inconvertible and the free-market premium well above 20 per cent., South Africa placed on the market the whole of the \$70 million which it sold out of its gold stock.

As in 1970, within the relatively small change in overall gold reserves (at \$35 per ounce) there were two fairly large movements in opposite directions. After a \$1,945 million fall in 1970, countries' holdings declined by another \$1,060 to 36,125 million, while those of international monetary institutions — which had already risen by \$2,225 million in 1970 — went up by a further \$990 million. So far as the international institutions are concerned, the IMF's gold stock expanded by \$390 million. This was largely the net outcome of the following transactions: the receipt of \$480 million in repayment of drawings; the purchase of \$135 million from South Africa; the receipt of \$100 million in payment of gold subscriptions; the return of \$25 million previously deposited with the United States and the United Kingdom; and the sale by the Fund of \$385 million's worth of gold against currencies. The BIS's spot gold

World gold reserves.

Countries or areas	Changes in 1969	Changes in 1970	Changes in 1971	Holdings at end-1971
	in millions of US dollars			
United States	+ 970	— 785	— 865	10,205
United Kingdom	— 5	— 125	— 575	775
Other western Europe	— 745	— 435	+ 510	19,755
of which				
Belgium	*— 5*	*— 50*	*+ 75*	*1,545*
France	*— 330*	*— 15*	*— 10*	*3,525*
Germany	*— 460*	*— 100*	*+ 100*	*4,075*
Italy	*+ 30*	*— 70*	*— 5*	*2,885*
Netherlands	*+ 25*	*+ 70*	*+ 120*	*1,910*
Sweden	*—*	*— 25*	*—*	*200*
Switzerland	*+ 20*	*+ 90*	*+ 175*	*2,910*
Others	*— 25*	*— 335*	*+ 55*	*2,705*
Canada	+ 10	— 80	+ 5	795
Japan	+ 60	+ 120	+ 145	680
Latin America	+ 55	— 5	— 55	1,030
Middle East	— 35	— 80	+ 35	1,010
Other Asia	— 20	— 30	— 30	675
Africa	— 90	— 470	— 255	810
of which				
South Africa	*— 130*	*— 450*	*— 255*	*410*
Australia	+ 5	— 25	+ 20	260
Other countries	— 15	— 30	+ 5	130
Total for all countries	+ 190	— 1,945	— 1,060	36,125
International institutions	— 90	+ 2,225	+ 990	5,095
of which				
BIS	*— 130*	*+ 200*	*+ 590*	*310*
European Fund	*+ 20*	*— 5*	*+ 10*	*55*
IMF	*+ 20*	*+2,030*	*+ 390*	*4,730*
Grand total (at $35 per fine ounce)	+ 100	+ 280	— 70	41,220
Total revaluation effect	—	—	+ 3,535	3,535
of which on holdings of				
Countries	*—*	*—*	*+3,095*	*3,095*
International institutions	*—*	*—*	*+ 440*	*440*
Grand total, including revaluation effect	—	—	+ 3,465	44,755

position shifted from a negative one of $280 million at the end of 1970 to a positive one of $310 million at the end of 1971.

Apart from South Africa, the only other substantial declines in countries' gold reserves were in the United States and the United Kingdom. Most of the $865 million decrease in the US gold stock was the result of sales to European countries; only $70 million went to the rest of the world. The largest items were purchases of $475 million by France in connection with repayments to the IMF, and purchases of $175 and 110 million for reserve purposes by Switzerland and Belgium respectively. Outside the Group of Ten, the largest US gold transactions were purchases of $42 million from Burma and sales of $35 and 30 million respectively to the Lebanon and

Singapore. The fall of $575 million, to $775 million, in the United Kingdom's official gold stock was in sharp contrast to the strong improvement in that country's overall reserve position.

The gold reserves of the other Group of Ten countries expanded by $605 million. The $175 million rise in Switzerland's holdings was the result of purchases from the US Treasury, while the $145 and 100 million increases in the holdings of Japan and Germany were largely accounted for by IMF sales. The Netherlands and Belgium, whose gold stocks went up by $120 and 75 million respectively, obtained gold from both the Fund and the US Treasury.

In the first quarter of 1972 western official gold holdings are estimated to have shown little change. There were, however, further transfers totalling $615 million (valued at $35 per ounce) from countries to international institutions. The principal transactions were transfers of $545 million from the United States to the IMF. Of this amount, $400 million represented the resale by the United States of gold purchased from the Fund in 1956–60, while the remaining $145 million resulted from the withdrawal by the Fund of gold deposited with the Federal Reserve Bank of New York to mitigate gold losses suffered by the United States in connection with other countries' gold subscriptions to the Fund at the time of the 1965–66 general increase in Fund quotas.

The expansion of global reserves.

1971 is likely to go down in history as a year hors série, so far as the expansion of global reserves is concerned. During its course, countries' total official holdings of gold, foreign exchange, IMF reserve positions and special drawing rights increased by 43 per cent. — $39.4 milliard in current dollar terms — completely dwarfing the previous highest increase of 18 per cent., or $14.3 milliard, recorded only the year before.

It may be estimated that about $5.4 milliard of this increase can be accounted for by the revaluation in dollar terms of non-dollar reserve assets as a result of the changes in the exchange value of currencies. The effect of this on gold reserves was $3.1 milliard, and on Fund reserve positions and SDR holdings $0.5 milliard each. Its effects on non-dollar exchange reserves cannot be exactly gauged — they may, however, be roughly estimated at $1.3 milliard. Apart from the effects of exchange rate adjustments, therefore, last year's increase in global reserves may be put at some $34 milliard.

On the other hand, there were also a number of factors — mainly official monetary debt repayments — that had the effect of holding down the 1971 increase in global reserves. Firstly, repayment by the United Kingdom of its remaining central-bank indebtedness had a contractionary effect of $1.3 milliard. Secondly, British and French repayments of debt to the IMF also had a contractionary effect, of $3.3 milliard. The actual repayments were only $2.3 milliard, but their effect on global reserves was greater, because they were in part made at the expense of the United States' gold stock and its IMF reserve position. Thirdly, the amount of foreign exchange held in the reserves of the Swiss National Bank as a result of year-end swaps with Swiss commercial banks fell from $0.9 milliard at the end of 1970 to zero at the

Changes in global reserves.

Areas and periods	Gold	Foreign exchange	IMF reserve positions	SDRs	Total
	in millions of US dollars				
Group of Ten					
1969	+ 310	− 1,475	+ 135	—	− 1,030
1970	− 975	+ 8,535	+ 540	+ 2,340	+10,440
1971	+ 1,695	+25,775	− 835	+ 2,465	+29,100
Other developed countries					
1969	− 145	+ 495	+ 85	—	+ 435
1970	− 805	+ 1,680	+ 60	+ 305	+ 1,240
1971	+ 110	+ 5,400	+ 30	+ 270	+ 5,810
Developing countries					
1969	+ 25	+ 1,425	+ 20	—	+ 1,470
1970	− 165	+ 1,965	+ 370	+ 480	+ 2,650
1971	+ 230	+ 3,775	+ 5	+ 520	+ 4,530
All countries					
1969	+ 190	+ 445	+ 240	—	+ 875
1970	− 1,945	+12,180	+ 970	+ 3,125	+14,330
1971	+ 2,035	+34,950	− 800	+ 3,255	+39,440
of which revaluation effect	*+ 3,095*	*+ 1,300**	*+ 545*	*+ 505*	*+ 5,445**

* Estimate.

end of 1971. The total effect of these factors was $5.5 milliard, i.e. together they roughly offset the revaluation effect on non-dollar reserves of last year's exchange rate adjustments.

The expansion of reserves was dominated, as it had been the year before, by the foreign exchange element. The enormous rise in total exchange reserves was, of course, mainly the outcome of the basic payments deficit of the United States together with the flight of funds from that country. Monetary liabilities of the United States to foreign official agencies in fact went up by $27.4 milliard during 1971. But, in addition, dollars received by foreign monetary authorities were placed in markets outside the United States; and to the extent that these funds were re-lent outside the United States and converted by the borrower into another currency, they gave rise to further reserve increases. Thus, the growth in exchange reserves of countries other than the United States exceeded the increase in US liabilities to foreign official agencies by $7.9 milliard. $2.2 milliard — of which about $0.5 milliard represented revaluation effects — was accounted for by the expansion in foreign official holdings of sterling in the United Kingdom (excluding those of the United States). Of the remaining $5.7 milliard, some $0.8 milliard may be estimated to have been attributable to revaluation effects. It appears, therefore, that, excluding these effects, nearly $5 milliard of last year's total rise in exchange reserves was the result of diversification of reserves out of dollars into currencies other than sterling, as well as of official placements of funds in the Euro-dollar market.

Another salient feature last year was the contrast between the policies of the Group of Ten and the rest of the world as regards the placing of these assets. Group of Ten countries invested the additions to their exchange reserves in the United

States, thus accounting for practically the whole of the $27.4 milliard rise in US liabilities to foreign official agencies. It follows from this that countries outside the Group of Ten placed outside the United States an amount equal to nearly all of the $9.2 milliard increase in their exchange reserves. Thus these countries accounted for virtually all of the growth in sterling reserves. As a result of measures taken by the German authorities, their Deutsche Mark holdings in Germany seem to have shown some decline, but it is very likely that the amount of Deutsche Mark placed in the Euro-currency market rose substantially. There appears, moreover, to have been considerable channelling of reserves into Swiss franc assets held in Switzerland and probably also in the Euro-currency market. In addition, there was a further increase in their dollar reserves invested in the Euro-dollar market. Furthermore, since these countries account for the bulk of non-dollar exchange reserves, the growth of $9.2 milliard in their exchange reserves contains the greater part of the estimated $1.3 milliard increase in total exchange reserves resulting from the new valuations.

Not only the asset composition but also the country break-down of last year's increase in global reserves was very uneven. Reflecting the direction of short-term money flows, most of it — 77 per cent. in fact — went to Group of Ten countries other than the United States. Their total reserves expanded by $30.4 milliard in current dollar terms, or 63 per cent. In this group, easily the largest rises were recorded by Japan ($10.5 milliard), the United Kingdom (6.0), Germany (4.8) and France (3.3). Developed countries outside the Group of Ten added $5.8 milliard, or 50 per cent., to their reserves — with Australia (1.6) and Spain (1.4) showing by far the biggest gains. Developing countries' reserves rose by $4.5 milliard, or 25 per cent., a large part of which went to certain oil-producing countries.

Monetary movements.

United States. The net reserve position of the United States showed an adverse change of $29.8 milliard in 1971, after inclusion of the year's SDR allocation. Of this amount, $9.1 milliard was the counterpart of short-term outflows through the banking system. The deterioration of the combined external monetary position of the official and banking sectors was therefore $20.7 milliard.

Of the $9.1 milliard short-term outflow through the banking system, $6.7 milliard took the form of a reduction in the banks' liabilities to non-official foreigners. This corresponded almost exactly to the amount which US banks repaid during the year to their foreign branches. In fact, such repayments amounted to $4.8 milliard in the first quarter alone; however, the Export-Import Bank issued $1.5 milliard of special short-term securities to the banks' foreign branches in order to mop up a part of these funds, so that the net outflow to the branches for the quarter came to $3.3 milliard. In the second quarter the banks returned $1.5 milliard, but this was fully offset by a further $1.5 milliard of short-term securities issued to their overseas branches, this time by the US Treasury. During the second half of the year the banks' total short-term liabilities to non-official foreigners declined by another $4.3 milliard, of which the repayment of the special securities accounts for $3 milliard.

The remaining $2.4 milliard short-term outflow through the banks last year consisted of an increase in their claims on non-residents. Nearly the whole of this took

United States: External monetary movements.

Items	1970	1971 Year	1971 1st quarter	1971 2nd quarter	1971 3rd quarter	1971 4th quarter	1972 1st quarter
	in millions of dollars (+ = increase in assets, decrease in liabilities)						
Reserves	−2,475	− 2,345	− 145	− 840	− 1,370	+ 10	+ 100
of which							
Gold	*− 785*	*− 865*	*− 110*	*− 455*	*− 300*	—	*− 545*
Foreign exchange	*−2,150*	*− 380*	*− 375*	*+ 65*	*− 70*	—	*− 65*
SDR allocations	*+ 865*	*+ 720*	*+ 720*	—	—	—	*+ 710*
SDR transfers	*− 15*	*− 470*	*− 125*	*− 195*	*− 150*	—	—
IMF gold tranche position	*− 390*	*−1,350*	*− 255*	*− 255*	*− 850*	*+ 10*	—
Liabilities to foreign official agencies	−7,345	−27,420	−4,570	−5,625	−11,335	−5,890	−2,690
of which							
Liquid	*−7,620*	*−27,620*	*−4,775*	*−5,790*	*−11,510*	*−5,545*	*−2,410*
Non-liquid	*+ 275*	*+ 200*	*+ 205*	*+ 165*	*+ 175*	*− 345*	*− 280*
Net official position	−9,820	−29,765	−4,715	−6,465	−12,705	−5,880	−2,590
Short-term claims on foreigners reported by banks	+1,135	+ 2,405	− 120	+ 355	+ 850	+1,320	+ 695
Liabilities to foreign non-official institutions and persons	+6,240	+ 6,690	+2,535	− 130	+ 2,140	+2,145	− 560
Banks' net position	+7,375	+ 9,095	+2,415	+ 225	+ 2,990	+3,465	+ 135
Total including SDR allocations	−2,445	−20,670	−2,300	−6,240	− 9,715	−2,415	− 2,455
Total excluding SDR allocations	−3,310	−21,390	−3,020	−6,240	− 9,715	−2,415	− 3,165

place in the second half of the year, the chief borrowers being Japan, Canada and western Europe. While there is usually some seasonal increase in US bank lending towards the end of the year, the size of the outflows during the latter part of 1971 owed a good deal both to the international exchange crisis and to the exemption, in the fourth quarter, of export credits from the voluntary foreign credit restraint programme.

The 1971 official settlements deficit was, of course, overwhelmingly financed by the increase of $27.4 milliard in liabilities to official foreigners. It was, however, the reserve losses — minor in comparison to the piling-up of further indebtedness, but substantial in relation to what reserves there were left to lose — that led to the dollar's being declared formally inconvertible on 15th August. These reserve losses became more serious from quarter to quarter, until the decision to halt them was taken.

In the first quarter the reserve loss was only $0.1 milliard including the SDR allocation, and $0.9 milliard excluding it. While the latter figure was a little higher than the second-quarter loss, two factors somewhat mitigated its seriousness. One was that nearly half of it was a decline in official exchange holdings which consisted principally in a reduction of sterling balances that were the counterpart of assistance given earlier to the Bank of England. Furthermore, $0.3 milliard of the first-quarter reserve loss had a counterpart in extinction of Federal Reserve swap debts to foreign monetary authorities — though it should be added that this was only achieved with the aid of an equivalent issue of Swiss-franc-denominated bonds to the Swiss National Bank, to replace dollars it had been holding under swaps with the Federal.

The second-quarter reserve loss was more serious — not only because it came on top of the first-quarter loss, but also because of its composition. There was no further reduction in official foreign exchange holdings; in fact they rose slightly. The whole of the loss therefore fell on what may be called the real US reserve position. In particular, more than half of it was a gold loss, the main element in which was a $0.3 milliard gold sale to France in connection with a French debt repayment to the IMF. Furthermore, the Federal Reserve's total swap debt, after its first-quarter decline, increased a little despite gross repayments of swap drawings totalling nearly $0.5 milliard.

Then in the third quarter, up to 15th August, the rate of decline of reserves accelerated to $1.4 milliard. The gold stock was drawn down by a further $0.3 milliard, two-thirds of which represented a second gold sale to France in connection with a French repayment to the Fund, bringing it down to very little over $10 milliard. The main third-quarter reserve loss, however, arose out of drawings totalling $0.9 milliard on the Fund — of which $0.6 milliard was in connection with UK and French debt repayments to the Fund. Finally, in addition to the reserve loss, there were further drawings of $2.4 milliard on the swap network in early August. This brought the Federal's total outstanding swap debts to just over $3 milliard.

Since August of last year the continuing official settlements deficits have, of course, been reflected entirely in further increases in official liabilities. In the first quarter of 1972 there were, however, some changes in the composition of US reserve assets, and even a $0.1 milliard rise in their total. Holdings of SDRs rose by $0.7 milliard on receipt of the year's allocation. On the other hand, the gold reserve, for reasons described on page 114, declined by $0.5 milliard.

United Kingdom. In 1971 the improvement in the United Kingdom's net reserve position was $8.2 milliard — more than twice as much as in 1970 and second only to Japan's $10.3 milliard surplus. During the course of the year the use of the gross inflow shifted away from debt repayment to accumulation of assets. Thus, whereas $1.6 milliard out of the $2.6 milliard net official surplus for the first quarter was devoted to debt repayment, during the last nine months of the year all but $0.6 milliard of the $5.5 milliard surplus was added to official assets in one way or another. Taking the year as a whole, $2.2 milliard of the official surplus was used to reduce external indebtedness, including repayments of $1.3 milliard to the IMF, as well as the reimbursement during the first quarter of the almost $1 milliard of central-bank assistance still outstanding at the end of 1970. Of the remaining $5.9 milliard, the 1971 allocation of SDRs accounted for $0.4 milliard, $3.4 milliard was added to the official gold and foreign exchange reserves and $2.2 milliard was placed with overseas monetary authorities by means of special swap transactions. At the end of the year gross official reserves stood at $6.6 milliard; and if the special swaps are included, the figure comes to $8.8 milliard.

The net official surplus for the year as a whole was derived about equally from the balance of payments and from monetary inflows — the former, including the SDR

United Kingdom: External monetary movements.

Items	1970	1971 Year	1971 1st quarter	1971 2nd quarter	1971 3rd quarter	1971 4th quarter	1972 1st quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Official financing							
Gold and foreign exchange reserves . .	+ 35	+3,385	+ 270	+ 300	+1,335	+1,480	+ 135
SDR allocations	+ 410	+ 360	+ 300	—	—	+ 60	+ 325
SDR transfers	— 145	+ 15	— 85	+ 5	+ 65	+ 30	+ 35
Counterpart of gold subscription to IMF .	+ 90	—	—	—	—	—	—
Net transactions with IMF	+ 320	+1,340	+ 690	+ 20	+ 630	—	+ 25
Other monetary authorities	+2,785	+3,060	+1,455	+1,200	— 405	+ 810	— 50
Total	+3,495	+8,160	+2,630	+1,525	+1,625	+2,380	+ 470
Other monetary movements							
Sterling balances (gross) of overseas-sterling-area holders							
official[1]	— 430	—1,150	— 500	— 480	— 205	+ 35	— 515
private	— 390	— 940	— 160	— 35	— 235	— 510	
of non-sterling-area holders							
official[1]	— 25	— 515	— 20	— 150	— 50	— 295	
private	— 190	— 870	— 15	+ 20	— 350	— 525	
Sterling claims of UK banks[2]	— 75	+ 45	— 215	+ 230	— 145	+ 175	+ 260
Foreign currency transactions of UK banks[3] .	— 680	— 595	— 115	— 105	+ 5	— 380	+ 110
Total	—1,790	—4,025	—1,025	— 520	— 980	—1,500	— 145
Overall balance. .	+1,705	+4,135	+1,605	+1,005	+ 645	+ 880	+ 325
Overall balance excluding SDR allocations . . .	+1,295	+3,775	+1,305	+1,005	+ 645	+ 820	—

[1] Includes sterling reserves of international organisations other than the IMF. [2] Excludes export credit. [3] Excludes trade credit and UK residents' Euro-dollar borrowing in London for investment overseas; includes UK banks' net transactions in currencies of the overseas sterling area.

allocation, amounting to \$4.1 milliard and the latter to \$4 milliard. During the first part of the year the monetary inflow reflected mainly the payments surplus of the overseas sterling area, whilst during the second half, when it rose from \$1.5 to 2.5 milliard, it was to a large extent speculative in character. For the year as a whole, nearly 90 per cent. of the monetary inflow came from a \$3.5 milliard increase in overseas residents' holdings of sterling and the remainder from a rise in the banks' net foreign currency liabilities.

Roughly three-fifths of the increase in sterling balances was in those of the overseas-sterling-area countries, which rose by \$2.1 milliard. To a large extent this reflected a further very sizable balance-of-payments surplus in these countries. They added \$1.2 milliard to their sterling reserves, nearly all of it in the seasonally favourable first half of the year; and in addition private sterling-area holdings rose by \$0.9 milliard during the year. While this, too, reflected the payments surplus of the area, by far the greater part of it occurred in the second half of the year, owing mainly to a speculative movement into sterling, as well as to the attraction of UK interest rates.

Outside the sterling area, sterling balances went up by $1.4 milliard in 1971. Most of this increase was in private holdings, which rose by $0.9 milliard; but official non-sterling-area balances also showed a significant rise — the first for many years — of $0.5 milliard. To a very large extent the increase in non-sterling-area balances, both official and private, appears to have been speculative in character, since it was heavily concentrated in the period when exceptional exchange controls were in force that prevented residents outside the sterling area from adding to their holdings of a wide range of interest-bearing sterling assets. In sterling terms, the sterling balances of the non-sterling area had risen by the end of 1971 to £1.2 milliard — the level at which they had stood shortly before the series of sterling crises began in 1964.

The increase in the banks' net foreign currency liabilities, which accounted for the remainder of the monetary inflow, principally reflected switching into sterling after the December currency realignment. During the first half of the year switching had fallen away sharply from the high levels recorded late in 1970, following the restrictions placed in January 1971 on the banks' on-lending foreign currency to UK companies, for domestic use, for periods of less than five years. To this restriction was added, following the August crisis, a ban on the banks' having a net "switched into sterling" position. It was this further restriction that produced a small outflow through the banks' foreign currency positions in the third quarter, while their removal led to the inflow at the end of the year.

Since the currency realignment the official monetary surplus has fallen away considerably. For the first quarter of 1972 it came to less than $0.5 milliard, of which the 1972 SDR allocation accounted for $0.3 milliard. In April the remaining debt to the IMF was liquidated.

Germany. Following an increase of $6.2 milliard in 1970, Germany's net official monetary assets rose by a further $4.4 milliard in 1971, of which over 90 per cent. was added to the exchange reserves. Most of the difference between these two figures can be accounted for by the decline in net inflows through the banking system — from $2.2 milliard to $0.6 milliard. Moreover, as a significant part of last year's increase in the banking system's net foreign liabilities measured in US dollar terms appears to have been the accounting result of the appreciation of the Deutsche Mark, the 1971 official monetary surplus owed little to banking-sector inflows.

The much smaller inflow of funds through the banks was essentially the result of two factors. The first of these was the placing of further obstacles in the way of increases in the banks' foreign liabilities. The second factor was that after there had been a certain upward movement of the Deutsche Mark exchange rate other currencies began to appear more attractive to hold. Together, these influences produced a $1.3 milliard outflow through the banks in June. Coming on top of the usual seasonal outflow earlier in the year, this brought the total reduction in the banks' net foreign liabilities during the first half of the year to $2.4 milliard; the $3 milliard inflow during the rest of the year is largely accounted for by end-year operations, together with the valuation changes already mentioned.

Germany: External monetary movements.

Items	1971 Year	1971 January–May	1971 June–August	1971 September–December	1972 January–March
	in millions of US dollars (+ = increase in assets, decrease in liabilities)				
Net official position	+ 4,415	+ 5,300	− 2,025	+ 1,140	+ 1,165
Gold	+ *100*	+ *55*	+ *45*	—	—
Foreign exchange	+ *4,090*	+ *5,100*	− *2,410*	+ *1,400*	+ *1,075*
SDRs	+ *195*	+ *195*	—	—	+ *180*
Other (net)	+ *30*	− *50*	+ *340*	− *260*	− *90*
Banks' net position	− 570	+ 1,080	+ 830	− 2,480	+ 2,175
Overall balance including SDR allocations	+ 3,845	+ 6,380	− 1,195	− 1,340	+ 3,340
Overall balance excluding SDR allocations	+ 3,675	+ 6,210	− 1,195	− 1,340	+ 3,170

In the official monetary sector, developments during 1971 divide into three phases. During the first phase, up to May, net official spot assets rose by $5.3 milliard, while, in addition, the authorities purchased $2.7 milliard of exchange forward. The inflow to the reserves ceased when the Deutsche Mark began to float; and from early June onwards the Bundesbank re-entered the exchange market, this time on the selling side. Between then and early August its gross sales of exchange totalled $4.8 milliard; on the other hand, it had to take in the exchange from its maturing forward contracts. These transactions largely explain the fact that during the three months June–August the authorities were able to reduce net official assets by $2 milliard. The third phase began in September, when the Bundesbank began to buy dollars again in the market to slow down a further appreciation of the Deutsche Mark. To this was added, near the end of the year, the usual seasonal inflow through the banking system. Consequently, though the balance of payments showed a $1.3 milliard deficit in the last four months of the year, net official assets rose by $1.1 milliard.

In the first quarter of 1972, although the banks re-exported $2.2 milliard of funds, net official assets rose by $1.2 milliard. The exchange reserves went up by $1.1 milliard, owing partly to the maturing of forward contracts in January, and partly to substantial spot purchases of exchange by the Bundesbank in February to moderate the upward movement of the Deutsche Mark. In March there was virtually no change in the reserves, while in April they showed only a small rise.

France. After Germany, France had the largest official monetary surplus of any continental European country last year, net official assets increasing by $3.5 milliard. $2.3 milliard was added to the exchange reserves, while most of the rest was used to repay France's remaining $1 milliard of indebtedness to the IMF, including full reconstitution of the gold tranche position. By far the largest part of the increase in net official assets took place in the first eight months of the year, when there was a substantial inflow of funds through the banks.

During the first half of 1971 France was not greatly affected by speculative movements of funds. Nevertheless, the net official position improved by $1.1 milliard

France: External monetary movements.

Items	1971 Year	1971 January–June	1971 July–August	1971 September–December	1972 January–March
	in millions of US dollars (+ = increase in assets, decrease in liabilities)				
Official assets	+ 2,900	+ 735	+ 1,930	+ 235	+ 195
Gold	*— 10*	*— 10*	—	—	—
Foreign exchange	*+ 2,300*	*+ 525*	*+ 1,585*	*+ 190*	*+ 5*
SDRs	*+ 175*	*+ 180*	*— 10*	*+ 5*	*+ 180*
IMF reserve position	*+ 435*	—	*+ 395*	*+ 40*	*+ 10*
Other	—	*+ 40*	*— 40*	—	—
Official liabilities	+ 600	+ 345	+ 150	+ 105	— 50
to foreign monetary authorities	*— 10*	*— 40*	*— 75*	*+ 105*	*— 50*
to IMF	*+ 610*	*+ 385*	*+ 225*	—	—
Net official position	+ 3,500	+ 1,080	+ 2,080	+ 340	+ 145
Banks' net position	— 1,310	— 405	— 1,220	+ 315	— 410
Overall balance including SDR allocations .	+ 2,190	+ 675	+ 860	+ 655	— 265
Overall balance excluding SDR allocations .	+ 2,030	+ 515	+ 860	+ 655	— 425

over these months, of which \$0.4 milliard came from an inflow through the banks. Exchange reserves rose by \$0.5 milliard and there was a \$0.4 milliard repayment to the Fund.

In July and early August the franc came under strong upward pressure. The inflow through the banks during these two months amounted to \$1.2 milliard, with a further substantial increase in the banks' net foreign exchange liabilities, as well as a \$0.6 milliard rise in franc balances held by non-residents. Net official assets rose by \$2.1 milliard in these two months, \$1.6 milliard being added to exchange reserves and \$0.6 milliard repaid to the Fund. The bulk of the July–August inflow took place before the exchange market was closed. Subsequently, with the reserves protected from further inflows of funds by the introduction of the financial exchange market, and with banks forbidden to add any further to their net foreign liabilities, net official assets increased by only \$0.3 milliard over the rest of the year. In fact, during these months the banks' net foreign liabilities actually declined by \$0.3 milliard, following a ban on importers' taking bank advances in foreign exchange and the controls imposed on sales of foreign exchange by exporters.

During the first quarter of 1972 there was practically no change in France's net external assets, apart from the allocation of special drawing rights. The overall payments deficit, excluding the SDR allocation, was \$0.4 milliard; but this was just about covered by an inflow of funds through the banks.

Italy. Including the SDR allocation, Italy recorded an official monetary surplus of \$1.1 milliard in 1971, exchange reserves going up by \$1 milliard. While the Italian surplus was quite modest in comparison with those of Germany and France, it would have been considerably larger but for two factors. Firstly, the authorities deliberately held down the rise in reserves late in the year — in fact reserves actually decreased somewhat during the last quarter — by influencing the policies of public and private Italian borrowers in the Euro-bond market. That this influence was quite substantial can be seen — though its size cannot be measured — by the swing from a net increase of $0.9 milliard in foreign loans taken up by Italian borrowers during the first nine months of the year to net loan repayments of $0.3 milliard in the last quarter. Secondly, Italy's reserves, expressed in dollar terms, were not much affected by changes in valuation, as the dollar value of the gold and gold-guaranteed assets was still calculated at $35 per ounce of gold at the end of the year.

Contrary to the usual seasonal pattern, most of the official monetary surplus came in the early part of the year. During the first four months of 1971 net official assets rose by $0.8 milliard, of which the SDR allocation accounted for $0.1 milliard. This increase was, of course, related to the taking-up of foreign loans already referred to; in addition, there was a counter-seasonal $0.3 milliard reduction in the banks' net foreign position. In the next five months, though the payments surplus was a little over $0.9 milliard, net official assets rose by less than $0.5 milliard, since domestic monetary conditions were such that there was an outflow of $0.5 milliard through the banks. Finally, in the last quarter, although there was a net inflow through the banks of $0.4 milliard, following a request by the authorities that they reduce their net foreign asset positions, net official assets declined by $0.2 milliard.

During the first four months of 1972, despite receipt of the third SDR allocation, Italy's net official monetary assets showed a further decline of $0.2 milliard.

Netherlands. External monetary movements in the Netherlands during 1971 were in a number of respects rather different from those in most other countries: there was an outflow, of $0.4 milliard, as opposed to an inflow through the banking system; a large part of the increase in net official assets came from the revaluation, in dollar terms, of non-dollar reserve assets; and, contrary to the general trend, the composition of reserves shifted away from foreign exchange to other types of assets.

The outflow through the banks began in the second quarter. With domestic liquidity plentiful and loan demand only moderate, the banks invested substantial sums abroad from April onwards, their net foreign exchange assets showing an increase of $0.5 milliard between then and the end of the year. Some $0.1 milliard of this increase may have been the result of valuation changes.

In the official monetary sector such changes were much more important. Of a total increase of $0.5 milliard in official monetary assets, roughly half can be explained in this way. Valuation changes also account in part for the extent of the change in the composition of reserves; to a much larger extent, however, this came about by an actual shift from foreign exchange, in particular dollars, to other assets. Thus, excluding valuation changes, total reserves went up by $0.3 milliard, with the gold reserve, SDR holdings and the Fund reserve position all rising, by $0.1, 0.4 and 0.2 milliard respectively; at the same time, foreign exchange reserves declined by $0.4 milliard — dollar reserves alone falling by $0.5 milliard — and GAB claims by $0.1 milliard. Most of the increase in SDR holdings came from conversions of dollars at the US Treasury.

Apart from the valuation changes, there was little further movement in the total of the net official monetary position after the first quarter of 1971 — partly because of the

Continental European countries, Canada and Japan: External monetary positions.

Countries	End of year	Gold, SDRs and net foreign exchange	Net IMF and GAB position	Total official assets (net)	Commercial banks (net)	Total foreign assets (net)	Changes (+ = increase in assets, decrease in liabilities) Official: Including SDR allocations	Official: Excluding SDR allocations	Banks
		in millions of US dollars							
Austria	1970	1,605	160	1,765	— 55	1,710	+ 210	+ 180	— 115
	1971	2,090	145	2,235	— 345	1,890	+ 470	+ 450	— 290
Belgium-Luxemburg	1970	2,435	390	2,825	— 850	1,975	+ 455	+ 385	— 275
	1971	2,740	650	3,390	— 990	2,400	+ 565	+ 485	— 140
Denmark	1970	435	25	460	— 15	445	+ 35	+ 10	— 5
	1971	620	50	670	— 60	610	+ 210	+ 180	— 45
Finland	1970	395	65	460	— 90	370	+ 120	+ 100	— 40
	1971	565	65	630	— 55	575	+ 170	+ 150	+ 35
France	1970	4,765	— 610	4,155	—1,075	3,080	+ 1,985	+ 1,820	— 450
	1971	7,220	435	7,655	—2,385	5,270	+ 3,500	+ 3,340	—1,310
Germany	1970	12,615	915	13,530	—3,445	10,085	+ 6,165	+ 5,965	—2,165
	1971	16,870	1,075	17,945	—4,015	13,930	+ 4,415	+ 4,245	— 570
Greece	1970	275	35	310	5	315	— 5	— 25	— 5
	1971	475	35	510	5	515	+ 200	+ 185	—
Iceland	1970	40	—	40	— 5	35	+ 20	+ 15	— 5
	1971	55	5	60	— 10	50	+ 20	+ 15	— 5
Ireland	1970	665	30	695	.	.	+ 5	— 10	.
	1971	955	40	995	.	.	+ 300	+ 285	.
Italy	1970	5,245	275	5,520	90	5,610	+ 495	+ 390	+ 10
	1971	6,310	355	6,665	— 125	6,540	+ 1,145	+ 1,040	— 215
Netherlands	1970	2,675	540	3,215	— 160	3,055	+ 705	+ 615	— 160
	1971	3,060	700	3,760	220	3,980	+ 545	+ 455	+ 380
Norway	1970	675	120	795	100	895	+ 95	+ 70	+ 55
	1971	1,075	65	1,140	— 65	1,075	+ 345	+ 320	— 165
Portugal	1970	1,485	20	1,505	200	1,705	+ 55	+ 55	+ 25
	1971	1,835	30	1,865	200	2,065	+ 360	+ 360	—
Spain	1970	1,745	45	1,790	— 50	1,740	+ 905	+ 865	— 45
	1971	3,130	105	3,235	— 245	2,990	+ 1,445	+ 1,400	— 195
Sweden	1970	575	125	700	160	860	+ 40	+ 5	+ 75
	1971	960	90	1,050	150	1,200	+ 350	+ 310	— 10
Switzerland	1970	5,185	—	5,185	1,050	6,235	+ 690	+ 690	+ 395
	1971	6,930	—	6,930	.	.	+ 1,745	+ 1,745	.
Turkey	1970	85	— 75	10	.	.	+ 45	+ 30	.
	1971	480	— 65	415	.	.	+ 405	+ 390	.
Canada	1970	3,960	670	4,630	1,540	6,170	+ 1,735	+ 1,610	+ 85
	1971	5,195	330	5,525	160	5,685	+ 895	+ 775	—1,380
Japan	1970	3,820	970	4,790	1,060	5,850	+ 1,130	+ 1,005	+ 365
	1971	14,635	490	15,125	—1,470	13,655	+10,335	+10,205	—2,530

Note: For Group of Ten countries, plus Switzerland, the figures are those used for multilateral surveillance. They do not in most cases correspond exactly to published reserve figures. In addition, the procedures adopted by the various countries for converting their non-dollar assets and liabilities at the end of 1971 into US dollars are not consistent.

outflow through the banks and partly because the guilder was floating. In the first quarter of 1972, however, net official assets rose by $0.5 milliard. Practically the whole of this increase took place in early March, when, in the face of a sharp inflow of funds, the authorities purchased $0.4 milliard of dollars in two days. The March increase in reserves was to a large extent the counterpart of a nearly $0.3 milliard reduction in the banks' net foreign assets. In April net official assets declined slightly.

Belgium-Luxemburg Economic Union. The 1971 pattern of changes in the net external monetary position of the BLEU was in certain respects rather similar to that of the Netherlands. A significant proportion of the increase in net official assets for the year as a whole came from changes in the dollar valuation of non-dollar reserve assets, and there was also a change in the composition of reserves away from foreign exchange to other assets. On the other hand, the BLEU, like most other European countries but unlike the Netherlands, experienced an inflow of funds through the banks.

In the banking sector the net increase in the banks' foreign liabilities for the year as a whole was something less than $0.2 milliard. There was a $0.2 milliard inflow in April and May — during the first phase of the exchange crisis — followed by an outflow of the same size in June, when the authorities acted to limit the banks' net foreign liabilities and banned interest payments on non-resident franc accounts. These restrictions were lifted in September and in the last two months of the year there was a moderate further inflow, which gathered momentum early in 1972.

In the official monetary sector it may be estimated that valuation changes accounted for about one-third of the year's $0.6 milliard increase in reserves. These changes also affected the composition of reserves. At the same time, however, there was, as in the Netherlands but on a smaller scale, an actual shift from exchange reserves to other assets. Excluding valuation changes, the BLEU's reserves may be estimated to have risen during 1971 by $0.4 milliard. The gold reserve increased by $0.1 milliard, while SDR holdings and the Fund reserve position both went up by $0.2 milliard; exchange reserves, on the other hand, fell by $0.1 milliard. Within the slightly decreased total of exchange reserves, however, holdings of dollars with exchange cover provided by the Federal Reserve increased by $0.2 milliard. Apart from valuation changes, the increase in official monetary assets was concentrated in the first eight months of the year, when they went up by $0.6 milliard. For the rest of the year, despite the gain resulting from valuation changes, they showed scarcely any further upward movement. Then, in the first three months of 1972 they increased by another $0.2 milliard. Apart from the SDR allocation, there were purchases by the National Bank of nearly $0.2 milliard of dollars in February, when the dollar came temporarily under pressure in the market. The first-quarter increase in reserves was more than accounted for by an inflow of $0.5 milliard to the banks. In April net official monetary assets showed a small decline.

Switzerland. Switzerland's net official monetary assets showed a $1.7 milliard increase in 1971. This figure, however, considerably understates the true inflow to the reserves, since at the end of 1970 they included $0.9 milliard of dollars held under end-year swaps with the commercial banks, whereas in 1971 there was no end-year reserve increase of that kind.

The main feature of reserve movements last year was the $2.1 milliard increase that took place during the first two weeks of August. Before that, there had been a $0.9 milliard decline during January and February as end-1970 swaps with the banks were liquidated, followed by an increase of $0.6 milliard during the three months March–May. Of this increase, less than 30 per cent. is accounted for by the month of May taken as a whole; in effect, while there was a $0.7 milliard inflow at the beginning of that month that was the immediate cause of the decision to close the exchange market and to revalue the franc, most of these funds had left the country again by the end of the month. After the tremendous August inflow, the authorities did not intervene in the exchange market again during the rest of the year. Total net official monetary assets showed little further rise during the rest of the year, despite a $0.3 milliard increase in December in the dollar value of the gold stock and of the National Bank's holdings of Swiss franc securities issued to it by the US Treasury. Looking at the composition of reserves, the gold stock increased over the year by $0.4 milliard, more than half of which was the result of valuation changes. Foreign exchange reserves proper went up by $0.8 milliard. Their rise was held down, however, by purchases in March and August of non-marketable US Treasury securities for a total of $0.6 milliard.

Owing to major statistical changes, it is not possible to say at all precisely what the movement in the Swiss banks' net foreign position during 1971 was. In the first half of the year they added almost $0.9 milliard to their net foreign assets, somewhat less than the amount which they had swapped with the authorities over the end of the previous year. There appears to have been some, though not a very large, net inflow in the third quarter and a larger net outflow during the final quarter. For the year as a whole, therefore, the banks may have increased their net foreign assets by somewhat more than $1 milliard.

During the first four months of 1972 Switzerland's net official monetary assets declined by $0.3 milliard.

Austria. Austria's net official assets rose by $0.5 milliard in 1971, of which banking inflows provided $0.3 milliard. Virtually the whole of the official monetary surplus was taken in the form of additions to the exchange reserves, and almost three-quarters of it came in July and August, which are in any case months of seasonal strength for the current account. The increase in the banks' net external liabilities was unusually large, and most of it occurred during the last five months of the year; it would presumably have been even higher but for the imposition of controls on banking inflows in May, which were made more severe in August. In the first quarter of 1972 net official assets and the banks' net foreign liabilities both went up by $0.1 milliard.

Sweden. The $350 million increase in Sweden's net official assets during 1971 broadly reflected the overall payments surplus. By far the largest part of the net official surplus took the form of a $325 million rise in exchange reserves; $245 million of this amount came in during the first eight months, most of it before mid-year. There was then virtually no further movement in reserves until December, when, apart from valuation changes, the exchange reserves rose by \$70 million, largely as the counterpart to a \$55 million reduction in the banks' net foreign assets. This inflow through the banks followed a net outflow of almost the same size the preceding month. There was a further marked increase of \$230 million in net official monetary assets during the first quarter of 1972, but very little further reduction in the banks' foreign position.

Norway. The 1971 increase in Norway's net external monetary assets, at \$345 million, was almost exactly the same as in Sweden. And, as in Sweden, it was reflected closely in the movement of the exchange reserves, which went up by \$355 million over the year, practically all in the first eight months. In Norway, however, almost half of the official monetary surplus was the counterpart to an opposite movement in the banks' net foreign position, from net assets of \$100 million to net liabilities of \$65 million. This movement was largely concentrated in the third quarter of the year, no doubt in connection with the dollar crisis. In addition, relatively tight domestic monetary conditions may also have played some part in the banking inflow. In the last quarter of the year the banks began adding again to their net foreign assets, and the rise in reserves slowed down considerably. It continued to be rather moderate in the first quarter of 1972, when net official assets rose by \$50 million, including the SDR allocation.

Denmark. The net official monetary position of Denmark also showed a considerable improvement, of \$210 million, in 1971. Exchange reserves went up by \$160 million and in addition a \$25 million drawing on the IMF made in 1969 was repaid. \$45 million of the net official surplus had a counterpart in an increase in the banks' net foreign liabilities. More than the whole of last year's increase in reserves came in the last quarter, when the balance of payments swung sharply from deficit to a surplus of \$205 million, owing partly to substantial borrowing abroad. As, in addition, there was a \$80 million inflow through the banks, net official assets put on \$285 million during the quarter. There was a further net official surplus of \$140 million in the first quarter of 1972, this time accompanied by a \$35 million net outflow through the banks.

Finland. Including the year's SDR allocation of \$20 million, Finland's net external monetary assets rose by \$170 million in 1971. Exchange reserves went up by \$130 million and \$20 million of gold was purchased from the US Treasury. In addition to the official monetary surplus, there was also an improvement of \$20 million in the banks' net foreign position. During the first three months of 1972 net official assets put on a further \$100 million.

Spain. Net official monetary assets, which had doubled during 1970, doubled again, from \$1.8 to 3.6 milliard, in the fifteen months to March 1972. This increase, almost all of which was added to exchange reserves, was primarily associated with the balance-of-payments surplus. Nevertheless, at \$0.2 milliard, the inflow through the banks in 1971 was unusually large.

Portugal. The substantial \$0.4 milliard rise in Portugal's net official assets during 1971 was concentrated in the second half of the year and was almost entirely in the form of an increase in exchange reserves. The further \$0.1 milliard rise in net official assets during the first quarter of 1972, however, mainly reflected changes in the dollar value of Portugal's non-dollar reserve assets.

Other European countries. In four other European countries — Greece, Iceland, Ireland and Turkey — there were increases in reserves during 1971 that were, either absolutely or in relative terms, unusually large. They ranged from \$20 million in Iceland to \$0.4 milliard in Turkey and were virtually all in the form of additions to exchange reserves. The most striking development among this group of countries was in Turkey, whose reserves had been virtually zero at the beginning of the year.

Japan. Whereas some part of Japan's overall payments surpluses in the preceding three years had financed net acquisitions of foreign assets by Japanese banks, the huge and unprecedented surplus of \$7.8 milliard in 1971 was accompanied by a decrease of \$2.5 milliard in the banks' net position. Net official assets therefore rose by \$10.3 milliard, more than tripling during the course of the year. The international currency crisis not only affected the size of the overall surplus but was also the main factor explaining the reversal of the banks' position.

The addition to net official assets can be entirely accounted for by increased dollar holdings. Holdings of gold and SDRs together also rose, by \$0.3 milliard; on the other hand, there was a \$0.5 milliard reduction in Japan's Fund reserve position resulting principally from liquidation of its remaining GAB claims and of the \$0.3 milliard bilateral claim on the Fund, outside the GAB, taken over in 1970 from Italy. More than half the year's increase in reserves came in the third quarter; indeed, almost \$4 milliard flowed in during the two weeks between the suspension of dollar convertibility and the Japanese decision to let the yen float.

The reduction in the banks' net external assets was concentrated in the months August–November, during which there was a fall of \$2.7 milliard, following a \$0.3 milliard rise in the first seven months of the year. The banks switched \$1 milliard out of foreign exchange in August by borrowing abroad; then over the next three months they ran down their gross foreign currency claims by \$1.6 milliard, while official measures prevented any further significant increase in their borrowing from abroad. Banks' yen-denominated liabilities to non-residents, which rose by \$0.3 milliard in the first five months of the year, were subsequently restrained by official controls from any further increase.

In the first quarter of 1972 net official assets rose by \$1.4 milliard, while the banks increased their net external liabilities by a further \$0.3 milliard. In April official assets declined, for the first time since July 1970.

Canada. A reduction of \$1.4 milliard in the net external assets of Canadian banks in 1971 amply financed the overall payments deficit and provided, together with the year's SDR allocation, for an increase of \$0.9 milliard in net official assets. As short-term interest rates in Canada went above those in the United States, there was an inflow of $0.5 milliard through the banks during the first quarter of 1971. Subsequently, the interest rate comparison became unfavourable to Canada again, but the banking inflow continued — amounting to $0.9 milliard for the remainder of the year. A large part of the year's improvement in the net official position came in the fourth quarter, when $0.6 milliard was added to the reserves, practically all in the form of US dollars. The exchange reserves also increased substantially in the third quarter but this was to a considerable extent offset — as was a smaller rise in the first quarter — by a decline in Canada's IMF gold tranche position, as other countries made repayments in Canadian dollars to the IMF. In the first quarter of 1972 there was a further large banking inflow of $0.5 milliard. As, however, the balance of payments turned into heavy deficit, net official assets rose by little more than the $0.1 milliard SDR allocation.

International Monetary Fund.

For the International Monetary Fund the most important event of the period under review was the formal suspension of dollar convertibility. As this meant that effectively the United States no longer had a par value, the operations of the Fund were greatly reduced after mid-August 1971.

The second allocation of SDRs, made on 1st January 1971, totalled 2.9 milliard units and brought the total outstanding to 6.4 milliard. Total gross use of SDRs in 1971 amounted to 1.3 milliard, nearly 40 per cent. more than in 1970, despite the very low volume of operations in the last months of the year. Participating countries used 1,170 million of SDR units in 1971. Direct transfers amounted to 480 million, from the United States to Belgium (130) and the Netherlands (350); transfers between countries under the designation procedure totalled 362 million and transfers to the General Account of the Fund were 328 million. The Fund itself transferred 130 million of SDR units to participating countries during the year. Thus, participating countries' total gross receipts of SDRs during 1971 came to 972 million.

On a net basis the broad pattern of SDR flows during 1971 was not dissimilar to that of 1970. The less-developed countries used a net amount of 310 million, while the Fund accepted a net amount of 199 million and developed countries 112 million. By the end of the second year of operation of the scheme the biggest holder of SDRs was the Netherlands, whose holdings amounted to 570 million, or 350 per cent. of its cumulative allocations; after that came the General Account of the Fund with 489 million, followed by Belgium with 405 million, representing 290 per cent. of its cumulative allocations. Easily the largest net user was the United States with 484 million, or 31 per cent. of its cumulative allocations. The less-developed countries as a whole had used 43 per cent. of their cumulative allocations at the end of 1971, with the degree of use ranging from 32 per cent. for Latin America to 67 per cent. for the Middle East.

On 1st January 1972 a third allocation of SDRs, amounting to nearly 3 milliard, was made — bringing the total issue during the first basic period to 9.3 milliard. Use of SDRs, which had fallen away to very low levels during the last four months of 1971, remained insignificant during the first quarter of 1972. In April 1972 the first substantial transaction for many months occurred when the United Kingdom used 425 million in a currency repurchase from the Fund.

During 1971 member countries' net use of the Fund's resources declined quite considerably, by $966 million. Gross drawings were $1,900 million, about the same as in 1970; but gross repurchases nearly doubled, from $1,532 to 2,866 million. Transactions were dominated by operations with three countries. The United States, with $1,362 million, accounted for just over 70 per cent. of total drawings, and the United Kingdom and France together, with $1,332 and 1,005 million respectively, for 86 per cent. of total repurchases. In the rest of the Fund's membership there were net drawings of $9 million. During the last four months of the year total drawings were only $269 and repurchases 157 million.

International Monetary Fund: Drawings and repurchases in 1971.

Countries or areas	Drawings	Repurchases*	Net drawings
	in millions of US dollars		
United States	1,362		1,362
United Kingdom		1,332	—1,332
Continental Europe	112	1,145	—1,033
of which			
France	*—*	*1,005*	*—1,005*
Spain	*—*	*54*	*— 54*
Yugoslavia	*96*	*25*	*71*
Middle East	56	16	40
Asia	144	129	15
of which			
China (Taiwan)	*60*	*—*	*60*
India	*—*	*65*	*— 65*
Africa	53	104	— 51
Latin America	173	140	33
Total	1,900	2,866	— 966

* Including repayments of $44 million by other members' drawings ($28 million for the United Kingdom and $16 million for France) and of $15 million through Fund purchases of gold against currencies.

Eighteen different currencies were used in drawings and repurchases during 1971. The principal currencies drawn were the Belgian franc ($690 million), the Dutch guilder (672), the Deutsche Mark (229) and the French franc (100). The currencies most used for repurchases were again the Dutch guilder (484) and the Belgian franc (431), followed by the Japanese yen (368) and the Canadian dollar (351). By the end of 1971 Fund holdings of both Belgian francs and Dutch guilders had fallen to little over $50 million, equivalent to 8 per cent. of each country's quota. For the first year in the Fund's history the use of the US dollar was quite insignificant; dollar drawings were $10 million and repurchases $38 million. Furthermore, the share of all currencies together in repurchases was the smallest in the Fund's history, since $479 million of gold and $302 million of SDRs were used in repurchases. During the year the Fund repaid the whole of its $485 million outstanding GAB borrowings. It also repaid to Japan the $250 million borrowed outside the GAB.

During the first quarter of 1972 Fund transactions remained at a relatively low level. Expressed in US dollars at $35 per ounce (or in SDRs), drawings totalled $260 million and repurchases $147 million. In April 1972 the United Kingdom repurchased $950 million; at the same time the United States drew $200 million of sterling from the Fund. As a result of these two transactions the United Kingdom's gold tranche position was fully reconstituted for the first time since 1964.

Foreign exchange markets.

The main features of the evolution of exchange markets during the period under review have already been described in Chapter I, which includes a table, on page 30, showing the changes that occurred between May and December of last year in the values of leading currencies against gold and the dollar. Conditions in the foreign exchange markets became progressively more unsettled as the year advanced, in three main phases. The first, during which most other leading currencies were very firm against the dollar, culminated in May with several cracks in the exchange rate structure, the Deutsche Mark and the guilder being floated and the Swiss franc and the Austrian schilling revalued. There followed a temporary lull until about mid-year. Then, in the second phase, the flight from the dollar became quite general, forcing the United States off gold on 15th August and leaving nearly all other major currencies floating both against the dollar and amongst one another. Market uncertainty was greatest during the third phase, from late August to mid-December. Currencies were appreciating against the dollar in an unco-ordinated fashion and with a proliferation of national exchange controls that in some cases made the transaction of ordinary foreign exchange business extremely difficult.

The currency realignment of 18th December brought some relief to the markets, and subsequently the dollar opened relatively strong. Between mid-January and mid-March 1972, however, it weakened again substantially — in particular against the Belgian franc, the guilder, the Deutsche Mark and the yen, but to a lesser extent against other currencies too. The strengthening of European currencies in the first part of March may have been related in part to the announcement that the EEC countries had agreed on the arrangements described in the following paragraphs concerning the margins of fluctuation between their currencies. But it was only when the monetary authorities demonstrated — by a combination of interest rate policy, exchange controls and market intervention — their determination to defend the new rate structure that pressure on the dollar eased. Since then calmer, if basically still rather uneasy, conditions have prevailed in the exchange markets.

Exchange-market arrangements amongst members of the European Economic Community. The 1971 exchange crisis broke out only one month before the Common Market countries, in accordance with a decision taken by the EEC Council of Ministers in February 1971, were to have begun narrowing, from 1.5 to 1.2 per cent. on either side of parity, the margins within which the currencies of member countries would have been permitted to fluctuate against one another in the exchange markets. These plans had, of course, to be shelved in May 1971.

When the period of generally floating exchange rates began in August 1971, the Belgian, Dutch and Luxemburg authorities decided to maintain the fluctuations between their currencies within the 1½ per cent. range on either side of parity that had existed before the guilder began to float in May 1971. This meant intervening, by buying one another's currency, to the extent necessary to prevent the rate between the guilder and the Belgian franc from moving at any given moment more than 1½ per cent. away from the rate of B.fr. 13.81 = Fl. 1 derived from the respective gold parities of the two currencies. Shortly after this arrangement came into force the guilder went to its upper limit against the Belgian franc, following the unwinding of speculative positions taken up in Belgium after the guilder had begun to float in May. Both the Belgian and Dutch authorities intervened to prevent any further appreciation of the guilder against the franc, and by the end of September the Nederlandsche Bank had accumulated B.fr. 6.4 milliard as a result of these interventions. Subsequently a change in conditions enabled the National Bank of Belgium to repurchase part of these francs with guilders bought in the market. In December and January the remaining debt was paid off out of Belgium's reserves. The arrangement still stands, but since then the two currencies have not been so far apart as to require any further official intervention.

Meanwhile, immediately following the December currency realignment, the IMF permitted the margins of fluctuation of all other Fund members' currencies vis-à-vis the US dollar to be widened to 2¼ per cent. on either side of the new central or middle rates. In the absence of any further action by EEC countries this would have meant that, except for the relation between the Belgian franc and the guilder, any two Common Market currencies could over time have fluctuated against one another by up to 9 per cent. and that, also with the exception of the Belgian franc and the guilder, any two Common Market currencies could at a given point in time have been up to 4½ per cent. apart from each other. Following a new decision of the EEC Council of Ministers in March of this year, the Common Market countries brought a scheme into operation on 24th April under which, apart from the Benelux arrangements described above, which (as already mentioned) continue in force, neither the market fluctuations of any other two EEC currencies over time nor the distance between two currencies at any point in time can exceed those possible between any one of these currencies and the US dollar, i.e. 4½ and 2¼ per cent. respectively.

The scheme provides for this to be done by means of market intervention in EEC currencies, except in cases where the currency of an EEC member is at its upper or lower limit vis-à-vis the dollar, when intervention is to be in dollars. Intervention in EEC currencies takes place by means of members with strong currencies either purchasing weak currencies outright or lending their currencies to the countries with weak currencies for the latter to intervene themselves. Liabilities arising out of intervention in EEC currencies are, as a rule, to be settled by the end of the following month. When a country settles such liabilities out of its own reserves, it should use each of its different reserve assets pro rata to their importance in its total reserves. So far, no interventions have taken place under the scheme. The United Kingdom, Denmark and Ireland joined the scheme on 1st May, followed later in the month by Norway. It is expected that other European countries, outside the EEC, may associate themselves in due course with these arrangements.

Sterling. Having begun the year 1971 a little below par on the dollar, spot sterling strengthened rapidly and reached the upper limit in mid-February. From then on until the closing of the exchange market in August it continued to be very firm, except for a brief period following the Bank rate reduction in early April. Moreover, by 13th August the upward pressures on sterling had become such that the three-month forward rate went to a slight premium.

Following the reopening of the market, spot sterling rose to 3 per cent. above its dollar parity on 26th August. Measures, described later, were then taken to slow down the inflow of funds, with the result that during the first half of September quotations eased a little to around 2½ per cent. above par. Further buying of sterling then took the rate to almost 4 per cent. above the dollar parity on 8th October, at which point the authorities reinforced the exceptional exchange controls introduced in late August. The spot rate was then held at about the same level until early December, when it was allowed to rise to 5³/₈ per cent. above par on the dollar immediately before the currency realignment.

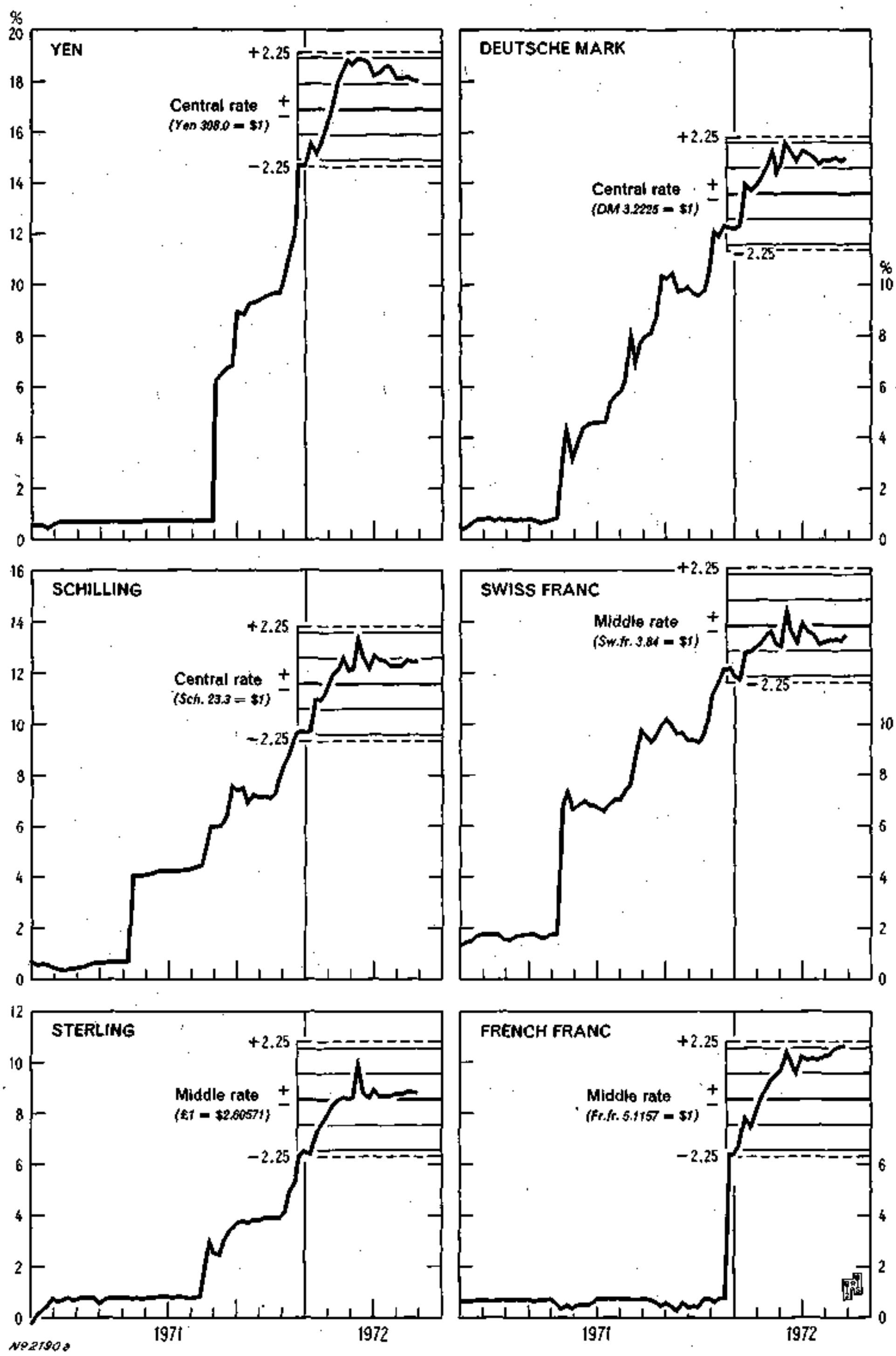
When the markets reopened on 21st December, spot sterling was quoted at over $2.55; this was well above the closing rate of the previous week but just on 2 per cent. below the new middle rate against the dollar. Early in January the new lower limit was almost reached but shortly after that, as part of a general weakening of the dollar, sterling began to appreciate quite rapidly, going slightly above the new middle rate early in February. A month later, when the dollar again came under pressure, spot sterling rose temporarily to almost 1½ per cent. above the middle rate. The pressure soon eased, however, and during April and May the rate was relatively stable at a level slightly above what is now the new par on the dollar. The premium of three-month forward sterling, which had emerged in August 1971 and persisted as expectations of dollar devaluation grew, continued to be quite significant after the exchange rate realignment until late in January. It then ran off and gave way to a slight forward discount.

Deutsche Mark. Before the decision to allow it to float as from 10th May 1971, the spot Deutsche Mark had been almost continuously at its upper limit against the dollar since the beginning of the year. In the three-month forward market the discount of the Deutsche Mark, reflecting the difference between Deutsche Mark and dollar interest rates, persisted until the beginning of April; but as speculative forces got the upper hand a premium emerged which by early May had reached 1⅓ per cent. per annum.

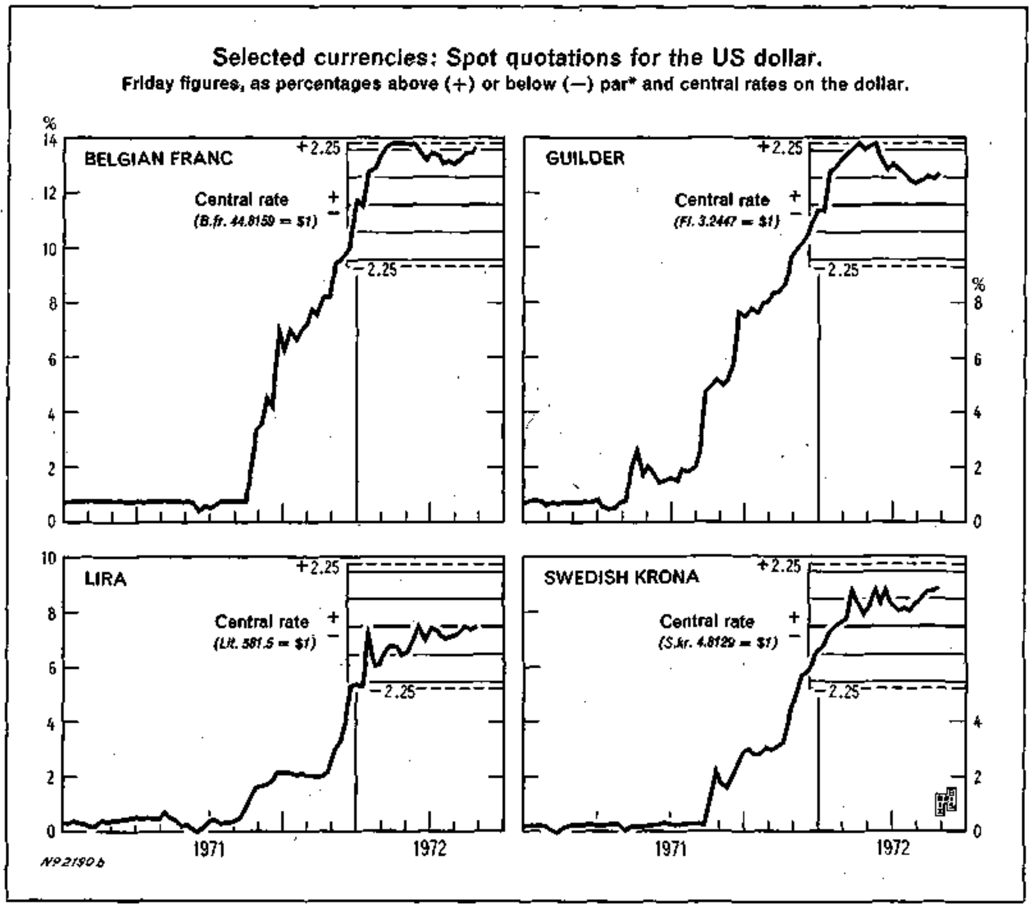
After the float began, the spot rate against the dollar rose to 4½ per cent. above par within two weeks. It then declined quite markedly, to a low point of 2½ per cent. at the very beginning of June, partly in connection with a rise in Euro-dollar interest rates. The authorities then entered the market as substantial sellers of dollars, and the rate at once appreciated quite sharply, reaching nearly 4¾ per cent. above the dollar parity in late June and 5¾ per cent. at the end of July. When speculation started up again in early August the Bundesbank stopped selling dollars, and on 12th August, with the spot rate more than 8 per cent. above par, the authorities bought some dollars in the market. The premium of the three-month forward Deutsche Mark, which had run off in June, reappeared in mid-July and was practically 3 per cent. per annum on 13th August.

The spot rate, which on that day had finished a little more than 8 per cent. above par on the dollar, showed a somewhat lower premium of about 6¾ per cent. when markets reopened on 23rd August. The upward trend of the Deutsche Mark soon reasserted itself, however, and towards the end of September the spot rate was 10½ per cent. above par. Market purchases of dollars, both spot and forward, by the

Selected currencies: Spot quotations for the US dollar.
Friday figures, as percentages above (+) or below (–) par* and central or middle rates on the dollar.



* As at 1st January 1971.



* As at 1st January 1971.

authorities then brought quotations down a little; and late in October, when monetary policy was eased, the premium went well below 10 per cent. Subsequently the Deutsche Mark rose sharply again, and on 17th December it closed 12¼ per cent. above par.

The currency realignment meant an appreciation of the Deutsche Mark, comparing the new central rate with the old dollar parity, of 13.6 per cent., i.e. nearly 1¼ percentage points above the closing rate on 17th December. When markets reopened, the spot Deutsche Mark was quoted at about half-way between the central rate and the new lower limit against the dollar until early January. In mid-January it rose above the central rate, and in February and March demand for Deutsche Mark was such that the authorities bought substantial amounts of dollars in the spot market, where the Deutsche Mark at one point was quite near, without actually reaching, the upper limit. When the pressures eased, the spot rate fell back and in mid-May was some 1¼ per cent. above the central rate. Since the realignment the three-month forward Deutsche Mark has continued at a premium, which reached a peak of 3 per cent. per annum in the second week of March and declined to about 1½ per cent. by mid-May.

Guilder. Like the Deutsche Mark, the guilder was very firm against the dollar during the early months of 1971. And, also like the Deutsche Mark, it floated from early

May 1971 onwards. The float began at a premium of 2½ per cent. on the dollar parity, but for most of the time before the August crisis the premium was less than 2 per cent., rising sharply to 4¾ per cent. on 13th August. During the period of rather general floating rates the spot guilder moved up fairly steadily against the dollar, to reach a 10½ per cent. premium on 17th December.

Following the realignment the guilder was, after the Belgian franc, the second European currency to go above its new central rate, in the second week of January. The upper limit against the dollar was reached on a number of occasions in February and early March, when the authorities bought substantial quantities of dollars. As the pressure eased spot guilder rates fell and by mid-May had come back to less than 1 per cent. above the central rate. In the three-month forward market, however, the premium of the guilder was still well over 2 per cent. per annum.

Belgian franc. As with the other European currencies already discussed, the franc was more or less continuously at its ceiling against the dollar in the regulated exchange market during the first four months of 1971. Following the May crisis, rather than revalue the franc or allow it to float, the authorities enforced a strict separation of the two exchange markets — with the regulated market still being used for commercial transactions and the financial market for other exchange operations. By doing this, they successfully relieved the strain in the regulated exchange market, where the franc had by mid-June returned to par against the dollar. At the same time the premium of the financial franc, which in May had been about 1½ per cent., soon disappeared. By mid-July, however, the franc was back at its upper limit against the dollar in the regulated market, while in the financial market it was at a premium of nearly 2½ per cent. on 13th August.

On 23rd August the franc began to float in both exchange markets and the two rates almost immediately came together at a premium of about 2½ per cent. on the dollar parity. Subsequently quotations for the franc followed much the same pattern as those for the guilder, though at a somewhat lower level, until by 17th December the premium was nearly 10 per cent. Following the realignment, the franc was already above its new central rate in the regulated market on 31st December, and it was also the first currency to reach its new upper limit against the dollar — in the second week of February. After the speculative flurries in February and March the rate eased, but in mid-May it was again nearly 2 per cent. above the central rate.

French franc. Although the franc was very firm during the early months of 1971 and right against its upper limit at the beginning of May 1971, the Bank of France did not withdraw from the market on 5th May. Instead, exchange controls were tightened and this, in conjunction with the clearly stated intention of the authorities not to revalue or float, caused the spot rate for the dollar to ease. Early in July, however, the franc returned to its upper limit, where it remained, despite further steps to discourage inflows, until 13th August, by which time the authorities had taken in substantial amounts of dollars.

A double exchange market was then introduced, with official intervention confined to the market for trade and (within certain limits) related items and for current official transactions. Strict regulations were introduced to enforce this division. In what came to be known as the official market the franc was in considerable demand, especially once it was the only major currency still held within its previous limits. Meanwhile the "financial" franc had gone to a premium of some 4 per cent. During September and October, however, the commercial franc came well away from the ceiling and the authorities even managed to sell a substantial volume of dollars in the market. In the financial market, which in October was enlarged to include residents' transactions in foreign securities (previously hived off in a separate market), the franc was at a premium of between 2 and 3 per cent. for most of that month.

Towards the end of November, however, the commercial franc rose again to its upper limit against the dollar, requiring renewed official purchases of dollars on a considerable scale, while the premium of the financial franc stood at 5½ per cent. immediately before the currency realignment. Some speculation was diverted, so far as regulations allowed, to the forward market, where the premium, expressed as an annual rate of interest, reached double figures on several occasions.

The double exchange market was continued after the general realignment, but there was some considerable dismantling of exchange controls. The commercial franc opened close to its new floor, while the financial franc fell to a slight discount on the commercial franc for a few days; but subsequently the two rates converged. After the turn of the year the commercial franc picked up and moved above its new middle rate early in February. A month later, when the dollar came under pressure in most markets, it almost reached the upper limit, while the financial franc rose to nearly 5 per cent. above the middle rate. Although the commercial franc, along with other European currencies, subsequently eased, by mid-May it was not far from the upper limit again, while the financial franc was still 4 per cent. above what became the new dollar parity in May. Early in May the authorities enlarged the scope of the official exchange market by transferring to it all trade-related services (principally transport and insurance).

Swiss franc. The May 1971 revaluation was the first change in the franc's parity for thirty-five years. Intervention limits were set, as before, at 1.8 per cent. on either side of par; but in view of the generally uncertain situation prevailing in the exchange markets, the National Bank indicated that it would effectively operate within one-third of that spread. After revaluation the franc remained mostly below its new parity until early August, when speculators turned their attention to it again. The Swiss authorities soon took deterrent measures and the franc was only consistently above par during the final week of trading before 15th August; nevertheless the exchange inflow to Switzerland was the largest to any single country in the first part of the month. Further defensive measures were taken during the period of floating from 23rd August onwards, but the franc remained in strong demand and by 17th December the spot rate was over 5 per cent. above the new dollar parity.

A further appreciation of 6.4 per cent. against the dollar, while keeping the gold parity unchanged, was agreed to as part of the currency realignment, bringing the total appreciation against the dollar to 13.9 per cent. since May. Shortly after the markets reopened the franc went down close to its new floor against the dollar, but there was no heavy selling. Subsequently the movements of the rate have been broadly in line with those of other leading European currencies, but with the difference that, with domestic interest rates so much lower than elsewhere, the franc has remained below its new middle rate except during the speculative episode in early March.

Lira. Although Italy's reserves increased by the best part of $1 milliard during the first four months of 1971, the lira was never close to its upper limit against the dollar in the spot market, and in fact did not quite reach it even in early May. It was, however, drawn into the August crisis and shortly before the markets were closed had reached its ceiling. It reopened at a moderate premium on the dollar parity of a little over 1 per cent., which by late November had increased to 2¼ per cent. Closing at 4 per cent. above its dollar parity on 17th December, it reopened the next week close to its new lower limit. Since then the lira, like the Swiss franc, has been below its middle rate on the dollar except during early March of this year.

Schilling. The May 1971 revaluation was accompanied by a widening of the margins of fluctuation almost to the full 1 per cent. on either side then permitted by the International Monetary Fund. Following the revaluation the schilling was quoted at its new lower limit vis-à-vis the dollar, and when the markets closed on 13th August it was still ½ per cent. below its dollar parity. During the period of general floating the schilling appreciated to 4½ per cent. above its new dollar parity. Following the realignment it showed little further appreciation, opening 1½ per cent. below its new central rate. In the first part of March the schilling went to 1¾ per cent. above the central rate and it has since remained well within the upper half of its present permitted range of fluctuation.

Yen. The yen was at its upper limit against the dollar in the exchange market from early February 1971 until the decision to abandon the upper intervention limit, on 28th August. The rate then immediately jumped to 5½ per cent. above the dollar parity. Despite additional heavy official purchases of exchange it continued to appreciate quite rapidly until, by mid-October, the premium was 9½ per cent. From then on there was little further upward movement of the rate until early December, when the premium rose to 12½ per cent. just before the currency realignment.

The new central rate then established for the yen meant an effective appreciation of 16.9 per cent. against the dollar as compared with the old parity. When the market reopened the rate was not far from the new lower limit and some outflow of funds took place. Early in January, however, the yen began to strengthen again and by late February the new upper limit had almost been reached. As in other countries whose currencies came under very strong pressure at that time, the authorities intervened to purchase dollars in the market. The rate subsequently eased and by late April was about 1 per cent. above the new central rate for the dollar.

Canadian dollar. The Canadian dollar continued to float throughout the period under review. Having already appreciated to about 6½ per cent. above its former parity with the US dollar in the course of the last seven months of 1970, the Canadian dollar fluctuated rather narrowly against the US dollar during the period under review in comparison with the movements of other currencies. Having begun the year 1971 a little above 99 US cents, it reached 100 US cents in February. Subsequently reductions in domestic interest rates, together with rises in US and Euro-dollar interest rates, brought the rate below 99 US cents late in May and a low point of about 97½ US cents was reached in mid-June. By 13th August the Canadian dollar was almost at 99 US cents again and after rising practically to 99½ US cents on 17th August it eased sharply to 98½ US cents later the same month, owing to fears of the effects on Canada's trade of the US import surcharge. In October the Canadian dollar strengthened again, reaching 100 US cents late in the month. Immediately before the currency realignment it rose further, to 100½ US cents. After going slightly below par on the US dollar early in 1972, it strengthened again in March, and in mid-May was standing at over 101 US cents.

Other currencies. The currencies of Denmark, Norway and Sweden had all strengthened towards the end of 1970 and remained above par against the dollar thereafter. None was drawn into the May 1971 crisis, and in August the Norwegian krone was the only one to come close to its upper limit before general floating commenced. All three currencies then appreciated considerably, and just before the realignment their premiums over par were 4½ per cent. for the Danish krone, 6 per cent. for the Norwegian krone and a little less than 6 per cent. for the Swedish krona. New central rates were subsequently adopted — D.kr. 6.98, N.kr. 6.65 and S.kr. 4.81 = US $1 — embodying appreciations of about 7½ per cent. against the dollar. After opening, in common with other currencies, in the lower half of their new wider bands, the Swedish krona moved above its new central rate in mid-January, followed by the Norwegian krone about a month later; both were some 1½ per cent. above their central rates in the second week of March and in mid-May they stood at 1¼ and 1 per cent. above respectively. The Danish krone, on the other hand, was generally below its central rate by a small margin, except during March. In Finland a central rate of F.mk. 4.1 = US $1 was declared in December 1971, equivalent to an appreciation of about 2½ per cent. against the dollar.

By mid-1971 the Spanish peseta had been a little over ½ per cent. above par on the dollar for some twelve months, and it moved up closer to its ceiling as the August crisis developed. Between then and the currency realignment it floated to some 4½ per cent. above par, more than half of this appreciation occurring during the final week or so. Thereafter the authorities decided to retain the existing gold parity, adopting a middle rate of Pesetas 64.5 = US $1. The peseta was subsequently held at its new lower limit until mid-March 1972; it was then allowed to move up practically to its middle rate, where it has since remained.

The Portuguese escudo was held at ¾ per cent. above par from late January 1971 until it was allowed to float in August. It reached 4¾ per cent. above par by early December and a new central rate of Esc. 27.25 = US $1, equivalent to an appreciation of 5½ per cent. against the dollar, was then adopted. The escudo moved above the central rate during February 1972 and has since remained there.

Following the currency realignment the Greek authorities kept the exchange rate against the dollar unchanged at Dr. 30 = US $1, while in Turkey the lira was given a central rate of T£14 = US $1, representing a 7 per cent. appreciation against the dollar.

Other exchange developments.

Apart from the exchange rate changes which have already been described either in Chapter I or earlier in this chapter, the other most important exchange developments during the period under review consisted to a large extent of attempts by the countries that were on the receiving end of last year's flight from the dollar to limit the increases in their reserves by means of various kinds of direct controls over inflows of exchange. These controls were already on the increase from May 1971 onwards and their scope was considerably extended between August and December. In some cases they were supplemented by liberalisation of outward payments and transfers. Immediately following the currency realignment many of the controls imposed since the previous May were removed. However, when speculation against the dollar and in favour of certain other currencies began again early this year, new controls were introduced, or old ones reimposed, in the countries whose currencies came under upward pressure.

Among the first countries to tighten up controls last year were those that changed either their exchange rates or their exchange rate arrangements in early May 1971.

In *Germany,* on the same day as the Deutsche Mark began to float, the authorities virtually prohibited the payment of interest on deposits made by non-residents with German banks, the purchase by non-residents of German money-market paper and the placing by German banks of domestic fixed-interest securities "en pension" with foreign banks. Early in July the government announced that it was considering legislation to control what had been one of the main sources of the inflow of funds, viz. foreign borrowing by German non-bank corporations. On 1st January 1972 the so-called cash-deposit law came into force. This enables the government to call upon all residents to deposit on non-interesting-bearing accounts at the Deutsche Bundesbank a proportion, not exceeding 50 per cent., of their foreign borrowing. While the law is aimed primarily at non-bank corporations, its provisions also apply to those foreign liabilities of banks and other credit institutions that are not subject to compulsory minimum reserves. Following upward pressure on the new exchange rate in February 1972, the law was activated on 1st March in respect of credits taken up on or after 1st January 1972, with the cash-deposit ratio being fixed at 40 per cent. Borrowing of DM 2 million or less, borrowing directly connected with the normal settlement of transactions in goods and services, as well as borrowing to refinance or cover forward export claims or to finance investment abroad, was exempted.

In the *Netherlands,* shortly after the guilder began to float, a number of direct measures were taken to control inflows. The main banks agreed on 21st May not to pay interest on non-resident guilder demand deposits in cases where the deposits appeared to have been made for speculative purposes. In June non-residents were no longer allowed to use balances on convertible guilder accounts for investing in domestic Treasury paper or bankers' guilder acceptances. Then in September non-residents were no longer allowed to buy guilder bonds from residents except with the proceeds of non-residents' sales of such bonds to residents. This measure created a new exchange market for guilders, in which the proceeds of such sales are traded. In March 1972, when the guilder came under renewed upward pressure, the payment of interest on non-resident guilder demand deposits was banned and the general authorisation for non-residents to place guilders on time deposits with banks in the Netherlands was suspended.

In *Belgium-Luxemburg* the banks had already been asked by the authorities in March 1971 to limit the growth of their net external debit positions, failing which their rediscount quotas at the National Bank would be reduced by the extent that they exceeded the limits laid down. In May, when the two exchange markets were strictly separated, the banks were forbidden to open new convertible Belgian franc time-deposit accounts for non-residents or to pay interest on non-residents' convertible sight accounts. At the same time, residents were no longer allowed, except within rather narrow limits, to receive advance payments from non-residents for goods and services. Then in June the system of penalising banks that exceeded the limits laid down in March for their net external debit positions was changed from reducing their rediscount quotas to making them deposit on special non-interest-bearing accounts with the National Bank any amounts by which they exceeded their limits. The reason for this change was that the increase in their net debtor positions from May onwards stemmed essentially from non-residents' adding to their Belgian franc balances rather than, as previously, from foreign exchange operations which the banks themselves had initiated with non-residents. In September the limits on the banks' foreign positions were suspended and the amounts accumulated on the special accounts at the National Bank released. In March 1972, following a renewed inflow of funds, the banks were asked to limit the further increase on non-residents' convertible Belgian franc accounts to those amounts that were needed for current transactions, not to increase further their net external debtor positions and to limit their recourse to foreign money markets.

In *Austria,* simultaneously with the revaluation of the schilling, a gentleman's agreement between the National Bank and the banks provided for the latter to deposit on non-interest-bearing accounts at the National Bank, over and above normal reserve requirements, 40 per cent. of any further increase in their schilling liabilities to non-residents. In addition, the banks undertook not to increase their domestic liquid assets by advance repatriation of foreign assets. In June certain restrictions on purchases of foreign exchange were relaxed: the travel allowance for residents was raised from Sch. 15,000 to Sch. 26,000 per trip; residents were allowed freely to purchase foreign exchange forward for periods of up to twelve months instead of, as previously, six months; and certain minor relaxations were made in the regulations governing non-residents' ability to dispose of their property in Austria.

The gentleman's agreement with the banks, which had expired at the end of June, was revived following the August crisis, with the only difference that the proportion of any further increase in their schilling liabilities to non-residents which the banks agreed to deposit at the National Bank was raised to 75 per cent. At the same time the crediting to non-resident bank accounts of schillings obtained by converting out of foreign currencies was made subject to individual authorisation by the National Bank, except for amounts needed for making current payments. The provisions of this gentleman's agreement, originally scheduled to lapse at the end of October 1971, have since been extended until end-June 1972.

In *Switzerland* the first direct measures to stem inflows of funds during the period under review were taken in the second week of August, when the National Bank decided to block, for a period of ten days, except for use in purchasing dollars, all Swiss francs arising out of its purchases of dollars in the exchange market. A week later, on 16th August, this arrangement was replaced with a 100 per cent. reserve requirement on any further increase in the banks' net liabilities to non-residents and the prohibition of interest payments on non-resident Swiss franc deposits of over Sw.fr. 50,000 made after 31st July for any period of less than six months. On 27th August the prohibition on interest payments was extended to all non-resident Swiss franc deposits without exception. These measures are still in force. Also with effect from 16th August, the proceeds of Swiss franc loans raised by non-residents had to be converted at once into foreign currency, except for loans raised to pay for goods delivered or services rendered by Swiss residents.

Following the reopening of the exchange market, the banks, in agreement with the National Bank, decided on 25th August to limit conversions of dollars into freely available Swiss francs to $2 million per customer per day should the dollar exchange rate fall to Sw. fr. 3.96 and to $1 million if it fell to Sw. fr. 3.95. The Swiss franc proceeds of any conversions over and above these limits, at the exchange rates mentioned above, were blocked for three months on non-interest-bearing accounts. In December this agreement was replaced by a new one under the terms of which conversions of dollars into freely available Swiss francs were limited to $1 million per customer per day, regardless of the market exchange rate.

In February of this year, following a renewal of upward pressure on the Swiss franc, the regulations governing the conversion of the proceeds of Swiss franc loans, introduced last August, were modified so that 25 per cent. of the proceeds had to be converted at the Swiss National Bank's official dollar selling rate of Sw.fr. 3.9265; in early May this regulation was amended so that 40 per cent. of such proceeds have now to be converted at the National Bank, but at a rate of Sw.fr. 3.88. The same rate of exchange was also made available to the banks for their capital exports. Also in February, non-resident subscriptions to privately-placed medium-term Swiss franc notes were limited to 40 per cent. of the total of any such placement, while foreign banks were no longer allowed to subscribe to them at all. In April the application of the 100 per cent. minimum reserve requirement on the banks' net foreign liabilities was made more strict.

Coming to countries not directly involved in the May crisis, in *France* reserve requirements were reimposed in April 1971 on the banks' liabilities to non-resident banks. The ratio was initially fixed at 2¼ per cent. and subsequently raised in four stages to 12¼ per cent. by early August. Also in early August the banks were instructed not to allow any further increase in their net foreign liabilities, except such as might arise out of selling francs to non-residents for the settlement of debts to French residents. At the same time there was some further liberalisation of controls on outward movements of exchange. The travel allowance for residents was raised from Fr.fr. 2,000 to Fr.fr. 3,500 per trip and the former limit of two trips per year abolished; the facilities available to importers for obtaining exchange cover, in both the spot and the forward markets, were considerably enlarged; the regulations governing outward transfers of funds for direct investment and for prepayment of debts began to be administered more liberally; and the regulations governing the use of funds on blocked accounts of French citizens living abroad were considerably eased. Later in August the splitting of the exchange market was accompanied by the formalisation of an agreement reached earlier in the month not to pay interest on non-resident franc deposits at less than ninety days. At the same time authorised delays for payments to non-residents were shortened.

In December the approach of the currency realignment brought a renewal of heavy pressure on the French franc. Accordingly, as from 10th December, non-residents could only use the balances on their franc accounts for authorised transactions with residents. In particular, they could no longer convert into other currencies, transfer their balances to other non-residents or purchase French money-market paper. As from 14th December any increase in non-residents' franc balances on their end-November level was liable to be blocked. In addition, banks were no longer allowed to borrow francs from non-residents by means of swaps. At the same time, the regulations governing the making of loans in francs to non-residents were liberalised and the remaining restrictions on the taking of forward cover by importers of merchandise were abolished.

Following the currency realignment, most of the restrictions introduced earlier in the year were abolished. This included the limits on the banks' net foreign positions, the ban on interest payments to non-residents, the restrictions on convertibility of non-resident franc accounts, and the shorter period fixed in August for making import and other payments to non-residents. At the same time, the reserve requirements on the banks' liabilities to non-resident banks were reduced to 10 per cent. for sight deposits and 4 per cent. for other types of deposit. Then in February of this year banks were again, for the first time for three years, allowed to grant importers advances in foreign currencies. Finally, in May further relaxations of exchange controls were announced. These included freedom for residents to transfer abroad up to Fr.fr. 150,000 for house purchases; an increase from 250 to 1,000 in the amount of French francs that residents may freely send abroad, for any purpose whatever; an increase from Fr.fr. 50 to Fr.fr. 500 in the amount of domestic currency that residents going abroad for less than twenty-four hours may carry with them; freedom for residents to make gifts of up to Fr.fr. 50,000 to any member of their family residing abroad; and permission for non-residents to export freely the countervalue of Fr.fr. 3,500 in foreign bank-notes, as compared with the previous limit of Fr.fr. 500.

In *Japan* the first steps during the period under review to limit capital inflows were taken in April 1971. It was decided that, in principle, issues of Japanese bonds on foreign capital markets would not be allowed if the proceeds were to be converted into yen. In May non-residents were forbidden to purchase unquoted Japanese stocks and bonds; Japanese banks were no longer allowed to take up foreign credits or to guarantee such credits taken up by their customers; and Japanese corporations were asked, as far as possible, not to guarantee foreign borrowing by their overseas subsidiaries. Further measures followed in June, including some import liberalisation, greater freedom for residents to invest abroad and the curtailment of tax incentives for exporters. In July residents were allowed complete freedom to buy securities and real estate in the OECD area, as well as to make direct foreign investments of up to $8 million per project.

The next moves were made when Japan decided to try and maintain its existing parity after 15th August. Banks were instructed not to increase their Euro-dollar borrowings. When the yen began to float at the end of August, still further measures were introduced. They included a virtual ban on the receipt of advance payments for exports, strict control of non-residents' free yen accounts and day-to-day control over the banks' dollar positions. At the same time the amount of yen bank-notes that Japanese tourists could take abroad was raised from Yen 20,000 to Yen 100,000 and from 1st October there was some further removal of import quotas.

In January 1972 some of the controls imposed the previous year — including those on the banks' dollar positions, the ceilings on non-residents' free yen balances and the ban on the receipt of advance payments for exports — were lifted. In the following month, however, the last of these restrictions was reintroduced in the face of renewed inflows of funds. At the same time foreign banks operating in Japan were prohibited from making further conversions of dollars into yen. With effect from 1st March transfers abroad of up to $1,000 in foreign currencies were no longer subject to prior authorisation. In early May all residents were allowed to retain indefinitely foreign exchange earned in transactions with non-residents. Previously only banks and shipping, trading and insurance companies had been permitted to do so, other residents having been obliged to surrender their foreign exchange earnings within one month. Later that month further liberalisation measures, including an expansion of import quotas and greater freedom for export of capital by non-residents, were announced.

In *Italy* the banks were requested in August to bring their net foreign positions into balance by mid-September. Early in December, in order to limit speculative inflows, banks were asked not to sell lire to non-residents against foreign currency except for "normal" transactions. At the same time, the opening and operation of new capital lira accounts by non-residents were made subject to special authorisation. This measure was rescinded immediately following the currency realignment.

In the *United Kingdom* a whole range of measures was taken towards the end of August in an attempt to slow down the inflow of exchange. With minor exceptions, banks, discount houses and similar institutions were not allowed to pay interest on any increase after 30th August in sterling accounts of residents outside the sterling area; other financial institutions, together with local authorities, were prohibited from accepting any further deposits, whether in sterling or in foreign currency, from outside the sterling area; and residents of non-sterling-area countries were no longer allowed to add to their holdings of sterling certificates of deposit, Treasury bills or public-sector securities with maturities of less than five years. In addition, limits were placed on the banks' swaps with non-residents of sterling against foreign currency. Early in October the ban on non-resident acquisition of certain types of sterling securities was extended to all maturities, as well as to sterling acceptances, commercial bills and promissory notes. All these restrictions were removed following the currency realignment.

In his March 1972 budget speech the Chancellor of the Exchequer announced relaxations of restrictions on both inward and outward investment. Firstly, subsidiaries of foreign companies making new direct investment in the United Kingdom may now finance themselves in sterling from UK sources. Secondly, UK companies are now allowed to buy in the official exchange market foreign currency up to the equivalent of the first £1 million for direct investment in countries that are present or prospective EEC members.

In *Spain* the payment of interest on non-resident peseta accounts at less than 90 days' notice was prohibited in October 1971 and any increase in such deposits made subject to a 100 per cent. reserve requirement. Previously, in June 1971, the import deposit scheme introduced during the 1969 balance-of-payments difficulties had been abolished.

As regards exchange developments elsewhere in the world, in *Yugoslavia* the dinar had already been devalued by 16.7 per cent. in January 1971. At the time of the December 1971 currency realignment it was again devalued — by 18.7 per cent. against gold and 11.8 per cent. against the dollar — giving a new exchange rate for the dollar of Din. 17 = US $1, against Din. 15 = US $1 previously.

In the *USSR* the standard rates of exchange for the rouble against western currencies began to be adjusted soon after the August 1971 exchange crisis. At the beginning of September 1971 the rouble was devalued against a number of western currencies, the biggest downward changes being 5 per cent. against the Japanese yen and 3 per cent. against the Deutsche Mark. No change was made at that time in the rates against either the French franc or the US dollar. In December, however, following the announcement of the proposed devaluation of the dollar, the rouble was revalued against the dollar by 8.6 per cent., the standard rate for the dollar moving from Roubles 0.9 to 0.829 = US $1. Simultaneously the rouble was revalued, by smaller amounts, vis-à-vis other western currencies. The changes included upward movements of 3.5 per cent. against the Deutsche Mark, 3.1 per cent. against the Swiss franc and 2.8 per cent. against the lira. On the other hand, the rouble was also devalued, by a further 1.5 per cent., against the yen. There have subsequently been some minor adjustments of the exchange rate for the rouble against western currencies.

In *Bulgaria, Hungary, Poland* and *Rumania* there were currency appreciations of 8.6 per cent., or thereabouts, against the US dollar in December 1971, while in *Czechoslovakia* the appreciation was 9.9 per cent.

In the *sterling area* there were various significant developments during the period under review.

Between 23rd August and 17th December 1971 a number of sterling-area currencies, of which the South African rand was the most important, moved from being pegged on sterling to the dollar. Following the realignment of leading currencies, although a numerical majority of sterling-area countries maintained their existing rates of exchange against sterling, thus appreciating 8.6 per cent. against the dollar, a certain number — including Ceylon (since 22nd May renamed Sri Lanka), Guyana, Jordan, Kenya, Pakistan, Tanzania, Uganda and Zambia — maintained their existing rates of exchange against the dollar, thereby depreciating 7.9 per cent. against sterling. Yet others — of which South Africa, India and Ghana were the most important — changed their rates in December 1971 against both the dollar and sterling. South Africa reduced the gold value of the rand by 12.3 per cent., the new gold content being 1.09135 grammes and the new dollar exchange rate R. 0.75 = US $1. Against the dollar, therefore, South Africa devalued by 4.8 and against sterling by 12.3 per cent. The Indian rupee, on the other hand, appreciated by 3 per cent. against the dollar, thus depreciating 5.1 per cent. against sterling. The new rates for the dollar and sterling are Rupees 7.28 = US $1 and Rupees 18.97 = £1. Ghana devalued in December 1971 by 43.9 per cent. against the dollar and 48.3 per cent. against sterling. In February 1972, however, these devaluations were reduced to 20.4 and 26.7 per cent. respectively. Australia and New Zealand kept their gold parities unchanged — like the majority of sterling-area countries — but reduced the effective appreciation of their currencies against the dollar, and hence depreciated slightly against sterling, by fixing new middle rates in fairly narrow bands at the lower end of their permitted wider margins. Australia adopted a new middle rate of A $0.8396 = US $1, with margins of 0.2 per cent. on either side, for an effective appreciation of 6.3 per cent. against the US dollar. New Zealand adopted a middle rate of NZ $0.8367 = US $1, with margins of 0.5 per cent. on either side, representing an effective appreciation of 6.7 per cent. against the US dollar. In May 1972 Pakistan devalued by 56.7 per cent. The new dollar rate is Rupees 11 = US $1, as against Rupees 4.76 = US $1 previously.

In addition to these various realignments of exchange rates, a number of those members of the sterling area that had switched to a dollar peg at some stage in the preceding months decided after the December 1971 currency realignment to remain pegged to the dollar rather than to sterling. They included Ceylon, Jordan, Kenya, Pakistan, Uganda, Tanzania and Zambia. At the same time Australia and New Zealand went over to a dollar peg. South Africa, on the other hand, returned to pegging the rand to sterling.

Finally, there were two changes in the composition of the sterling area. Libya ceased to be a member in December 1971. It allowed its currency, however, to appreciate 8.6 per cent. against the dollar in the general realignment. Bangla Desh joined the area in February. Its currency, the taka, is at par with the Indian rupee.

In the *French franc area* the rates of exchange between the French franc and all other currencies of the area remained unchanged throughout the period under review.

Israel devalued twice during the period under review. In August 1971 the gold content and the external value of the Israeli pound were lowered by 16.7 per cent., the dollar parity changing from I£3.5 to 4.2 = US $1. In December 1971 the Israeli pound was devalued along with the US dollar, but no new gold value has yet been officially declared. The rate of deposit on all imports subject to customs duties of more than 50 per cent. was reduced in January 1972 from 40 to 30 per cent.

In *Latin America* there were substantial further depreciations of the exchange value of a number of currencies. Under the crawling peg system adopted in 1971, the Argentine peso was devalued by a total of 20 per cent. in six stages between March and August 1971, from Pesos 4 to 5 = US $1. A dual exchange rate system was introduced in September, with a commercial exchange market for trade and trade-related transactions, for which the rate of Pesos 5 = US $1 was retained, and a financial market for all other operations, in which the rate was left to float freely. To avoid devaluing the commercial peso, a growing proportion of foreign exchange transactions relating to trade was subsequently transferred to the financial market. In late March, with the financial rate standing at Pesos 9.7 = US $1 and with 64 per cent. of exchange required for imports having to be purchased on the financial market, the peso had in effect been devalued since the introduction of the dual-market system by about 38 per cent. for trade purposes and by nearly 50 per cent. for other transactions. Since mid-May purchases of exchange to pay for non-essential imports have had to be made entirely in the financial market, where the rate has fallen further, to Pesos 9.85 = US $1. In Brazil there were seven further downward adjustments of the exchange rate, totalling just over 12 per cent., from Cruz. 5.195 to 5.915 = US $1, during the twelve months to mid-May. In Chile, under the dual-market system then in force, the rate applied to most non-trade transactions was changed by nearly 50 per cent. in July 1971 from Esc. 14.35 to just over Esc. 28 = US $1. Following the temporary suspension of all foreign exchange transactions early in December 1971, a multiple exchange rate system was introduced on the 13th of the month, i.e. slightly before the realignment of major currencies. Its most important features were that the old official rate of Esc. 12.2 = US $1 was limited to imports of basic foods and oil and that for most other imports and all exports a new rate of Esc. 15.8 = US $1 — equal to a devaluation of almost 23 per cent. — was introduced.

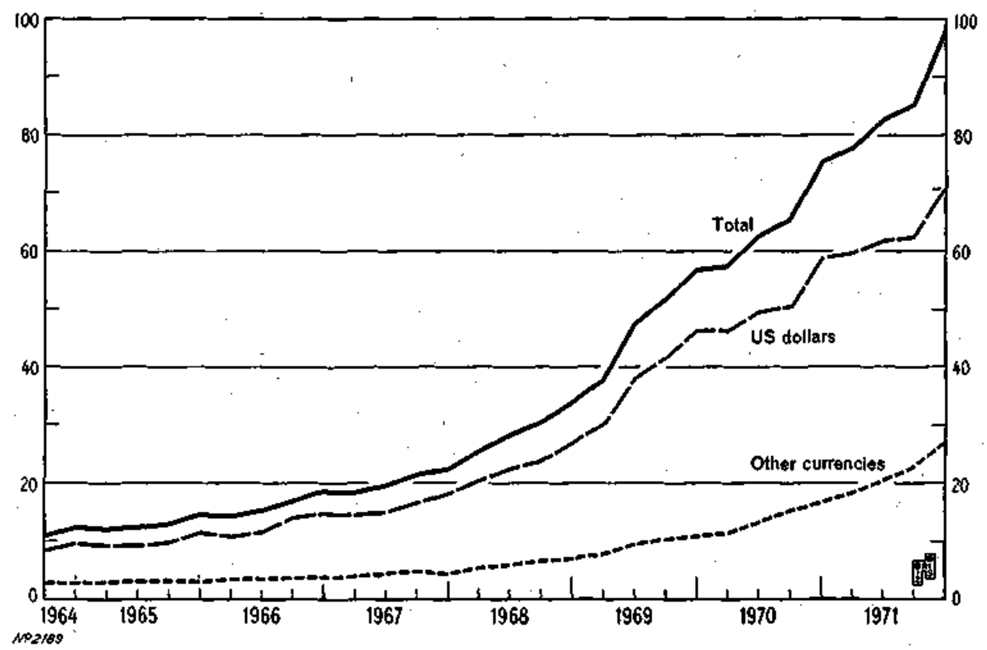
In Costa Rica there has been a multiplication of exchange rates, together with a marked effective depreciation of the currency, during the period under review. In the official exchange market surcharges of 15 and 30 per cent. were imposed in July 1971 on purchases of exchange for less essential categories of imports. The official rate of Colones 6.65 = US $1 continued in force for essential imports. In addition, the free-market rate depreciated by 23 per cent., from Colones 6.65 to 8.6 = US $1, between end-May and end-July 1971. In Uruguay, too, the currency depreciated considerably during the period under review; in March 1972, however, the increasingly elaborate multiple exchange rate system introduced in May 1971 was replaced by a dual exchange rate system. The rates for all exports and imports were fixed respectively at Pesos 495 and 500 = US $1 in March 1972, while a free exchange market, where quotations opened at Pesos 750 = US $1, was created for all other transactions. Prior to March 1972 the effective range of exchange rates had been Pesos 370–500 = US $1, with only crude-oil imports still allowed at the old official rate of Pesos 250 = US $1. By late April 1972 the official market rates had depreciated somewhat further, to Pesos 519–524 = US $1, while the free rate had moved to Pesos 870 = US $1.

V. THE EURO-CURRENCY MARKET.

General developments.

Despite the virtual disappearance of demand from banks in the United States for Euro-dollar funds, the Euro-currency market continued to expand strongly throughout 1971. External assets in foreign currencies of the banks of eight reporting European countries increased by $22.2 milliard to $100.4 milliard, a somewhat larger gain than in 1970; with a similar rise, their liabilities reached $97.9 milliard. Net of duplication, but including foreign currency positions vis-à-vis residents, the amount of foreign currency credit outstanding via the reporting European banks may be estimated to have gone up from $57 milliard to about $71 milliard and its dollar component from $46 to 54 milliard. In this expansion the Euro-market behaved in much the same way as the national money and credit markets, except that the rates of increase were even higher.

External liabilities in foreign currencies of banks of eight reporting European countries.
In milliards of US dollars.



Apart from the general inflationary climate, three main interrelated factors influenced the rapid growth of the Euro-currency market in 1971: the wide differential between Euro-dollar deposit rates and money-market yields obtainable in the United States; the size of the US payments deficit; and the crises in the exchange markets.

On the supply side of the market, the large premium registered by Euro-dollar rates over US rates, which mainly reflected the pronounced monetary ease in the United States, made the Euro-dollar market all the more attractive to both US and non-US holders of dollars. Thus, in 1971 not only was there a sizable flow of new funds from US residents into the market, but central banks outside the Group of Ten also seem to have placed in the market a substantial part of the dollars which accrued to them largely as a result of the US payments deficit. Moreover, lack of confidence in the dollar encouraged a diversification of official reserves out of dollars into certain other currencies. Since, however, there were deliberate barriers to the employment of non-dollar reserves in the national markets of the currencies concerned, most of them seem to have been placed in the Euro-currency market. On the other hand, the Group of Ten central banks, in accordance with an agreement reached in spring 1971 not to increase their reserve holdings in the Euro-market, shifted via the BIS some of their placements out of the market to the United States. On balance, therefore, the net amount of new official funds placed in the Euro-market was smaller than in 1970, although still quite substantial.

In addition, the huge US payments deficit contributed to private liquidity creation outside the United States and, together with the exchange crisis, was the main reason for the measures taken by a large number of countries to curb the inflow of foreign funds. These two factors, i.e. the general abundance of liquidity in national markets and the partial closure of these markets to foreign funds, were, together with the movement into currencies expected to be revalued, important influences maintaining the flow of new private funds to the Euro-market.

On the demand side the situation was quite different. Here the marked premiums shown by Euro-dollar rates over US money-market yields and the very liquid state of the US economy contributed to a further sharp reduction in US demand for Euro-currency funds. Thus, in 1971 the US banks repaid about $6.8 milliard to their foreign branches, or $1.7 milliard more than in the preceding year. Similarly, in so far as the US payments deficit was one cause of the general monetary ease outside the United States and of the measures introduced by several countries to discourage external borrowing by residents, the deficit, plus the general economic slow-down, tended to keep down demand for Euro-currency funds outside the United States as well. And in fact the increase in the Euro-banks' direct lending to non-banks was substantially smaller than in 1970.

On the other hand, shaken confidence in the dollar led at times to a demand for Euro-dollar funds for conversion into other currencies, although, on the whole, less evidence of this kind of activity is to be found in the Euro-currency statistics than might perhaps have been expected.

The combination of strong expansionary factors affecting the supply side of the market and several contractive influences on the demand side produced a decline in Euro-currency interest rates which was particularly pronounced in the case of non-dollar currencies. As the continued rapid growth of the market shows, however, this decline in rates was quite effective in attracting new borrowers to the market. Indeed, the 1971 increase in the banks' lending to countries (other than the United States) outside the reporting European area was by far the largest yet recorded.

A rather special factor which inflated the end-year figures in terms of dollars was the exchange rate realignment; this was, of course, reflected only in non-dollar assets and liabilities. Since the conversion methods used by the individual reporting banks and countries differ, it is not possible to give an exact figure for this revaluation effect. In round figures, however, its impact on the banks' external assets and liabilities may be estimated at $3 milliard. On the other hand, the figures do not show the full increase in external positions which occurred in 1971, since, owing to accounting changes, figures for Swiss banks uniformly exclude, as from September, their trustee accounts. The net effect on the gross figures of these two special influences was to understate the growth of the banks' dollar positions by about $1.5 milliard, and to boost that of the non-dollar positions by somewhat over $2.0 milliard.

The Euro-currency market during the currency crises.

Since the main forces shaping the development of the market underwent a radical change in the course of the year, it is of interest to trace the 1971 evolution of the market on a quarter-by-quarter basis.

In the first three months of 1971, against the usual seasonal trend, the market continued to expand quite strongly. Despite large US repayments, the increase in the banks' foreign currency assets was slightly larger than it had been in the first quarter of 1969, when banks in the United States had been borrowing heavily in the Euro-currency market. As in 1970, the dominant expansionary force was borrowing by non-bank firms, a development which reflected the combination of falling Euro-currency rates and continuing credit tightness in several European countries, notably Germany. Thus $2.4 milliard, or about 70 per cent., of the first-quarter increase in the reporting banks' assets was accounted for by direct lending to non-banks. A major part of these funds was provided by the banks' own switching out of domestic currency into dollars, and their net assets in dollars rose by $1.2 to 2.9 milliard.

The second quarter was the time of the first big confidence movement out of dollars into certain European currencies, notably into Deutsche Mark. However, owing partly to the fact that the movements which occurred during April and May were largely reversed in June, they were scarcely reflected in the quarterly Euro-currency statistics. On the contrary, the reporting European banks' net assets in dollars continued to rise, while their net position in the other reported currencies declined. Moreover, the increase in their claims on Germany slowed down from $1.5 milliard in the first quarter to $0.3 milliard. And, finally, there does not appear to have been heavy Euro-dollar borrowing by non-banks for hedging or outright speculative purposes, since the reporting banks' new dollar lending to non-banks decelerated from $1.5 milliard in the first quarter to $0.7 milliard. The only sign of a change in sentiment was the sharp rise in the banks' external liabilities in foreign currencies other than dollars, which, at $2.4 milliard ($2.0 milliard in Deutsche Mark), was the biggest quarterly increase ever recorded. But the reporting banks switched back about $1.0 milliard of their Deutsche Mark receipts into dollars and other currencies and thus, by helping to take the upward pressure off the Deutsche Mark, actually exerted a stabilising influence on the exchange markets.

External positions of reporting European banks in dollars and other foreign currencies.

End of month	Dollars: Total	Dollars: *of which* Non-banks	Other foreign currencies: Total	*of which* Non-banks	Deutsche Mark	Swiss francs	Sterling	Guilders	All other foreign currencies
	In millions of US dollars								
Liabilities									
1966 December .	14,770	4,130	3,690	510	970	1,220	710	70	720
1967 June . . .	14,930	4,090	4,290	510	1,470	1,300	950	90	480
1967 December .	18,120	4,680	4,330	470	1,670	1,400	800	100	360
1968 June . . .	22,380	6,390	5,800	700	2,180	2,030	1,020	120	450
1968 December .	26,870	6,240	6,890	1,040	3,010	2,290	800	250	540
1969 March . . .	29,860	7,600	7,670	930	3,060	2,800	900	280	630
1969 June . . .	37,960	8,690	9,450	1,320	4,260	3,290	910	340	650
1969 September.	41,540	9,960	10,240	1,340	4,800	3,790	760	240	650
1969 December .	46,200	10,460	10,630	1,320	4,640	4,030	810	350	800
1970 March . . .	46,050	11,100	11,420	1,370	4,430	4,960	970	350	710
1970 June . . .	49,440	11,000	13,090	1,660	5,550	5,360	940	410	830
1970 September.	50,230	10,770	15,190	2,310	6,830	5,740	940	550	1,130
1970 December .	58,700	11,240	16,590	2,450	8,080	5,720	940	550	1,300
1971 March . . .	59,600	11,120	18,000	2,530	9,360	5,250	1,320	450	1,620
1971 June . . .	61,930	10,910	20,400	3,110	11,330	5,670	1,420	490	1,490
1971 September*	62,430	9,380	22,650	2,700	12,380	6,730	1,460	510	1,570
1971 December .	70,820	9,980	27,110	2,750	14,890	7,760	2,110	860	1,490
Assets									
1966 December .	16,070	2,100	4,180	690	1,420	930	800	170	860
1967 June . . .	16,580	2,650	4,870	810	1,670	830	1,340	200	830
1967 December .	19,890	3,430	4,960	850	2,060	1,110	870	230	690
1968 June . . .	25,560	4,320	5,890	1,340	2,730	1,570	600	280	710
1968 December .	30,430	5,150	7,400	1,500	3,920	1,820	610	290	760
1969 March . . .	33,650	5,230	7,440	1,670	4,020	1,850	590	250	730
1969 June . . .	42,280	5,940	9,180	2,030	5,380	2,010	670	310	810
1969 September.	44,820	6,110	10,820	2,520	6,980	2,240	630	240	730
1969 December .	47,630	6,090	10,690	2,160	5,990	2,980	580	370	770
1970 March . . .	46,970	6,760	11,760	2,470	6,270	3,490	880	340	780
1970 June . . .	52,030	8,560	13,100	2,980	6,850	3,930	710	470	1,140
1970 September.	52,930	9,890	15,470	3,940	8,140	4,540	640	550	1,600
1970 December .	60,370	11,850	17,880	4,670	10,110	5,080	610	560	1,520
1971 March . . .	62,460	13,380	19,220	5,590	11,440	4,500	930	490	1,860
1971 June . . .	65,080	14,040	20,750	5,960	12,450	5,000	950	510	1,840
1971 September*	63,440	13,830	23,910	6,350	13,680	6,420	1,200	480	2,130
1971 December .	71,720	14,360	28,690	6,750	16,160	8,180	1,620	700	2,030
Net position									
1966 December .	1,300	–2,030	490	180	450	– 290	90	100	140
1967 June . . .	1,650	–1,440	580	300	200	– 470	390	110	350
1967 December .	1,770	–1,250	630	380	390	– 290	70	130	330
1968 June . . .	3,160	–2,070	90	640	550	– 460	– 420	160	260
1968 December .	3,560	–1,090	510	460	910	– 470	– 190	40	220
1969 March . . .	3,770	–2,370	– 230	740	960	– 950	– 310	– 30	100
1969 June . . .	4,320	–2,750	– 270	710	1,120	–1,280	– 240	– 30	160
1969 September.	3,280	–3,850	580	1,180	2,180	–1,550	– 130	—	80
1969 December .	1,430	–4,370	60	840	1,350	–1,050	– 230	20	– 30
1970 March . . .	920	–4,340	340	1,100	1,840	–1,470	– 90	– 10	70
1970 June . . .	2,590	–2,440	10	1,320	1,300	–1,430	– 230	60	310
1970 September.	2,700	– 880	280	1,630	1,310	–1,200	– 300	—	470
1970 December .	1,670	610	1,290	2,220	2,030	– 640	– 330	10	220
1971 March . . .	2,860	2,260	1,220	3,060	2,080	– 750	– 390	40	240
1971 June . . .	3,150	3,130	350	2,850	1,120	– 670	– 470	20	350
1971 September*	1,010	4,450	1,260	3,650	1,300	– 310	– 260	– 30	560
1971 December .	900	4,380	1,580	4,000	1,270	420	– 490	– 160	540

* New series as from September 1971

The situation changed in the third quarter. (Owing to the break in series caused by the exclusion of trustee funds, i.e. funds administered by Swiss banks at their clients' risk, the Swiss banks' positions have to be disregarded in considering the third-quarter figures. For the same reason all figures for previous quarters used for comparison in this and the following two paragraphs leave the Swiss banks out of account.) One significant development was the abrupt slow-down from $3.3 to 0.3 milliard in the increase in the banks' external lending in dollars and the acceleration in that in other foreign currencies from $1.1 to 3.8 milliard. The slow-down in the growth of their dollar liabilities was much less pronounced. As a result, the banks' net movement of $1.6 milliard into dollars in the first half of 1971 was reversed to the extent of $1.3 milliard, while at the same time their net external position in other foreign currencies, which had shifted from $0.4 milliard of assets to $1.2 milliard of liabilities in the first six months of the year, improved by $1.0 milliard; in addition, the banks seem to have reduced their dollar lending to residents by about $0.3 milliard.

On the other hand, as in the second quarter, there was very little evidence of Euro-dollar borrowing by non-bank firms for hedging or speculative purposes. In fact, after a $2.0 milliard increase in the first half of the year the reporting banks' external dollar assets vis-à-vis non-banks showed a $0.1 milliard decline. But perhaps the most remarkable feature of the third quarter was that despite the dollar crisis there was nothing like a flight of funds from the Euro-dollar market. As in the first and second quarters, the reporting banks' dollar liabilities to non-banks showed very little change. What did happen was that US residents' funds, attracted by the high Euro-dollar rates during August and September, took the place of non-bank funds withdrawn from the market by residents of other countries. Although this kind of substitution certainly added to the pressure on the dollar, the amounts involved were fairly small.

Instead of leading to an actual shrinkage of the market's dollar component, the currency crisis thus had the effect that, in contrast to the usual currency pattern, most of the $4.3 and 4.1 milliard growth in the reporting banks' assets and liabilities during the third quarter was in currencies other than the dollar.

In the fourth quarter the growth of the market accelerated sharply. At $12.9 and 13.1 milliard respectively, the increase in the banks' external foreign currency liabilities and assets was bigger than it had been in the first three quarters taken together, and it even exceeded the record expansion registered in the second quarter of 1969, when the demand pressure from US banks had led to near-crisis conditions in the market. It is true that an acceleration in the fourth quarter is the usual seasonal pattern and that a substantial part of the growth in the non-dollar component of the market was due to the revaluation effect; nevertheless, it is quite remarkable that despite large repayments from the United States, continuing uncertainties and widespread controls on residents' Euro-currency borrowing the market should have shown such a rapid expansion. In contrast to the usual seasonal pattern, the banks' switching out of dollars came to a halt. Moreover, the currency composition of the market's growth returned to normal, with the dollar component again accounting for the bulk of the increase in gross positions. What is perhaps most surprising is that dollar liabilities to non-banks went up by $0.6 milliard, which was the first increase since the fourth quarter of 1970. The dominant feature of the fourth quarter, however, was the huge $12.1 milliard increase in interbank lending, which can be partly explained by end-of-year operations. Direct lending to non-bank firms, the expansion in which had practically ceased in the third quarter, also picked up somewhat.

To sum up, although it had sometimes been feared that a dollar crisis such as occurred in 1971 might lead to a run on the Euro-dollar market, in fact nothing of the sort happened. Even during the crisis months there was some flow of dollars to the reporting European banks, and the only lasting trace the developments in the exchange markets seem to have left is an increase in the importance of the non-dollar currencies. Similarly, the quarterly statistics do not lend much support to assertions that the Euro-currency market played a leading rôle in the exchange-market turmoils in 1971. If that had been the case, the figures for the crisis periods would have shown large movements by the reporting banks themselves out of dollars or large increases in their dollar lending to non-banks, which then might have used these funds for hedging or speculative purposes; however, neither of these things seems to have happened on a really large scale.

The composition of the changes.

Taking the year as a whole, the reporting banks' external dollar assets rose by $11.3 milliard, or 19 per cent., and their liabilities by $12.1 milliard, or 21 per cent. The resultant $0.8 milliard decline in net assets was more than accounted for by two special influences. Firstly, the BIS, whose Euro-currency assets are included in the figures for the Swiss banks' foreign claims, shifted a substantial amount of funds from the Euro-dollar market to the United States. Secondly, the exclusion of trustee funds from the statistics as from the third quarter reduced optically the Swiss banks' net external asset position. Had it not been for these two factors, the reporting European banks would have shown a substantial increase in their net dollar assets.

External assets in other currencies rose by $10.8 milliard and liabilities by $10.5 milliard, or by about 60 per cent. in each case. As a result of this very rapid growth, the non-dollar component in the banks' external foreign currency positions expanded from 22 per cent. in 1970 to 28 per cent. a year later. Deutsche Mark alone accounted for 62 per cent. of the expansion and Swiss francs for another 25 per cent. However, in relative terms the largest increases occurred in sterling, with assets in that currency advancing from $0.6 to 1.6 milliard and liabilities from $0.9 to 2.1 milliard; this development was probably due to the much greater firmness of sterling in the exchange markets. In contrast to developments in earlier periods of upward pressure on the Deutsche Mark, the banks' net asset position in that currency dropped from $2.0 to 1.3 milliard. The net position in Swiss francs, on the other hand, shifted from $0.6 milliard of liabilities at the end of 1970 to $0.4 milliard of assets a year later; the greater part of this turn-round occurred during the fourth quarter and may have been related to the exceptionally wide forward premium registered by the Swiss franc during that period, which made Euro-Swiss franc holdings on a covered basis quite attractive.

A break-down of the figures between the bank and non-bank sectors shows that new foreign lending to non-banks slowed down from $8.3 milliard in 1970 to

$4.6 milliard in 1971, while the increase in claims on banks accelerated from $11.7 to 17.6 milliard. On the liabilities side, the overall rise was more than accounted for by borrowing from banks, which amounted to $23.6 milliard, while liabilities vis-à-vis non-banks actually declined by $1.0 milliard. However, the latter figure was influenced by the change in the Swiss banks' basis for reporting. Without the third-quarter changes in respect of Swiss banks, indebtedness vis-à-vis non-banks recorded a slight growth of $1.1 milliard, compared with increases of $4.5 and 1.9 milliard in 1969 and 1970 respectively. On this basis most of the 1971 expansion in liabilities to non-banks was in currencies other than dollars, whereas deposits received in dollars declined by $0.4 milliard in the first nine months of the year but went up by $0.6 milliard in the last quarter.

Sources and uses.

The tables on pages 155 and 156 indicate the origins and destinations of Euro-currency flows. The differences in the coverage and conception of the two tables have been described in previous Annual Reports, but it may be useful to mention some of the main ones again.

Both tables try to show the rôle of the reporting European banks as foreign currency intermediaries; they indicate where their foreign currency funds have come from and where they have been re-lent. The table on page 155 is more comprehensive in that — on the basis of rough estimates — it includes on the sources side the Euro-currency funds supplied by the banks themselves by switching out of domestic currency and on the uses side the Euro-currency funds employed by the banks for switching into domestic currency. Moreover, it includes the banks' position vis-à-vis domestic non-bank residents. On the other hand, it excludes the double-counting that arises when funds on their way from the original suppliers to the ultimate users pass through more than one reporting bank; this, together with some downward adjustments of the positions vis-à-vis the United States, explains why the totals are smaller than those given in the table on page 156.

Since the market is seen from the angle of the reporting European banks, all liabilities and assets vis-à-vis countries outside the reporting area, whether they be vis-à-vis banks or non-banks, are considered respectively as original sources and final uses of Euro-currency funds. The use of the adjectives "original" and "final" in this context is not, however, meant to imply that the line of causation runs only from sources to uses, and it is in fact quite likely that some part of the funds placed with banks outside the reporting area is redeposited by these banks within the reporting area. Except for the fact that it makes some allowance for the market's rôle as an interbank money market within the area, what the table basically does is to present a consolidated balance sheet of the reporting European banks' foreign currency business.

Defined along these lines, the Euro-currency market may be estimated to have expanded by $14 milliard to $71 milliard in 1971, and its dollar component from about $46 to 54 milliard. The geographical pattern of this increase was quite similar to that in 1970. In very approximate figures, assets vis-à-vis the United States declined by

Estimated size of the Euro-currency market
(outstanding amount of foreign currency credits channelled through reporting European banks).

End of period	Reporting European area: Total	of which: Banks[1]	of which: Non-banks	United States	Rest of the world	Total
	in milliards of US dollars					
Uses						
1969	15.2	7.1	8.1	16.8	12.0	44.0
1970	24.9	9.8	15.1	13.1	19.0	57.0
1971	33.6	14.5	19.1	8.3	29.1	71.0
Sources						
1969	22.3	10.7	11.6[2]	4.1	17.6	44.0
1970	28.5	15.0	13.5[2]	4.5	24.0	57.0
1971	33.4	18.2	15.2[2]	6.1	31.5	71.0
Net position[3]						
1969	− 7.1	− 3.6	− 3.5	+ 12.7	− 5.6	—
1970	− 3.6	− 5.2	+ 1.6	+ 8.6	− 5.0	—
1971	+ 0.2	− 3.7	+ 3.9	+ 2.2	− 2.4	—

[1] Includes: (a) under "Uses", the banks' conversions from foreign currency into domestic currency and foreign *currency funds supplied by the reporting banks to the commercial banks of the country of issue of the currency* in question (such as DM funds deposited with German banks); (b) under "Sources", deposits by official monetary institutions of the reporting area, the banks' conversions from domestic into foreign currency and foreign currency funds obtained by the reporting banks from the banks in the country of issue of the currency in question (such as funds received in Deutsche Mark from German banks). [2] Including trustee funds to the extent that they are transmitted by the Swiss banks to the other banks within the reporting area and to the extent that they are not reported as liabilities vis-à-vis non-banks outside the reporting area by the Swiss banks themselves. [3] A minus sign indicates that the country or area in question is a net supplier of Euro-currency funds, whereas a plus sign indicates that it is a net user.

$5 milliard, whereas claims on the rest of the outside world went up by $10 milliard and those on the reporting area by $9 milliard. On the sources side, the distribution was a more even one; about $5 milliard was provided from within the reporting area, $1.5 milliard flowed in from the United States and $7.5 milliard came from the rest of the outside world. On a net basis, therefore, the main feature of 1971 was a $6.5 milliard outflow from the United States, about $4.0 milliard of which was absorbed by the reporting European area while $2.5 milliard was rechannelled to the rest of the outside world. As a result of these flows and of the similar movements which occurred in 1970, the reporting European banks' net creditor position vis-à-vis the United States, which had amounted to about $12.5 milliard at the end of 1969, was reduced to $2 milliard at the end of 1971; their net debtor position vis-à-vis their own area, which had stood at $7 milliard, was eliminated; and their net liabilities to the rest of the outside area declined from $5.5 to 2.5 milliard.

Returning to the gross figures, the $4.8 milliard decrease in claims on the United States reflected, of course, the easy stance of US monetary policy and the resultant repayments by the US banks to their foreign branches. The consequent downward pressure on Euro-currency rates encouraged Euro-currency borrowing by the rest of the world. Thus, at about $10 milliard, the rise in the reporting banks' claims on the rest of the outside area was three and a half times as large as in 1969, when the US banks had nearly pre-empted the market. As can be seen from the table on page 156, particularly large increases in lending occurred vis-à-vis "Other western Europe" (+$2.2 milliard), Latin America (+$1.5 milliard), eastern Europe (+$1.3 milliard) and Japan (+$1.0 milliard); but, at $3.7 milliard, by far the largest expansion was in the residual item "Other", which includes, for instance, the Bahamas and Bermuda.

Foreign currency positions of reporting European banks vis-à-vis non-residents.

Positions vis-à-vis	December 1970			June 1971			December 1971*		
	Dollars	All other currencies	Total	Dollars	All other currencies	Total	Dollars	All other currencies	Total
	in millions of US dollars								
	Liabilities								
Outside area									
Other western Europe	4,470	640	5,110	4,300	1,370	5,670	4,930	2,410	7,340
Eastern Europe	1,020	630	1,650	910	700	1,610	1,230	1,070	2,300
Canada	3,780	150	3,930	4,000	320	4,320	3,990	390	4,380
Japan	550	30	580	780	40	820	900	40	940
Latin America	3,670	440	4,110	3,910	630	4,540	4,130	760	4,890
Middle East	2,680	440	3,120	3,760	800	4,560	3,970	1,170	5,140
Other	4,670	870	5,540	5,030	1,120	6,150	5,140	1,400	6,540
Total	20,840	3,200	24,040	22,690	4,980	27,670	24,290	7,240	31,530
United States	5,000	240	5,240	5,290	360	5,650	6,490	330	6,820
Total outside area	25,840	3,440	29,280	27,980	5,340	33,320	30,780	7,570	38,350
Inside area									
Belgium	2,050	930	2,980	2,130	1,210	3,340	2,240	1,470	3,710
France	3,940	1,150	5,090	3,960	1,150	5,110	5,950	1,440	7,390
Germany	1,470	1,660	3,130	1,280	1,930	3,210	1,450	2,010	3,460
Italy	5,000	1,520	6,520	5,210	1,400	6,610	6,340	2,140	8,480
Netherlands	2,500	840	3,340	2,890	790	3,680	2,660	1,680	4,340
Sweden	360	80	440	410	110	520	400	160	560
Switzerland	10,970	5,510	16,480	10,560	6,560	17,120	11,580	7,830	19,410
United Kingdom	5,990	1,070	7,060	6,790	1,530	8,320	8,600	2,450	11,050
Total inside area	32,280	12,760	45,040	33,230	14,680	47,910	39,220	19,180	58,400
Unallocated	580	390	970	720	380	1,100	820	360	1,180
Grand total	58,700	16,590	75,290	61,930	20,400	82,330	70,820	27,110	97,930
	Assets								
Outside area									
Other western Europe	2,600	890	3,490	3,330	1,110	4,440	3,980	1,700	5,680
Eastern Europe	1,650	500	2,150	2,100	640	2,740	2,360	1,110	3,470
Canada	2,320	170	2,490	2,370	170	2,540	1,800	400	2,200
Japan	2,320	240	2,560	2,420	390	2,810	3,090	430	3,520
Latin America	2,470	690	3,160	3,550	600	4,150	4,090	610	4,700
Middle East	810	80	890	900	120	1,020	1,190	200	1,390
Other	3,780	620	4,400	5,130	760	5,890	6,780	1,350	8,130
Total	15,950	3,190	19,140	19,800	3,790	23,590	23,290	5,800	29,090
United States	13,990	350	14,340	11,710	250	11,960	9,260	350	9,610
Total outside area	29,940	3,540	33,480	31,510	4,040	35,550	32,550	6,150	38,700
Inside area									
Belgium	2,260	1,420	3,680	2,670	1,590	4,260	3,170	2,370	5,540
France	4,680	1,160	5,840	5,280	1,270	6,550	6,710	1,950	8,660
Germany	2,870	5,410	8,280	3,080	7,010	10,090	2,640	8,390	11,030
Italy	5,510	1,030	6,540	5,600	1,220	6,820	6,930	1,920	8,850
Netherlands	1,610	980	2,590	1,790	1,110	2,900	1,790	1,120	2,910
Sweden	480	260	740	580	220	800	570	430	1,000
Switzerland	2,500	1,550	4,050	3,130	1,320	4,450	3,720	2,200	5,920
United Kingdom	10,250	1,980	12,230	11,430	2,470	13,900	12,990	3,730	16,720
Total inside area	30,160	13,790	43,950	33,560	16,210	49,770	38,520	22,110	60,630
Unallocated	270	550	820	10	500	510	650	430	1,080
Grand total	60,370	17,880	78,250	65,080	20,750	85,830	71,720	28,690	100,410

*Break in series between June and December 1971.

On the other hand, claims on Canada, where monetary conditions were somewhat similar to those in the United States, declined by $0.3 milliard.

The employment of Euro-currency funds within the reporting European area is estimated to have gone up by $8.7 milliard; the fact that despite its wider coverage — for it includes claims on residents and the switching of Euro-funds into domestic currency — this figure is much smaller than the $16.7 milliard increase which emerges from the table on page 156 is due to the elimination of double-counting resulting from redepositing between banks. The banks' direct foreign currency lending to non-banks within the reporting area went up by $4.0 milliard, or by $3.0 milliard less than in 1971. This slow-down, which would have been even more pronounced had it not been for the revaluation factor, reflected the sharp contraction in German firms' Euro-currency borrowing after the floating of the Deutsche Mark, the cessation of borrowing — and, in fact, repayments — by Italian public enterprises and the various measures inhibiting residents' recourse to the Euro-currency market in general. The banks' own use of Euro-currency funds is estimated to have gone up by $4.7 milliard. Apart from the revaluation effect and fairly sharp increases in Euro-sterling and Euro-French franc borrowing by the UK and French banks respectively, this expansion mainly reflected the rôle of the Euro-currency market as an interbank money market in general.

On the sources side, funds supplied from within the reporting European area are estimated to have risen by $5 milliard. Within this increase, funds obtained from non-banks went up by $1.7 milliard to $15.2 milliard; these two figures, however, include trustee funds transmitted by the Swiss banks to other banks in the reporting area, and since these funds probably derive to a considerable extent from outside Europe, the figures tend to overstate the rôle of the reporting European area on the supply side of the market.

The $1.6 milliard increase in liabilities to the United States, which was the largest expansion recorded in this item in any year except 1968, reflected both the liquid state of the US economy and the wide premium registered — particularly during the exchange crises — by Euro-dollar rates over US money-market yields.

The dominant influence behind the $7.5 milliard increase in funds received from the rest of the outside world seems to have been deposits by central banks. This holds true particularly for the $2.2 milliard and $2.0 milliard growth in liabilities to "Other western Europe" and the Middle East (including Libya) respectively.

On a net basis, the largest single movements during 1971 — apart from the $6.4 milliard reflux from the United States — were $1.5 and 0.7 milliard flows from the Middle East and Canada to the reporting European banks and a $2.7 milliard flow from the reporting European banks to the countries and areas grouped under "Other", as well as $0.8 and 0.7 milliard flows to Latin America and eastern Europe respectively.

Within the reporting European area, the banks' external positions in foreign currencies (see the table on page 156) showed, as usual, a major expansion in net liabilities to Switzerland, which, however, at $1.1 milliard, was smaller than the $4.5 and 3.9 milliard increases recorded in 1969 and 1970 respectively. In addition, there was in

1971 a $0.7 milliard growth in net liabilities to the Netherlands. On the other hand, the banks achieved a $2.4 milliard increase in their net asset position vis-à-vis Germany, most of it in the first part of the year; moreover, there were increases of $0.5 milliard each in net lending to the United Kingdom and France. A $1.1 milliard increase in the reporting banks' net assets vis-à-vis Belgium did not mean that these funds were all used in that country; it mainly reflected the intermediary rôle of the Belgian banks, which took up funds from other banks within the reporting European area and re-lent them to non-banks outside Belgium.

Individual reporting countries.

Reflecting the central rôle played by London in the Euro-currency market, the *UK banks,* as usual, showed by far the largest increase in external foreign currency positions. They accounted for 42 per cent. of the total growth in liabilities and 36 per cent. of that in assets. However, their total share of the market, which had already contracted from 50 to 47 per cent. in 1970, decreased further to 45 per cent. As in 1970, the decline was chiefly due to three developments.

The first of these was the increasing importance of the non-dollar component, in which London's predominance is much less pronounced than in the case of the dollar. In fact, quite a different picture is obtained if these two market segments are considered separately. Thus, it is seen that the UK banks' share in dollar positions fell only from 51 to 50 per cent. in 1971, while their share of business in other foreign currencies went up from 32 to 33 per cent.

The second influence was the declining rôle of the US banks' foreign branches in London. Whereas the "Other overseas banks" plus the acceptance houses showed a 29 per cent. increase in their foreign currency advances to non-residents, such advances by the US branches edged up by only 2.5 per cent.; it should be noted, however, that this near-stagnation conceals a shift of the order of several milliard dollars from loans to head offices to lending mainly outside the United States. The total share of the US branches in advances to non-residents, which had already dropped from 65 per cent. to 57 per cent. in 1970, declined further in 1971 to 51 per cent. In fact, in 1971 the US banks placed the greater part of their new funds with other banks in London, which then re-lent most of these funds abroad. The most rapid expansion in external advances in foreign currencies was achieved by the "Other foreign banks and affiliates" in London, with an increase of 63.5 per cent.

The third development was the large further expansion in UK banks' lending to residents of foreign currency borrowed from non-residents. This can be seen from the fact that of the $1.2 milliard increase during 1971 in UK banks' net foreign currency liabilities to non-residents two-thirds, or $0.8 milliard, had a counterpart in a rise in net foreign currency claims on residents. Most of this lending was to finance UK companies' overseas investments.

After the UK banks the *French banks* recorded the largest increase in external foreign currency liabilities, namely $4.8 milliard; their assets rose by $3.7 milliard. The resultant increase from $0.9 to 2 milliard in their net external debtor position reflected fairly closely the crisis in the exchange markets. Thus, in the summer quarter the French banks' net external liabilities in dollars rose by $0.5 milliard; since those in other foreign currencies also went up — by $0.1 milliard — and since there was a decline in their net dollar claims on residents, all of these funds were apparently switched into French francs. What probably happened was that the banks sold the dollars mainly to cover their forward purchases of dollars from customers. In addition, their net external liabilities in domestic currency rose by $0.6 milliard, so that there was a net inflow of $1.2 milliard through the banks in the third quarter.

Also in the third quarter, the *Dutch banks* drew down their net dollar assets by $0.4 milliard but used the proceeds to reduce their net debtor position in other foreign currencies.

The *Italian banks*, in contrast, swam against the tide; between March and September they improved their net external position in dollars from $0.3 milliard of liabilities to $0.8 milliard of assets, while their position in other foreign currencies shifted from $0.2 milliard of assets to $0.3 milliard of liabilities.

Among continental European countries the *Belgium-Luxemburg banks* hold first place in two respects. They transact the largest volume of business in Euro-currencies other than dollars and they are the largest direct lenders to foreign non-bank residents. In 1971 their gross assets in foreign currencies other than dollars went up by 88 per cent. and those in Deutsche Mark alone doubled. Moreover, they took up substantial funds from banks abroad and re-lent them to foreign non-banks, so that, while their total net external position showed little change, their net claims on foreign non-banks went up from $1.5 to 2.5 milliard. Their gross claims rose by $1.4 milliard, nearly half of which was vis-à-vis Germany.

In the case of Germany, whose currency is used widely for Euro-currency purposes, and where, in contrast to most other countries, official regulations do not discriminate between external positions in domestic and foreign currency, it is appropriate to consider the banks' total foreign positions. Thus, in 1971 the *German banks'* net external short-term indebtedness, nearly the whole of which is in Deutsche Mark, rose by $0.5 to 4.2 milliard. The major part of this expansion was the statistical reflection of the exchange rate changes; the smallness of the real increase — about $0.1 milliard — was largely due to the interest ban and to the high reserve requirements imposed on funds obtained from abroad. There was, however, a substantial inflow in the form of long-term borrowing and of sales of long-term assets, which are not covered by the regulations.

The *Swiss banks* are the biggest net suppliers of Euro-currency funds. In the first half of 1971 they increased their net external lending in foreign currencies other than the dollar by $0.7 milliard. Their net claims in dollars showed virtually no change, but this was due solely to a substantial reduction in the Euro-dollar placements of the BIS, which are included under the Swiss banks' foreign positions. The figures for the third quarter are not representative because of the break in series already referred to; nevertheless, there is some evidence of a tendency in that period to hold foreign assets in Swiss francs rather than dollars. However, by the fourth quarter the situation was back to normal. The banks increased their net external assets in foreign currencies

External liabilities and assets of banks in individual reporting countries in domestic and foreign currencies.

Countries	End of month	Liabilities		Assets		Net position		
		Domestic currency	Foreign currencies	Domestic currency	Foreign currencies	Domestic currency	Foreign currencies	Total
		in millions of US dollars						
Belgium-Luxemburg	1970 December	620	6,810	390	6,300	− 230	− 510	− 740
	1971 March	670	7,670	390	7,160	− 280	− 510	− 790
	June	720	8,020	450	7,580	− 270	− 440	− 710
	September	790	8,970	470	8,560	− 320	− 410	− 730
	December	890	10,500	480	10,120	− 410	− 380	− 790
France . . .	1970 December	1,290	9,150	340	8,260	− 950	− 890	− 1,840
	1971 March	1,350	9,550	270	8,620	− 1,080	− 930	− 2,010
	June	1,310	11,320	370	9,990	− 940	−1,330	− 2,270
	September	2,110	12,430	520	10,510	− 1,590	−1,920	− 3,510
	December	1,810	13,900	570	11,950	− 1,240	−1,950	− 3,190
Germany . .	1970 December	4,930	2,900	1,840	2,320	− 3,090	− 580	− 3,670
	1971 March	4,460	2,760	2,380	2,560	− 2,080	− 200	− 2,280
	June	4,150	2,320	2,790	2,370	− 1,360	50	− 1,310
	September	4,150	2,340	2,740	2,230	− 1,410	− 110	− 1,520
	December	6,050	3,110	2,160	2,790	− 3,890	− 320	− 4,210
Italy	1970 December	580	9,390	350	9,340	− 230	− 50	− 280
	1971 March	720	8,730	330	8,630	− 390	− 100	− 490
	June	800	8,880	360	8,980	− 440	100	− 340
	September	800	9,240	260	9,660	− 540	420	− 120
	December	890	12,410	230	12,550	− 660	140	− 520
Netherlands .	1970 December	1,110	4,020	620	4,270	− 490	250	− 240
	1971 March	1,150	4,420	530	4,700	− 620	280	− 340
	June	1,100	4,520	580	4,820	− 520	300	− 220
	September	1,220	4,610	560	5,070	− 660	460	− 200
	December	1,270	4,940	660	5,610	− 610	670	60
Sweden . .	1970 December	280	470	160	740	− 120	270	150
	1971 March	260	620	140	860	− 120	240	120
	June	270	620	130	910	− 140	290	150
	September	250	630	100	940	− 150	310	160
	December	290	640	120	950	− 170	310	140
Switzerland[1]	1970 December	5,460	6,140	5,120	11,730	− 340	5,590	5,250
	1971 March	5,890	6,980	5,640	13,620	− 250	6,640	6,390
	June	6,450	7,210	5,840	13,380	− 610	6,170	5,560
	September[2]	6,320	5,630	6,010	10,830	− 310	5,200	4,890
	December	6,800	6,510	6,290	12,820	− 510	6,310	5,800
United Kingdom .	1970 December	4,430	36,410	1,000	35,290	− 3,430	−1,120	− 4,550
	1971 March	4,590	36,870	850	35,530	− 3,740	−1,340	− 5,080
	June	4,650	39,440	1,060	37,800	− 3,590	−1,640	− 5,230
	September	5,500	41,230	850	39,550	− 4,650	−1,680	− 6,330
	December	6,860	45,920	1,070	43,620	− 5,790	−2,300	− 8,090
Total . .	1970 December	18,700	75,290	9,820	78,250	− 8,880	2,960	− 5,920
	1971 March	19,090	77,600	10,530	81,680	− 8,560	4,080	− 4,480
	June	19,450	82,330	11,580	85,830	− 7,870	3,500	− 4,370
	September[2]	21,140	85,080	11,510	87,350	− 9,630	2,270	− 7,360
	December	24,860	97,930	11,580	100,410	−13,280	2,480	−10,800
Canada . . .	1970 December	750	5,500	190	7,600	− 560	2,100	1,540
	1971 March	790	5,350	430	6,760	− 360	1,410	1,050
	June	800	5,450	270	6,750	− 530	1,300	770
	September	760	5,790	190	6,780	− 570	990	420
	December	830	6,280	230	6,990	− 600	710	110
Japan . . .	1970 December	540	5,000	10	7,320	− 530	2,320	1,790
	1971 March	680	4,740	10	6,990	− 670	2,250	1,580
	June	850	4,960	20	7,670	− 830	2,710	1,880
	September	910	5,880	30	7,150	− 880	1,270	390
	December	940	6,560	60	6,820	− 880	260	− 620

[1] Including Euro-currency assets and liabilities of the BIS. [2] New series as from September 1971.

External liabilities and assets of banks in individual reporting countries in dollars and other foreign currencies.

Countries	End of month		US dollars: Liabilities	US dollars: Assets	US dollars: Net	All other foreign currencies: Liabilities	All other foreign currencies: Assets	All other foreign currencies: Net
			in millions of US dollars					
Belgium-Luxemburg	1970	December	3,730	3,330	— 400	3,080	2,970	— 110
	1971	March	4,340	3,710	— 630	3,320	3,450	130
		June	4,310	3,950	— 360	3,710	3,630	— 80
		September	4,590	4,110	— 480	4,380	4,450	70
		December	5,090	4,530	— 560	5,410	5,590	180
France	1970	December	6,650	6,010	— 640	2,500	2,250	— 250
	1971	March	6,950	6,270	— 680	2,590	2,350	— 240
		June	8,250	7,340	— 910	3,080	2,650	— 430
		September	9,030	7,610	—1,420	3,410	2,900	— 510
		December	10,060	8,600	—1,460	3,840	3,350	— 490
Germany	1970	December	2,690	2,050	— 640	200	260	60
	1971	March	2,570	2,270	— 300	190	290	100
		June	2,100	2,020	— 80	220	350	130
		September	2,070	1,780	— 290	270	440	170
		December	2,680	2,200	— 480	430	590	160
Italy	1970	December	6,930	6,650	— 280	2,460	2,690	230
	1971	March	6,570	6,290	— 280	2,170	2,340	170
		June	6,330	6,740	410	2,550	2,240	— 310
		September	6,240	6,990	750	3,000	2,670	— 330
		December	8,150	8,660	510	4,260	3,890	— 370
Netherlands	1970	December	2,090	2,970	880	1,930	1,300	— 630
	1971	March	2,340	3,320	980	2,080	1,380	— 700
		June	2,250	3,470	1,220	2,260	1,350	— 910
		September	2,290	3,140	850	2,320	1,940	— 380
		December	2,450	3,170	720	2,490	2,440	— 50
Sweden	1970	December	320	520	200	160	230	70
	1971	March	420	600	180	210	260	50
		June	440	610	170	170	300	130
		September	430	620	190	200	320	120
		December	410	600	190	230	350	120
Switzerland[1]	1970	December	4,890	9,590	4,700	1,250	2,140	890
	1971	March	5,330	10,650	5,320	1,650	2,970	1,320
		June	5,390	10,010	4,620	1,830	3,370	1,540
		September[2]	4,360	8,120	3,760	1,260	2,700	1,440
		December	5,050	9,820	4,770	1,460	3,000	1,540
United Kingdom	1970	December	31,400	29,250	—2,150	5,010	6,040	1,030
	1971	March	31,080	29,350	—1,730	5,790	6,180	390
		June	32,860	30,940	—1,920	6,580	6,860	280
		September	33,420	31,070	—2,350	7,810	8,490	680
		December	36,930	34,140	—2,790	8,990	9,480	490
Total	1970	December	58,700	60,370	1,670	16,590	17,880	1,290
	1971	March	59,600	62,460	2,860	18,000	19,220	1,220
		June	61,930	65,080	3,150	20,400	20,750	350
		September[2]	62,430	63,440	1,010	22,650	23,910	1,260
		December	70,820	71,720	900	27,110	28,690	1,580
Canada	1970	December	5,370	7,430	2,060	130	170	40
	1971	March	5,230	6,570	1,340	120	190	70
		June	5,270	6,520	1,250	180	230	50
		September	5,600	6,520	920	190	260	70
		December	6,010	6,680	670	270	310	40
Japan	1970	December	4,680	6,870	2,190	320	450	130
	1971	March	4,460	6,520	2,060	280	470	190
		June	4,700	7,200	2,500	260	480	220
		September	5,690	6,680	990	190	470	280
		December	6,320	6,220	— 100	240	600	360

[1] Including Euro-currency assets and liabilities of the BIS. [2] New series as from September 1971.

by $1.1 milliard, mainly in dollars. Excluded from the fourth-quarter changes, and to a considerable extent also from the figures for the first half of the year, are the funds placed by the Swiss banks in the Euro-market at their customers' own risk, i.e. trustee funds.

In contrast to the preceding tables, the tables on pages 160 and 161 include the external positions of Canadian and Japanese banks.

The *Canadian banks* reduced their net creditor position vis-à-vis the United States by $1.5 milliard in 1971, so that if Canada were grouped together with the reporting European area the 1971 money flow from the United States to the Euro-currency market would have to be put at nearly $8 milliard. However, virtually the whole of the decline in the Canadian banks' net assets vis-à-vis the United States had as its counterpart a reduction in their foreign currency liabilities vis-à-vis residents, while their net position vis-à-vis the rest of the world showed little change.

The *Japanese banks'* net external creditor position in foreign currencies went up from $2.3 to 2.7 milliard in the first half of 1971 but dropped to $0.3 milliard in the second half. However, of this $2.4 milliard decline, $1.8 milliard was vis-à-vis the United States, whereas net borrowing in the Euro-market from UK banks went up by only about $0.3 milliard.

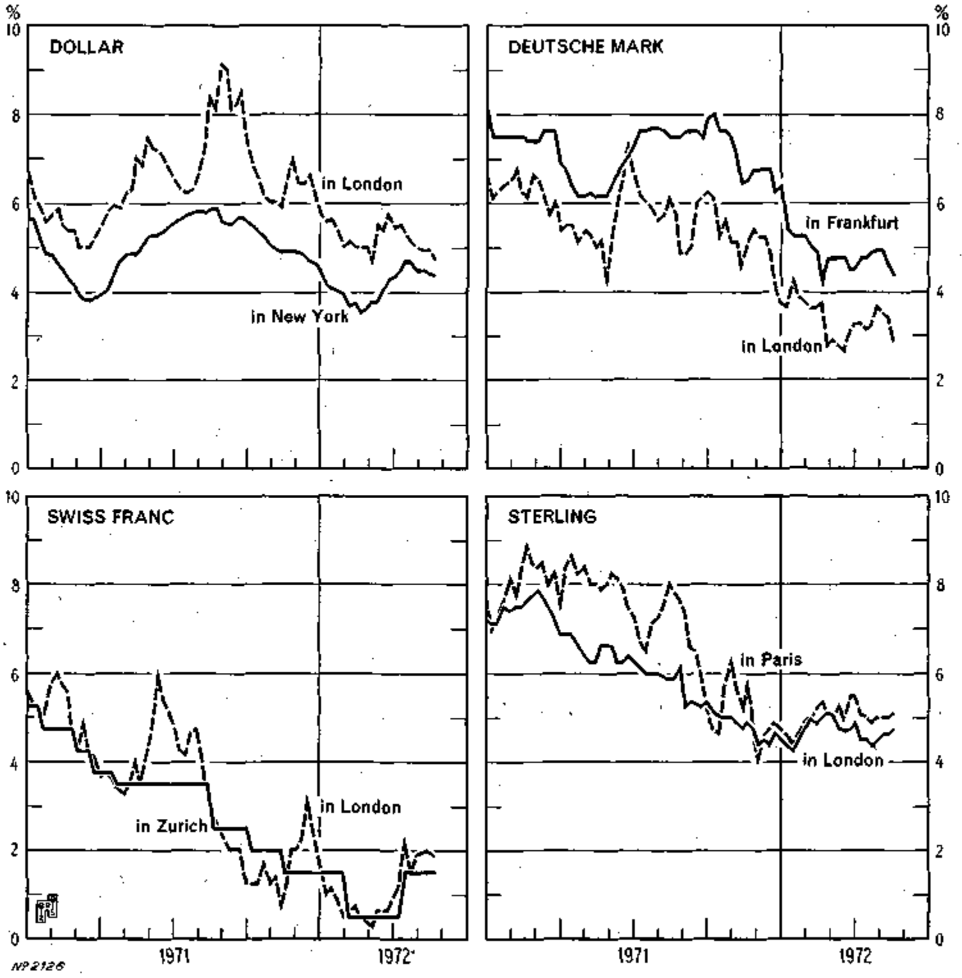
Interest rate developments.

The basic trend of Euro-dollar interest rates in 1971 was, as usual, dominated by developments in the United States, while the currency crises mainly accounted for the fluctuations around this trend.

Concurrently with the decline in US interest rates, the three-month Euro-dollar rate in London dropped to 5 per cent. in March — the lowest level for the year — and thus stood a full 7½ per cent. below the peak levels it had reached in 1969, though it continued to offer a comfortable premium over comparable rates in the United States. In view of the considerable repayments by US banks, this fall would have been even greater had it not been for strong demand from Germany and mopping-up operations by the US authorities.

However, with the renewed firming of US money-market conditions in the second quarter, Euro-dollar rates soon began to move up again, and under the influence of both the currency unrest and seasonal factors they touched 8¼ per cent. at the beginning of June. The temporary return to calm in the exchange markets and the unwinding of mid-year operations brought quotations back to below 6½ per cent. around the middle of July, but towards the end of the month the renewed outbreak of currency unrest began to push interest rates up once more. In August and early September the three-month rate at times exceeded 9 per cent., but rates receded quite sharply later in September and in October and dipped slightly below 6 per cent. in early November. Expectations regarding the outcome of the Group of Ten meetings in Rome and Washington, together with the usual end-year influences, contributed to some renewed tightening of rates in the second half of November. However, large US repayments — between 17th November and 15th December the US banks' liabilities

Three-month interest rates* in national markets and the Euro-market.
Weekly, in percentages per annum.



* Interbank deposit rates, except dollars in New York (certificates of deposit) and sterling in London (local-authority deposits).

to their foreign branches shrank from $3.4 to 1.4 milliard — helped to contain the upward pressures.

Following the exchange rate realignment, Euro-dollar rates eased in the latter part of December, and in January 1972 the downward movement was reinforced by the reversal of end-year operations and the marked monetary ease in the United States. By the end of the month, however, further nervousness in the exchange markets began to brake the decline. While US interest rates continued initially to go down, three-month Euro-dollar quotations stabilised at about 5 per cent.; Euro-Deutsche Mark and Euro-Swiss franc rates, on the other hand, reached new lows in the course of February. In March the somewhat firmer stance of US monetary policy made it temporarily attractive for the US banks to borrow in the Euro-currency market and, after dipping to about 4¾ per cent. in early March, the three-month Euro-dollar rate firmed to $5^5/_8$ per cent. towards the end of the month. By mid-May, however, quotations had fallen back to below 5 per cent.

It is worth noting that, in comparison with the potential gains and losses from exchange rate changes, the movement of Euro-dollar rates in 1971 was actually quite modest; this is an indication of the inherent stability of the market. For example, to compensate for a 5 per cent. devaluation of the dollar, three-month rates would have had to rise by over 20 percentage points at an annual rate, whereas the maximum increases that actually occurred during crisis periods were of the order of 3 percentage points.

Since the movement out of dollars was to a considerable extent a movement into Deutsche Mark and Swiss francs, the factors which pushed up Euro-dollar rates tended at times to push down the Euro-Deutsche Mark and Euro-Swiss franc rates. Thus, the rates for the Euro-Deutsche Mark were at a low point at the beginning of June and around the end of August, when those for the Euro-dollar reached their peaks. In the fourth quarter, however, the downward movement of the Deutsche Mark rate was chiefly a reflection of German domestic interest rate developments and the decline in Euro-dollar rates.

The easing of quotations was particularly pronounced in the case of Swiss francs, with the three-month rate falling from around 5½ per cent. in the first two months of 1971 to a low of ¼ per cent. in early March 1972. One of the main reasons for this drop was strong demand for forward Swiss francs in exchange for dollars due to Swiss residents' large investments in dollars. This led to a substantial forward premium on the Swiss franc, which eliminated the interest rate differential in favour of dollars; the resultant shifts into Swiss francs exerted, of course, a corresponding downward pressure on Swiss franc deposit rates. In fact, the rate for Euro-Swiss franc deposits at one month or less, as well as call-money rates in Switzerland, were sometimes quoted near to or even at zero during the fourth quarter of 1971 and the first quarter of 1972. During this period the somewhat unusual situation arose wherein Swiss franc rates in the Euro-market were at times appreciably lower than those quoted in Switzerland. This interest rate constellation resulted from the various measures taken by the Swiss authorities to counter the inflow of foreign funds. While it was relatively novel for the Swiss franc, such a situation has existed in the case of the Deutsche Mark ever since 1968.

VI. THE EUROPEAN MONETARY AGREEMENT.

The European Monetary Agreement (EMA), which came into force on 27th December 1958, serves as a framework for co-operation between the monetary authorities of Contracting Parties, with the broad objective of encouraging multilateralism in international trade and currency convertibility. Its two principal operational aspects are: the European Fund, from which members may receive short or medium-term balance-of-payments assistance, and the Multilateral System of Settlements, under which each member country's central bank is assured of obtaining settlement in US dollars of its holdings of other members' currencies at an exchange rate known in advance. The Agreement is operated by the Council of the Organisation for Economic Co-operation and Development (OECD) and by a Board of Management. The Bank for International Settlements, acting as Agent, is entrusted with the execution of all financial operations under the Agreement.

Review of the Agreement.

In 1968, following a comprehensive review, the Agreement was renewed for a three-year period which ended on 31st December 1971. Pending a general assessment of its working and its future, the Agreement has since been prolonged unchanged for a further one-year period.

Operations under the Agreement.

European Fund. At the end of March 1971 the total of credits outstanding was un/a 130 million,* all of which represented credits to Turkey.

In October 1970, as described in last year's Annual Report (pages 172–173), the Council decided to grant Turkey credits totalling un/a 115 million, of which un/a 75 million were refinancing credits to enable it to consolidate its debt to the European Fund. Of these credits, one — the thirteenth — for a total of un/a 10 million was granted in two tranches of un/a 5 million each, available on 31st May 1971 and 30th October 1971 respectively, and relating to repayments due on those dates.

Last year, when monetary gold became hard to obtain following the suspension of the convertibility of the US dollar into gold, Turkey was granted two further refinancing credits to enable it to postpone for short periods certain gold payments due to the European Fund. Of these, one — the fourteenth credit — for an amount of un/a 5 million, available on 30th October 1971 and repayable on 31st May 1972, was granted by a decision of the Board of Management. The other — the fifteenth credit — for un/a

* In accordance with Article 24 of the Agreement, the accounts of the European Fund are kept in terms of a unit of account (un/a) of 0.888 670 88 grammes of fine gold. This was the gold value of one US dollar prior to the increase in the official price for gold, from US $35 to US $38 per fine ounce, as announced to the IMF with effect from 8th May 1972. Up to that date the US dollar had been taken to be equal to the unit of account in the books of the European Fund.

7.4 million, available on 31st December 1971 and repayable on 30th June 1972, was granted by a decision of the Council. The credits bear interest at rates of 3 and 2 per cent. per annum respectively. Furthermore, the Council decided in March 1972 that the repayment of un/a 5 million, representing the second instalment of the eleventh credit, due by Turkey at the end of that month, should be postponed until the end of May 1972.

According to a decision by the Council in March 1972, Turkey was granted a further refinancing credit of un/a 25 million to provide for the consolidation of that part

EMA: Utilisation of credits granted from the European Fund.

At value date for settlements for month	Greece		Iceland		Spain		Turkey		Totals		
	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Total credit granted
	in millions of units of account										
1959											
February	15.0	—	—	—	—	—	21.5	—	36.5	—	36.5
December	—	—	—	—	51.0	24.0	0.5	21.0	51.5	45.0	96.5
1960											
December	—	—	5.0	7.0	76.0	24.0	15.0	21.5	96.0	52.5	148.5
1961											
December	—	—	7.0	5.0	—	—	—	50.0	7.0	55.0	62.0
1962											
December	—	—	5.0	—	—	—	—	80.0	5.0	80.0	85.0
1963											
December	—	—	—	—	—	—	—	95.0	—	95.0	95.0
1964											
December	—	—	—	—	—	—	—	105.0	—	105.0	105.0
1965											
December	—	—	—	—	—	—	—	90.0	—	90.0	90.0
1966											
December	—	30.0	—	—	—	—	—	80.0	—	110.0	110.0
1967											
December	—	30.0	—	—	—	—	—	95.0	—	125.0	125.0
1968											
December	—	30.0	—	5.0	—	—	—	110.0	—	145.0	145.0
1969											
December	—	25.0	—	—	—	—	—	105.0	—	130.0	130.0
1970											
January	—	15.0	—	—	—	—	—	105.0	—	120.0	120.0
March	—	15.0	—	—	—	—	—	100.0	—	115.0	115.0
May	—	15.0	—	—	—	—	—	95.0	—	110.0	110.0
July	—	15.0	—	—	—	—	—	90.0	—	105.0	105.0
October	—	15.0	—	—	—	—	—	115.0	—	130.0	130.0
1971											
January	—	—	—	—	—	—	—	115.0	—	115.0	115.0
February	—	—	—	—	—	—	—	130.0	—	130.0	130.0
October	—	—	—	—	—	—	—	125.0	—	125.0	125.0
December	—	—	—	—	—	—	—	127.4	—	127.4	127.4
1972											
March	—	—	—	—	—	—	—	127.4	—	127.4	127.4

of its credits which was not covered by the consolidation operation of October 1970. This credit — the sixteenth — was made available on 31st May 1972 and is repayable in four equal instalments of un/a 6.25 million at the end of each quarter of 1976. It bears interest at a rate of 3 ½ per cent. per annum.

On 31st May 1971 Turkey repaid un/a 5 million, being the second instalment of the seventh credit, and drew the same amount, representing the first tranche of the thirteenth credit.

On 30th October 1971 Turkey made repayments totalling un/a 15 million, covering the final instalment, of un/a 5 million, under the sixth credit and the first instalment, of un/a 10 million, under the eleventh credit. On the same date it made drawings of un/a 10 million, consisting of the last tranche (un/a 5 million) of the thirteenth credit and the whole of the fourteenth credit.

Finally, on 31st December 1971 Turkey repaid the first instalment of the twelfth credit (un/a 5 million) and drew the full amount of the fifteenth credit (un/a 7.4 million).

These transactions are all included in the table on the previous page, which shows the position regarding the utilisation of credits from the European Fund at the value date for multilateral settlements (the fifth working day of the following month) for February 1959, when the first credits were granted, for the end of each year from 1959 to 1969 and for each month from end-1969 to March 1972 in which transactions took place.

On the various credits granted between June 1959, when the first drawing was made, and March 1972 there were forty-two drawings totalling un/a 541.9 million. Repayments have amounted to un/a 414.5 million. The amount outstanding at the end of March 1972, therefore, was un/a 127.4 million. Taking account of the above-mentioned refinancing credit granted in March 1972, Turkey is due to repay un/a 32.4 million in 1972, un/a 20 million in 1973, un/a 25 million in 1974, un/a 25 million in 1975 and un/a 25 million in 1976.

Multilateral System of Settlements. The provisions of the Multilateral System of Settlements had to be implemented on several occasions during the year ended 31st March 1972. However, no amounts were in fact brought into the settlements, since the rates applicable under the System for conversion into dollars — the selling rates for the US dollar as last notified by member countries — were less advantageous than the rates prevailing on the exchange markets. The cumulative total of settlements, therefore, still stands at US $82.6 million, the level reached in August 1969.

(a) Following the monetary crisis in May 1971, Austria and Switzerland revalued their currencies by 5.05 and 7.07 per cent. respectively and notified new buying and selling rates with effect from 10th May 1971. At the same time Germany and the Netherlands decided to float their currencies and they suspended their buying and selling rates for the US dollar. In accordance with the procedure applied in September 1969, when Germany temporarily suspended its buying and selling rates for the first time, special settlements under Article 13 were also arranged for balances held in these two currencies.

The suspension of the selling rates for the US dollar by Germany and the Netherlands left member countries without any pre-determined conversion rate between the Deutsche Mark and the Dutch guilder, on the one hand, and the dollar, on the other. Moreover, whereas in September 1969 the exchange rate guarantee under the Agreement was soon re-established by the declaration of new buying and selling rates, it could be foreseen that the floating would last for a longer period on this occasion. At its session of June 1971, during which the Board of Management considered the situation, the representatives of the two countries in question made statements to the effect that, although their countries had suspended the selling rate for the US dollar, this rate would continue to be applicable for the purposes of the exchange rate guarantee under the Agreement — in the case of the Netherlands up to the amounts which were outstanding before the suspension of the margins, and in the case of Germany also to balances acquired after the suspension. The Agent communicated these statements to all member central banks.

(b) Following the suspension of the convertibility of the US dollar into gold in August 1971, special settlements had to be arranged under Article 14 of the Agreement. This Article provides that, in the event of any restriction in the buying and selling policy for gold fixed by the US financial authorities in relation to any member country, all member countries are entitled to notify balances held in other EMA countries' currencies which they wish to be settled through the Multilateral System.

As a consequence of the American measures, most member countries took immediate action concerning their buying and selling rates notified under Article 9.

Austria, Denmark, Norway, Portugal, Sweden, Switzerland and the United Kingdom suspended their buying rates for the US dollar, but maintained their selling rates unchanged.

Three more countries (in addition to Germany and the Netherlands — see (a) above), viz. Belgium, Italy and Spain, suspended both their buying and their selling rates but declared that the selling rates for the US dollar would remain in force for the purposes of the exchange rate guarantee under the EMA, but with a similar limitation to that applicable to balances in Dutch guilders, namely that the guarantee would apply only up to amounts which were outstanding before the suspension of the selling rate.

Iceland, while maintaining the parity of the Icelandic króna with the US dollar, widened its exchange rate margins from 0.114 to exactly 1.0 per cent. on either side of parity.

France announced that with the introduction of a dual exchange market in that country the exchange rate guarantee was applicable only to balances held on 'comptes étrangers en francs' and not to balances held on 'comptes financiers'.

At a meeting held in August 1971 the Board of Management examined the measures taken by various member countries following the suspension of the convertibility of the US dollar into gold. The Board agreed that in the above-mentioned cases where the exchange rate guarantee was maintained, either by keeping the selling rate unchanged or by making a specific statement accompanying its suspension, it was not necessary to arrange for special settlements under Article 13, because official balances could be brought into the settlements at the end of each month at the same selling rates as hitherto.

(c) In December 1971, in connection with the realignment of currencies, all member countries, except Greece and Iceland, notified new buying and selling rates. At the end of the year, therefore, all EMA countries had again notified margins beyond which they would not allow their currencies to fluctuate. With the exception of Greece, Iceland and Turkey, all member countries are now applying margins of about 2¼ per cent. on either side of the central rate or of parity.

With the notification of new buying and selling rates, the temporary quantitative restrictions on balances in Belgian francs, Italian lire, Dutch guilders and Spanish pesetas ceased to apply. Consequently, the only quantitative limitations which still apply under the exchange rate guarantee of the Agreement are those established in 1963 in relations between the Bank of England and each of the other EMA central banks. In the case of balances in Belgian francs and French francs there still remain limitations concerning the source of funds covered by the exchange rate guarantee. This guarantee, therefore, does not apply to French francs held on 'comptes financiers'. As regards Belgian francs, according to the rule applicable since the Agreement came into force, balances covered by the exchange rate guarantee do not include those resulting from transactions on the free market.

Statement of Account.

The operations of the European Fund described in the previous pages are reflected in the summary of the Statement of Account on the following page.

Credits and claims outstanding, which amounted at the beginning of operations to un/a 35 million, representing long-term claims on Norway and Turkey taken over from the EPU, stood at un/a 139.3 million at end-March 1971. Of this sum, un/a 130 million represented credits outstanding and un/a 9.3 million the balance of the long-term claims on Norway and Turkey. In October 1971 the amount outstanding declined by un/a 5 million to un/a 134.3 million following the repayment of credits by Turkey. As mentioned above, this was the only repayment of credits which was not accompanied by equivalent drawings. In December 1971 the total fell by un/a 0.6 million as the net result of the eleventh amortisation payment in respect of the long-term claims on Norway and Turkey, amounting to un/a 3.0 million, and the above-mentioned repayment of credits (un/a 5 million) and drawing on credits (un/a 7.4 million) by Turkey. The amount outstanding at the end of March 1972 therefore came to un/a 133.7 million, made up of un/a 127.4 million in respect of credits outstanding and un/a 6.3 million representing long-term claims on Norway and Turkey.

The Fund's non-liquid assets thus fell by un/a 5.6 million during the year ended March 1972. With undistributed net income during the period amounting to un/a 6.9 million, the Fund's liquid resources rose from un/a 106.9 million at the end of March 1971 to un/a 119.5 million at the end of March 1972.

There was no call-up of capital in the period under review, so that the amount of member countries' uncalled contributions remained at un/a 297.9 million. At the end of

March 1972 member countries' paid-up contributions totalled un/a 38 million and, together with the un/a 148 million of active former EPU capital, the total of the Fund's operating capital came to un/a 186 million. The amount of un/a 607.5 million shown as the capital liability of the Fund in the Statement of Account also included the uncalled contributions mentioned above and the unused balance of the EPU capital, equivalent to US $123.5 *million.*

Net income received during the calendar year 1971 amounted to un/a 8.3 million, only un/a 0.3 million less than the 1970 total, which constituted a record. A drop, compared with 1970, in income on the Fund's liquid dollar investments was not fully offset by the rise, owing to the higher amounts outstanding, in income received from interest on claims and credits drawn. It brought the cumulative total of net income

EMA: Summary of the Statement of Account of the European Fund.

At value date for settlements for month	Assets				Total of Statement	Liabilities	
	Liquid resources	US Treasury account	Uncalled capital of member countries	Credits and claims out-standing		Capital Fund	Income and expendi-ture account
	in millions of units of account						
Opening	113.0	123.5	328.4	35.0	600.0	600.0	—
1959 December	104.4	123.5	302.9	80.0	610.9	607.5	3.4
1960 December	106.4	123.5	297.9	87.5	615.3	607.5	7.8
1961 December	109.2	123.5	297.9	87.8	618.4	607.5	10.9
1962 December	90.4	123.5	297.9	110.5	622.3	607.5	14.8
1963 December	82.1	123.5	297.9	123.1	626.6	607.5	19.1
1964 December	79.3	123.5	297.9	130.6	631.4	607.5	23.9
1965 December	101.3	123.5	297.9	113.1	635.8	607.5	28.3
1966 December	89.4	123.5	297.9	130.5	641.3	607.5	33.8
1967 December	82.6	123.5	297.9	142.8	646.9	607.5	39.4
1968 December	71.8	123.5	297.9	160.1	653.3	607.5	45.8
1969 December	96.6	123.5	297.9	142.2	660.3	607.5	52.8
1970 December	106.8	123.5	297.9	139.3	667.6	607.5	60.1
1971 January	121.6	123.5	297.9	124.3	667.3	607.5	59.8
February	106.8	123.5	297.9	139.3	667.6	607.5	60.1
March	106.9	123.5	297.9	139.3	667.7	607.5	60.2
April	107.2	123.5	297.9	139.3	668.0	607.5	60.5
May	107.4	123.5	297.9	139.3	668.2	607.5	60.7
June	110.0	123.5	297.9	139.3	670.8	607.5	63.3
July	109.7	123.5	297.9	139.3	670.4	607.5	62.9
August	109.9	123.5	297.9	139.3	670.7	607.5	63.2
September	110.2	123.5	297.9	139.3	671.0	607.5	63.5
October	115.6	123.5	297.9	134.3	671.3	607.5	63.8
November	115.9	123.5	297.9	134.3	671.7	607.5	64.2
December	119.5	123.5	297.9	133.7	674.7	607.5	67.2
1972 January	119.1	123.5	297.9	133.7	674.3	607.5	66.8
February	119.4	123.5	297.9	133.7	674.5	607.5	67.0
March	119.5	123.5	297.9	133.7	674.6	607.5	67.1

received since the start of operations to un/a 78.8 million. The payment of interest on member countries' contributions was again based on the principle that the cumulative amount of interest paid to each member country should be equal to 90 per cent. of the share in the Fund's net income which the country would have received if the Fund had been liquidated at the end of the period in respect of which interest is paid. The amount paid out in respect of 1971 came to un/a 1.2 million and brought the cumulative amount of interest paid in gold to member countries to un/a 12.3 million. This corresponds to an average annual rate of interest of 2.6 per cent. on the un/a 38 million of called-up contributions. At the end of January 1972, after the payment of interest on contributions in respect of the second half of 1971, undistributed net income amounted to un/a 66.8 million. Of this amount, un/a 58.6 million represented the equivalent share, in the Fund's net income, attributable to the un/a 148 million of active EPU capital transferred to the Fund. Virtually all of the remainder represented the 10 per cent. balance of the Fund's net income not yet allocated.

Management of the European Monetary Agreement.

The Board of Management of the EMA supervises the execution of the Agreement and advises the Council of the OECD on all related matters. The Board also follows the economic and financial situation in member countries on the basis of reports made by the Secretariat, by the various committees of the Organisation and, on occasion, by special missions. In discharging these functions the Board meets when necessary, recently about six times a year. In December 1971 the Council re-appointed M. Hay, Vice-President of the Directorate of the Swiss National Bank, as Chairman of the Board for a further year.

The Bank for International Settlements, as Agent, presents monthly reports on the operations carried out under the Agreement and on the investments of the European Fund. To assist the Board in following international financial developments, the Bank also provides monthly statistical material on the international gold and foreign exchange markets and on the external monetary positions of OECD countries, which the Representative of the Bank comments upon regularly at the Board's meetings.

Since 1963 the Bank for International Settlements has also been entrusted with the transmission of confidential information to participating member central banks relating to the conclusion and utilisation of concerted bilateral arrangements through which special support is given to the currency of a member country.

VII. ACTIVITIES OF THE BANK.

1. Development of co-operation between central banks and international organisations.

The Bank has continued to be a primary centre for facilitating co-operation among central banks. It has worked closely with them to implement policies agreed upon, participated in various technical committees and, when necessary, joined in actions designed to reduce strains in individual markets. In other areas, the Bank's business relations with central banks have continued to expand.

In addition to the regular meetings of the Governors of the central banks of the Group of Ten countries and Switzerland and to those of the Board of Directors, the Bank has continued to organise periodic meetings of central-bank officials to examine matters such as the development of the gold and foreign exchange markets and the Euro-currency market, as well as to study and exchange information on other economic and monetary problems of interest to central banks. The Bank also provides the Secretariat for the Committee of Governors of the central banks of the member countries of the European Economic Community and for its working parties and sub-committees, which hold regular meetings, mostly in Basle. Recently the central banks of Denmark, Ireland, Norway and the United Kingdom have begun to participate in these EEC meetings. In addition, there have been meetings of other groups of central-bank experts for the purpose of exchanging views on various technical and legal questions of interest to central banks.

The Bank continued during the past year to carry out the functions entrusted to it in August 1964 by the Ministers of the Group of Ten of collecting and distributing to all participants of the Group and to Working Party No. 3 of the OECD statistical data concerning the financing of external surpluses and deficits of the Group of Ten countries. It also assembles and distributes statistical data on the Euro-currency market. Furthermore, the Bank has again been associated with other work of the Group of Ten and of the OECD.

2. Operations of the Banking Department.

The Balance Sheet of the Bank and the Profit and Loss Account as at 31st March 1972, certified by the auditors, are reproduced at the end of this Report; both are expressed in gold francs.*

An important change has been made in the presentation of the Balance Sheet, in that this time the liabilities position is shown in two columns, the one giving the

* In this chapter the term "francs" (abbreviated to F) signifies *gold* francs, except where otherwise indicated. The method of conversion into gold francs (units of 0.290 322 58... grammes fine gold — Article 4 of the Statutes) of the various currencies included in the Balance Sheet is different from that adopted in preceding years; the conversion is based, depending on the currency, on the gold parity or on the "central rate" in relation to the US dollar, the latter being calculated on the basis of US $38.00 = one ounce of fine gold.

amounts before allocation of the net profit and the other those after its allocation in accordance with the recommendations to be made by the Board of Directors to the Annual General Meeting on 12th June 1972. The object of this new presentation is to make it easier to understand the Balance Sheet by incorporating in it items that appear in the annexes at the end of the Report.

* * *

The balance-sheet total at 31st March 1972 was the highest ever recorded at the end of a financial year, namely,	F 29,362,151,157
against, on 31st March 1971,	F 23,856,469,498
The rise of	F 5,505,681,659

— the equivalent of 23 per cent. — was thus very appreciable.

It should, however, be pointed out that a considerable part of this increase was due to a short-term deposit received for a period running over the end of the financial year. In the opposite direction, the monetary adjustments effected in the course of the financial year, and particularly those following the Washington agreement of December 1971, resulted in a parallel net decrease in both assets and liabilities of the order of 1,150 million francs.

The total of the monthly statement of account increased fairly regularly up to the end of November 1971, when it reached a record level of 30,655 million francs; by the end of December 1971 it had fallen to approximately the level at which it ended the financial year.

BIS: Development of the balance-sheet total over the past ten financial years.

Financial years ended 31st March	Total of Balance Sheet	Movement over the year	
	in millions of francs		in percentages
1963	4,950	+ 218	+ 5
1964	5,778	+ 828	+ 17
1965	7,850	+ 2,072	+ 36
1966	7,882	+ 32	—
1967	8,232	+ 350	+ 4
1968	12,041	+ 3,809	+ 46
1969	14,643	+ 2,602	+ 22
1970	20,699	+ 6,056	+ 41
1971	23,856	+ 3,157	+ 15
1972	29,362	+ 5,506	+ 23

The following items are not included in the Balance Sheet:

(i) gold under earmark, bills and other securities held in custody for the account of central banks and other depositors;

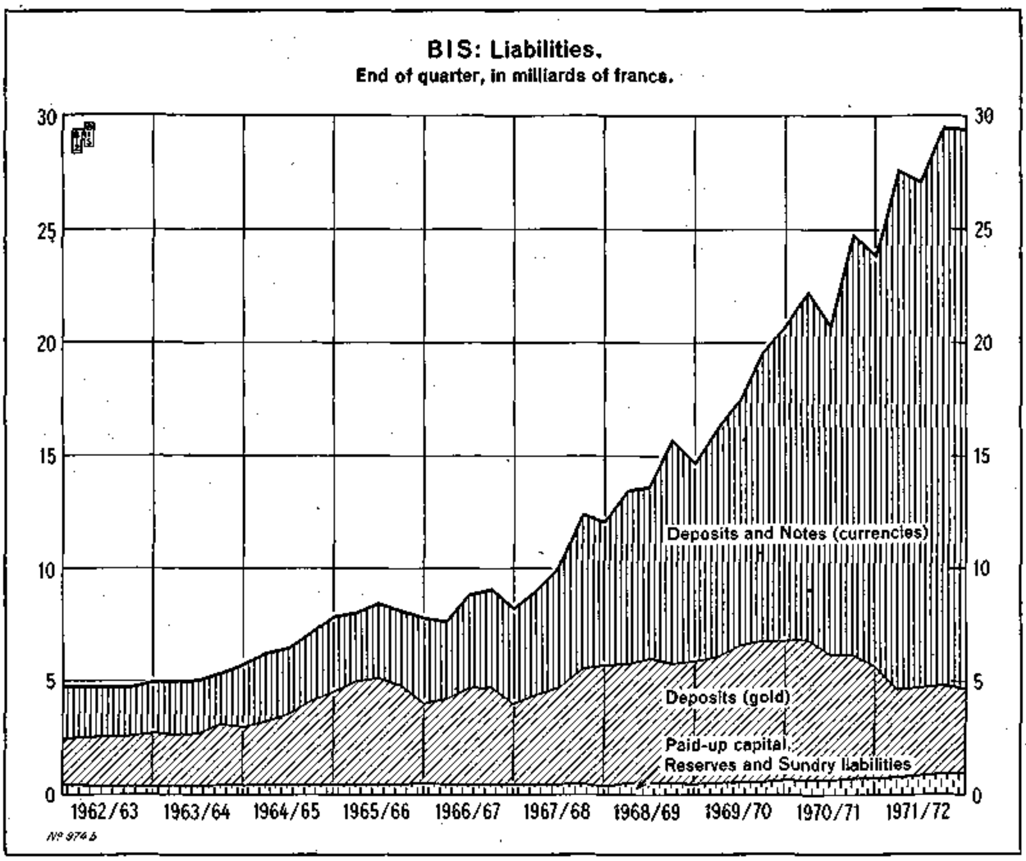
(ii) the assets (gold under earmark, bank balances, bills and other securities) held by the Bank as Agent for the Organisation for Economic Co-operation and Development in connection with the European Monetary Agreement, as Depositary under the Act of Pledge concluded with the European Coal and Steel Community and as Trustee for international government loans.

As was done in the case of the Balance Sheet at 31st March 1971, the amounts in question are shown at the foot of the assets column under the heading "Memorandum accounts (b)". The figures are given in the table below.

BIS: Memorandum accounts (b).

Items	Financial years ended 31st March 1971	1972	Difference
	in millions of francs		
Earmarked gold	958	969	+ 11
Bank balances	15	19	+ 4
Bills and other securities	499	400	− 99
Total of items not included in the Balance Sheet	1,472	1,388	− 84

LIABILITIES (COMPOSITION OF RESOURCES).



A. Capital, reserves, provisions and miscellaneous liabilities.

(a) Paid-up capital F 300,703,125

This rose from 290.5 million francs at 31st March 1971, i.e. by 10.2 million.

The increase was due to the fact that, in accordance with Article 6 of the Statutes, the Bank made at the end of June 1971 a further issue of shares of the third tranche of its capital, which are reserved for subscription by central banks. As a result of this issue the South African Reserve Bank became a member of the BIS. Furthermore, in accordance with the provisions of Article 9 of the Statutes, the founder central banks which exercised their rights under Article 8 (2) to subscribe for a proportion of any new issue placed some of the shares so subscribed at the disposal of the Bank for cancellation. Consequently the Board of Directors was able to issue an equivalent number of new shares to other member central banks.

On the occasion of this further issue of shares, a total of 16,400 shares was subscribed. The subscription price was fixed by the Board of Directors at 1,125 francs per share. As the Bank's shares are paid up to the extent of 25 per cent., or 625 francs per share, the subscription price included a premium of 500 francs per share, viz. 80 per cent. of the amount paid up. The aggregate premium received on this issue of shares of the third tranche therefore amounted to 8.2 million francs, and was allocated as to 1,025,000 francs to the Legal Reserve Fund and as to 7,175,000 francs to the General Reserve Fund.

As a consequence of the operations mentioned above, the number of issued shares, paid up to the extent of 25 per cent., rose from 464,725 to 481,125. The Bank's issued capital thus went up from 1,161.8 million francs to 1,202.8 million; the uncalled capital increased from 871.4 million francs to 902.1 million.

(b) Reserves

(1) *Legal Reserve Fund* F 30,070,313

This compares with 29 million francs at 31st March 1971; the increase of 1.1 million derived from the above-mentioned allocation to this Fund of part of the premiums received by the Bank, so as to maintain it at 10 per cent. of the Bank's paid-up capital.

(2) *General Reserve Fund*

– before allocation of the net profit for 1971–72 F 144,133,210

This compares with 100 million francs at 31st March 1971; of the increase of 44.1 million, 7.1 million was due to the allocation to this Fund, as already mentioned, of the greater part of the premiums received by the Bank, and 37 million to a transfer from the net profit for 1970–71;

– after allocation of the net profit for 1971–72	F 205,133,210

The amount due to be transferred to the Fund from this profit is thus 61 million francs.

(3) *Special Dividend Reserve Fund*

– before allocation of the net profit for 1971–72	F 36,807,964

This compares with 22 million francs at 31st March 1971; the difference of 14.8 million represents the amount transferred from the net profit for 1970–71;

– after allocation of the net profit for 1971–72	F 61,207,964

This is on the basis of the recommendation that 24.4 million francs be transferred to the Fund from this profit.

(4) *Free Reserve Fund*

– before allocation of the net profit for 1971–72	F 120,200,000

This compares with 98 million francs at 31st March 1971; the difference of 22.2 million represents the amount transferred from the net profit for 1970–71;

– after allocation of the net profit for 1971–72	F 156,800,000

The amount it is proposed to allocate to the Fund from this profit is 36.6 million francs.

The Bank's overall reserve position may thus be summarised as follows:

– before allocation of the net profit for 1971–72	F 331,211,487

This compares with 249 million francs at 31st March 1971, giving an increase of 82.2 million;

– after allocation of the net profit for 1971–72	F 453,211,487

This gives an additional increase of 122 million.

(c) The item "Miscellaneous" rose to	F 98,419,824

This compares with 50.7 million francs, giving an increase of 47.7 million.

(d) Provision for Building Purposes F 82,065,109

This compares with 80.7 million francs; the slight gain was the result of an exchange difference. It should be noted that the Board of Directors considered that there was no reason this year to increase the Provision in question.

(e) Profit and Loss Account F 148,832,656

This figure represents the net profit for the financial year 1971–72; it shows a rise of 49.4 million francs compared with the net profit for the preceding financial year, which amounted to 99.4 million. Details of the proposed allocation of the profit for 1971–72 are given in Section 6 below; these proposals, which have already been referred to several times in connection with the development of the reserves, recommend in particular that a sum of 26,832,656 francs should be applied in payment of the dividend on 1st July 1972.

BIS: Development of the composition of resources over the past ten financial years.

Financial years ended 31st March	Paid-up capital and reserves	Borrowed funds	Sundry liabilities	Balance-sheet total
	in millions of francs			
1963	150	4,561	239	4,950
1964	150	5,370	258	5,778
1965	151	7,417	282	7,850
1966	151	7,449	282	7,882
1967	151	7,764	317	8,232
1968	170	11,548	323	12,041
1969	200	14,133	310	14,643
1970	463	20,060	176	20,699
1971	539	23,086	231	23,856
1972*	754	28,401	207	29,362

*After allocation of the net profit for the year.

B. Borrowed funds.

The following tables show the *origin*, *nature* and *term* of the Bank's borrowed resources.

BIS: Borrowed funds, by origin.

Origin	Financial years ended 31st March 1971	1972	Movement
	in millions of francs		
Deposits of central banks	22,104	27,125	+ 5,021
Deposits of other depositors	515	792	+ 277
Notes	467	484	+ 17
Total	23,086	28,401	+ 5,315

All categories of borrowed resources registered an increase. The sharp growth in "Deposits of central banks" (+ 23 per cent., i.e. the same percentage as for the previous financial year) was responsible for the greater part of the rise in the balance-sheet total and was largely due to a deposit received for a short period running over the end of the financial year. The expansion of "Deposits of other depositors" was very marked in relative terms (+ 54 per cent.). The very slight growth in "Notes", all of which were expressed in Swiss francs, was entirely attributable to the revaluation of that currency in the course of the financial year.

It may be noted that the individual shares of these three items in the total of borrowed resources have hardly changed over the financial year, the first still accounting for virtually the whole amount.

BIS: Borrowed funds, by nature and term.

Term	Deposits in gold			Deposits in currencies			Notes		
	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement
	1971	1972		1971	1972		1971	1972	
	in millions of francs								
Sight	2,846	3,219	+ 373	96	69	− 27	—	—	—
Not exceeding 3 months	1,691	112	−1,579	16,748	21,767	+5,019	—	—	—
Over 3 months	402	369	− 33	836	2,381	+1,545	467	484	+ 17
Total	4,939	3,700	−1,239	17,680	24,217	+6,537	467	484	+ 17

(a) Deposits in gold F 3,700,032,951

This figure compares with that of 4,939 million francs at 31st March 1971. The decline of 1,239 million, or 25 per cent., over the year was due to the contraction in time deposits, in particular those at not exceeding three months, which fell to a very low level. This contraction was attributable to:

(i) large withdrawals by a central bank, which used the funds to wind up operations carried out with the Bank;

(ii) conversions of time deposits into sight deposits, in view of the fact that the possibilities open to the Bank of utilising gold remuneratively were gradually decreasing. These conversions explain the rise in sight deposits, in which category, however, there were also some withdrawals.

(b) Deposits in currencies F 24,217,208,314

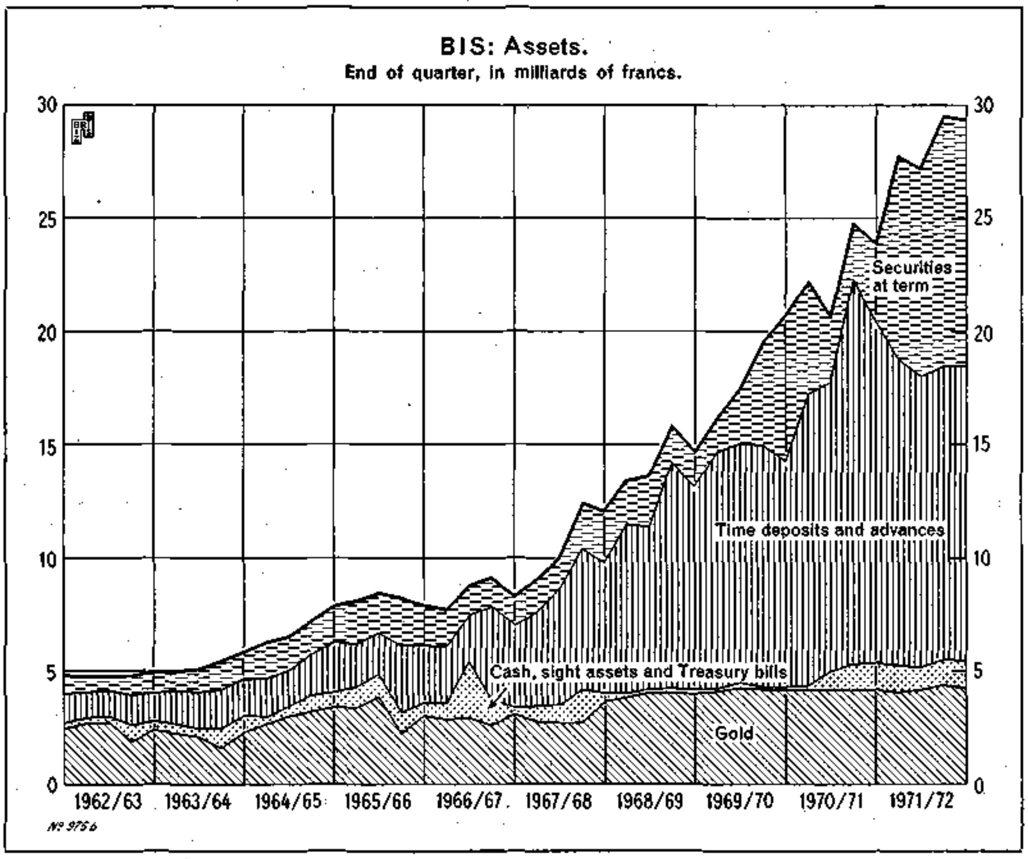
This figure compares with that of 17,680 million francs at 31st March 1971, giving a rise of 6,537 million, or 37 per cent. The main source of the increase was again the deposit running over the end of the financial year, referred to above. This deposit accounts for the expansion of funds at not exceeding three months. The other new resources received were mainly at over three months, in which category resources virtually tripled.

(c) Notes F 483,677,691

This figure compares with that of 467 million francs at 31st March 1971; the reason for this increase of 17 million has been given above.

At the beginning of the financial year "Deposits in gold" represented 21 per cent. of the total of borrowed resources, "Deposits in currencies" 77 per cent. and "Notes" 2 per cent. On 31st March 1972 the proportions were 13, 85 and 2 per cent. respectively. Thus the share of gold in the total resources continued to contract and that of resources in currencies to increase.

ASSETS (EMPLOYMENT OF RESOURCES).



The following table gives a break-down of the main items of the assets according to their *nature*.

BIS: Distribution, by nature, of sight assets and other investments.

Nature	Financial years ended 31st March 1971		1972		Movement	
	in millions of francs					
Sight assets						
Gold	4,202		4,253		+ 51	
Currencies	53	4,255	75	4,328	+ 22	+ 73
Treasury bills						
Currencies		1,058		1,117		+ 59
Time deposits and advances						
Gold	90		252		+ 162	
Currencies	14,969	15,059	12,780	13,032	−2,189	−2,027
Securities at term						
Gold	424		279		− 145	
Currencies	3,059	3,483	10,605	10,884	+ 7,546	+ 7,401
Total						
Gold	4,716		4,784		+ 68	
Currencies	19,139	23,855	24,577	29,361	+ 5,438	+ 5,506

The table calls for the following observations:

(a) Gold — F 4,252,402,814

This consisted entirely of gold in bars. The very moderate expansion of this item — 51 million francs — was slightly greater than that registered by net assets in gold. The latter rose by 37 million, from 654 million to 691 million; half of the increase accrued from the new issue of shares.

(b) Cash on hand and on sight account with banks — F 75,445,317

This item registered an increase of 22 million francs.

(c) Treasury bills — F 1,117,052,805

This figure was the highest reached during the financial year and represented a rise of 59 million francs over that recorded on 31st March 1971.

Assets at sight or cashable on demand, comprising the three items analysed above, totalled 5,313 million francs on 31st March 1971 and accounted for 22.3 per cent. of the balance-sheet total. On 31st March 1972 the corresponding figures were 5,445 million and 18.5 per cent. Over the same period sight deposits on the liabilities side rose from 2,942 million to 3,288 million francs, but the percentage of these items in relation to total resources fell from 12.3 to 11.2 per cent. It follows that the overall ratio of assets at sight or cashable on demand to the equivalent items on the liabilities side declined somewhat.

(d) Time deposits and advances F 13,031,993,155

This figure compares with one of 15,059 million francs at 31st March 1971, representing a fall of 2,027 million. While time deposits and advances in gold went up by 162 million — rising from 90 million to 252 million — those in currencies contracted fairly appreciably, from 14,969 million to 12,780 million. The decline of 2,189 million, or 15 per cent., was the result of large net withdrawals from the Euro-market, in that disinvestments involving substantial amounts of US dollars were only very slightly offset by investments carried out in other currencies.

(e) Securities at term F 10,884,313,375

By comparison with the figure of 3,483 million francs at 31st March 1971, this represents a considerable expansion — of 7,401 million. While securities at term in gold registered a decline of 145 million, falling from 424 million to 279 million, those in currencies rose by 7,546 million, from 3,059 million to 10,605 million, and thus more than tripled. This growth was mainly the result of the following operations, which had the effect of greatly increasing the Bank's assets on the US market:

(i) a large investment corresponding on the assets side to the already-mentioned deposit received for a short period running over the end of the year; this investment accounts for the growth in funds invested at not exceeding three months shown in the table below;

(ii) substantial other investments, mainly in certificates of deposit; these investments were made with funds withdrawn from the Euro-market (see the foregoing item) as well as with deposits received in US dollars from central banks for investment by the Bank on the US market.

The table below shows the distribution of time deposits and advances and securities at term by *maturity.*

BIS: Time deposits and advances and securities at term, by maturity.

Periods	Financial years ended 31st March 1971	Financial years ended 31st March 1972	Movement
	in millions of francs		
Not exceeding 3 months	14,107	18,141	+ 4,034
Over 3 months	4,435	5,775	+ 1,340
Total	18,542	23,916	+ 5,374

Forward gold operations.

This item appears in the Balance Sheet under the heading "Memorandum accounts (a)". The outcome of the operations it covers was a *negative* net balance (gold payable) of F 393,075,329,

compared with a *positive* net balance of 877 million francs at the end of March 1971, which represents a movement over the financial year amounting to 1,270 million. This movement was attributable to the maturing of swaps of gold (sold spot and repurchased forward) against currencies, and to the conclusion of swaps of gold (bought spot and resold forward) against currencies.

* * *

The financial year 1971–72 was a very active one; the results are to be seen in the marked rise in the balance-sheet total and, more particularly, in a very pronounced expansion in the volume of operations. The latter, in fact, reached the record level of 433 milliard, compared with 250 milliard in 1970–71 and 213 milliard in 1969–70.

3. The Bank as Trustee for international government loans.

In conformity with the agreements in force, the Bank continued in the year under review to perform the functions of Trustee for the new bonds of the German External Loan 1924 (Dawes Loan) and of the German Government International Loan 1930 (Young Loan) which were issued by the Government of the Federal Republic of Germany in accordance with the London Agreement on German External Debts of 27th February 1953. As regards the Dawes Loan, only bonds of the funding issues are still outstanding and these will mature on 15th October 1972. As for the Young Loan, the funding bonds will mature on 1st December 1972, whereas the final maturity date for the conversion bonds is fixed at 1st June 1980.

The financial year 1971–72 ended for the Dawes Loan on 15th April 1972 and for the Young Loan on 1st June 1972. The interest in respect of the financial year 1971–72 amounted to the equivalent of about 900,000 francs for the Dawes Loan and of about 32.4 million francs for the Young Loan; it was duly paid to the Bank and distributed by the latter among the Paying Agents. Redemption in respect of the financial year 1971–72 was effected solely by purchases of bonds on the market in the case of the Dawes Loan, whereas in the case of the Young Loan recourse was also had to drawings.

The question whether the exchange guarantee attached to the Young Loan under the terms of the London Agreement is applicable in the case of the revaluations of the Deutsche Mark has still not been settled. The dispute was submitted in May 1971 to the court of arbitration provided for in the Agreement; the arbitral proceedings are in progress. The question raised by the temporary floating of the exchange rate for the Deutsche Mark has been submitted to the governments of the countries in which issues were made.

The position as regards the Dawes and Young Loans is shown in the following tables.

German External Loan 1924 (Dawes Loan).
Funding bonds.*

Issue	Currency	Nominal value: Bonds issued	Bonds purchased for redemption in respect of the financial years 1958–59 to 1970–71	Bonds purchased for redemption in respect of the financial years 1971–72	Balance after redemption
American . . .	$	8,211,000	3,191,000	281,000	4,739,000
Belgian	£	157,800	64,800	5,600	87,400
British	£	2,232,700	909,700	79,600	1,243,400
Dutch	£	291,700	110,000	10,800	170,900
French	£	499,100	204,800	19,400	274,900
Swiss	£	115,000	46,200	4,200	64,600
Swiss	Sw.fr.	418,000	150,000	14,000	254,000

* The conversion bonds still outstanding were redeemed on 15th October 1969, the final maturity date.

German Government International Loan 1930 (Young Loan).

Issue	Currency	Nominal value*: Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years 1958–59 to 1970–71	Bonds purchased or drawn for redemption in respect of the financial years 1971–72	Balance after redemption
		Conversion bonds			
American . . .	$	55,524,000	9,895,000	1,133,000	44,496,000
Belgian	B.fr.	202,852,000	35,538,000	3,820,000	163,494,000
British	£	20,664,500	3,592,800	404,000	16,667,700
Dutch	Fl.	52,577,000	9,007,000	981,000	42,589,000
French	Fr.fr.	501,716,000	87,768,000	9,761,000	404,187,000
German	DM	14,505,000	2,499,000	258,000	11,748,000
Swedish . . .	S.kr.	92,780,000	16,183,000	1,786,000	74,811,000
Swiss	Sw.fr.	58,387,000	10,164,000	1,059,000	47,164,000
		Funding bonds			
American . . .	$	9,015,000	1,512,000	146,000	7,357,000
Belgian	B.fr.	45,683,000	7,765,000	749,000	37,169,000
British	£	4,930,600	828,500	79,800	4,022,300
Dutch	Fl.	8,500,000	1,428,000	137,000	6,935,000
French	Fr.fr.	110,503,000	18,450,000	1,787,000	90,266,000
German . . .	DM	416,000	68,000	6,000	342,000
Swedish . . .	S.kr.	6,014,000	1,014,000	98,000	4,902,000
Swiss	Sw.fr.	1,405,000	235,000	22,000	1,148,000

* Nominal value on 1st May 1972 established in accordance with the provisions of the London Agreement on German External Debts of 27th February 1953 but without taking account of the revaluations of the Deutsche Mark or of other similar monetary measures.

The Bank is also Trustee for the assented bonds of the Austrian Government International Loan 1930, the service of which was carried out in conformity with the relevant agreements.

The following table shows the position with regard to this Loan.

Austrian Government International Loan 1930.

Issue	Currency	Nominal value			
		Bonds assented	Bonds purchased or drawn for redemption in respect of the financial years		Balance after redemption
			1959 to 1970	1971	
American . . .	$	1,667,000	903,000	99,000	665,000
Anglo-Dutch .	£	856,600	454,800	43,300	358,500
Swiss	Sw.fr.	7,102,000	3,217,000	363,000	3,522,000

4. The Bank as Depositary under the terms of the Act of Pledge concluded with the European Coal and Steel Community.

The following table shows the amounts outstanding on the secured loans issued by the European Coal and Steel Community between 1954 and 1961 for which the Bank performs the functions of Depositary in accordance with the provisions of the Act of Pledge concluded between it and the Community on 28th November 1954.

During the financial year 1971–72 the amounts received by the Bank for the service of the secured loans and distributed by it among the Paying Agents came to the equivalent of about 17 million francs in respect of interest and of about 39 million francs in respect of redemption. By the end of the financial year the total amount outstanding had been reduced to the equivalent of approximately 312 million francs.

5. The Bank as Agent for the Organisation for Economic Co-operation and Development (European Monetary Agreement).

The Bank's activities in its continuing capacity as Agent for the execution of the financial operations of the EMA under the Organisation for Economic Co-operation and Development have been described in Chapter VI of this Report. The Bank has received in this connection, as last year, a contribution of Sw.fr. 500,000 towards its administrative expenses, together with the reimbursement of its out-of-pocket expenses; these amounts have been credited to "Costs of administration" in the Bank's Profit and Loss Account.

6. Net profits and their distribution.

The accounts for the forty-second financial year ended 31st March 1972 show a surplus of 156,364,072 francs. The surplus for the financial year 1970–71 was 133,049,026 francs. The very large increase is again mainly attributable to the substantial expansion in the Bank's resources in currencies and to the considerable growth in the volume of its operations.

Secured loans of the European Coal and Steel Community.

Series of Secured Notes	Dates of issue	Countries of issue	Lenders	Original amounts of loans		Amounts unredeemed on 1st April 1972	Rates of interest %	Year of final maturity or redemption
1st	1954	United States	US Government	$	100,000,000	46,300,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	110,600,000	3½	1982
3rd	1955	Germany	Westdeutsche Landesbank Girozentrale, Düsseldorf and Münster[1]	DM	50,000,000	22,407,200	3¾	1981
4th	1955	Luxemburg	Caisse d'Epargne de l'Etat, Luxemburg	B.fr.	20,000,000	11,060,000	3½	1982
				L.fr.	5,000,000	—	3½	1961
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[2]	1,143,341	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	12,500,000	4¼	1974
7th	1957	United States	Public issue	$	25,000,000	6,000,000	5½	1975
8th	1957	United States	Public issue	$	7,000,000	—	5	1962
9th	1957	United States	Bank loans	$	3,000,000	—	5	1962
10th	1957	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	65,643,032	5⅜	1982
11th	1959	United States	Public issue	$	35,000,000	16,600,000	5	1978
12th	1959	United States	Public issue	$	15,000,000	—	4½	1963
13th	1960	United States	Public issue	$	25,000,000	15,100,000	5⅜	1980
14th	1960	United States	Public issue	$	3,300,000	—	4¾	1963
				$	3,300,000	—	4⅞	1964
				$	3,400,000	—	5	1965
15th	1961	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	77,667,019	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	33,250,000	4½	1981

[1] The original lenders, Rheinische Girozentrale und Provinzialbank and Landesbank für Westfalen Girozentrale, were merged as from 1st January 1969 under the name Westdeutsche Landesbank Girozentrale. [2] This loan, which was contracted in French francs, was converted into Deutsche Mark in 1959. The original amount was 350,000,000 old French francs.

In view of the high level of earnings, the Board of Directors has decided to transfer 7,531,416 francs to the Provision for Exceptional Costs of Administration; on the other hand, no transfer is being made this year to the Provision for Building Purposes. As a result of these decisions, the net profit amounts to 148,832,656 francs, against 99,448,906 francs for the previous financial year. The allocation of this amount is fixed by Article 51 of the Statutes.

On the basis of this provision, the Board of Directors recommends that the net profit of 148,832,656 francs be applied by the General Meeting in the following manner:

(i) an amount of 17,888,437 francs in payment of the preferential dividend of 6 per cent. per annum, this dividend being fixed at 37.50 francs per share on 464,725 shares and at 28.125 francs per share on the 16,400 shares issued at the end of June 1971;

(ii) an amount of 8,944,219 francs — a sum falling within the statutory limit of 20 per cent. of the remainder of the net profit — to be appropriated in payment of the maximum further dividend of 3 per cent. per annum, this dividend being fixed at 18.75 francs per share on 464,725 shares and at 14.0625 francs per share on the 16,400 shares issued at the end of June 1971;

(iii) an amount of 61,000,000 francs to be transferred to the General Reserve Fund;

(iv) an amount of 24,400,000 francs, the maximum authorised by the Statutes, to be transferred to the Special Dividend Reserve Fund; following this transfer this Fund would reach an amount of 61,207,964 francs, corresponding to the preferential dividend for three years; and finally

(v) an amount of 36,600,000 francs, comprising the remainder of the available net profit, to be transferred to the Free Reserve Fund. This Fund can be used by the Board of Directors for any purpose which is in conformity with the Statutes.

If these proposals are accepted, the total dividend will amount to 56.25 francs per share on the 464,725 shares which are entitled to the dividend for the full year, and to 42.1875 francs per share on the shares issued at the end of June 1971. This dividend will be paid on 1st July 1972 to the shareholders whose names are entered in the Bank's share register on 20th June 1972 and will amount, when the distribution relates to a whole financial year, to 76.60 Swiss francs per share, compared with 75.05 Swiss francs per share last year, and, when the distribution relates to nine months, to 57.45 Swiss francs per share. The conversion into Swiss francs for this year's dividend has not been made on the basis of the official parity of the Swiss franc, as in the past, but on the basis of the new gold parity of the US dollar and the central rate for the Swiss franc against the US dollar announced in December 1971.

The Balance Sheet, the Profit and Loss Account and the movements during the financial year on the paid-up Capital, Reserve Funds and Provisions will be found at the end of this Report. The Bank's accounts have been audited by Messrs. Price Waterhouse & Co., Zurich, who have confirmed that the Balance Sheet and the Profit and Loss Account give a true and fair view of the state of the Bank's affairs at 31st March 1972 and of its profit for the year ended on that date. Messrs. Price Waterhouse & Co.'s report is appended at the foot of the Balance Sheet.

7. Changes in the Board of Directors and in the Management.

M. Henri Deroy, whose mandate as a member of the Board was due to expire on 31st March 1972, was re-appointed under Article 27(2) of the Statutes by M. Olivier Wormser, Governor of the Bank of France, in March 1972.

The mandate of Mr. Per Åsbrink, who had been elected to the Board under Article 27(3) of the Statutes, was due to expire on 31st March 1972. He was re-elected at the meeting of the Board held on 13th March 1972.

Mr. M. J. Babington Smith, whose mandate as a member of the Board was due to expire on 6th May 1972, was re-appointed under Article 27(2) of the Statutes by the Rt. Hon. Sir Leslie O'Brien, Governor of the Bank of England, at the meeting of the Board held on 10th April 1972.

At the same meeting Sir Leslie O'Brien appointed Mr. Michael J. Balfour as his Alternate in the absence of Mr. C. Jeremy Morse to succeed Mr. Rupert G. Raw, who retired at that time from the Bank of England. The Chairman expressed the Bank's gratitude to Mr. Raw for his valuable services during a period of nearly nine years.

At its meeting held on 14th June 1971 the Board appointed M. Maurice Toussaint as a Manager of the Bank. The appointment took effect as from 1st July 1971.

CONCLUSION.

A year ago economic expansion in most industrial countries was slowing down while in a few there was stagnation or actual recession. This situation had been brought about by the restrictive measures undertaken earlier — without conspicuous success — to curb price inflation and rather explosive wage increases.

In general, the past year has seen an even further slackening of productive activity. While restraint has been maintained in some countries to combat continuing inflation, the general direction of policy has been increasingly shifted to initiate a revival — not without some sense of frustration over the unsolved inflation problem. The quickest response was in Canada, where production picked up at a good rate from early in 1971. On the other hand, the expansionary measures taken by the United Kingdom last year had little effect. Consequently a very strong fiscal stimulus was administered by the budget of March 1972, and no doubt a turn-round will soon be evident.

In the United States policy began to shift from restraint to expansion early in 1970, despite continuing cost-push inflation, but the recession dragged on. In the past year both budget stimulus and monetary ease were strongly increased, still with little success before the President's new anti-inflationary programme on 15th August 1971. In November, however, it became apparent that the turning-point of the stubborn recession had been reached, and the renewal of expansion has been confirmed in subsequent months.

France and Italy have been exceptions, though in different ways. In France the rate of expansion of output, though declining slightly in both the past two years, remained above 5 per cent. In Italy the increase in production dropped off sharply during the past year; but this was due to a very disturbed labour situation rather than to policy restraint. In Germany there has been some autonomous rebound of economic activity since early in 1972, and the more favourable outlook has led to postponement of some proposed stimulative measures. Signs of economic revival have also recently begun to show up in several of the smaller countries.

The period of faltering expansion and even recessionary reactions was accompanied by a very threatening development on the inflation front. Despite a distinct easing of labour-market conditions, the inflation of prices and exceptionally large negotiated wage increases continued with few signs of let-up. Indeed, in the United Kingdom and the United States the rate of inflation actually accelerated in the midst of significant under-utilisation of resources. While wage-push inflation has been a fairly continual problem for many countries in the post-war period, this was the first time that high rates of wage and price increases have seemed so unresponsive to a slackening of economic activity.

During the past year this state of affairs generally continued. In the spring of 1972 wage levels in most European countries were still about 10 per cent. higher than a year earlier and consumer prices were up by about 5–8 per cent. And in Japan and Canada, too, there was little easing of the wage pressure. In Germany, however, with competition sharpened by substantial currency revaluation, industry had some success in resisting labour's demands: since late last year wage increases have been in the 7–8 per cent. range, compared with double that level previously. In Italy also wage increases have tended to be lower. None the less, the general condition of very large wage increases in the face of weakened demand has given the cost-push inflation problem a new importance.

The United Kingdom authorities attempted to put a brake on the wage/price spiral by reducing pay awards in the public sector to about 7–8 per cent. and successfully faced some strikes to hold the line. But an important strike in the coal industry early this year was only ended by concession of a wage increase of about 16 per cent., which, of course, does not help the prospects for the control of inflation.

The United States authorities made the most determined stand against wage/price inflation, showing a clear-sighted reading of the real problem involved and not hesitating to reverse their previous policy attitude. There was little doubt that during the first half of last year the efforts of the Administration to stimulate an expansion of demand were being offset by the wage/price spiral. Hence, on 15th August the President imposed a freeze on prices and wages and set up a control system to operate after the freeze period was over. There has since been a marked reduction in the rate of inflation; however, the authorities have to contend with strong labour opposition, so that the degree of success that can be anticipated in the future is not certain. The alternatives are not happy to contemplate. As has been said with insight: "When a nation permits its economy to become engulfed by inflation, policy-makers no longer have any good choices. That is the tough legacy and also the chief peril of inflation."

Although the problem of inflation control was, perhaps, of deeper social and political significance, the drama of last year was provided by the convulsions of the international monetary system. The denouement of 1971 was many years in the making. The persistent disequilibrium of the gold/dollar system and of the dollar itself was clearly not sustainable indefinitely and of necessity had to undergo basic adjustment — despite quite dogged resistance.

The first step in bringing this process to a head in 1971 resulted from strong divergences in monetary policy between the United States and several European countries. Easy monetary conditions in the United States and restrictive policies in Europe induced a heavy flow of funds across the Atlantic, like water seeking its own level. This movement, based on interest arbitrage, started in 1970 and continued in the first quarter of 1971. It was particularly large in the case of Germany. Finally, speculation on the possibility of a new revaluation of the Deutsche Mark arose at the end of March, increasing progressively in April. The dollar intake was so large in the first days of May that the German authorities were obliged to stop their support of the exchange rate and to let their currency float. The Dutch authorities followed suit, as they would otherwise have been flooded with dollars, and Switzerland and Austria took the opportunity to effect a small revaluation of the Swiss franc and the schilling.

The rôle of widely divergent monetary policies in the May crisis, each strongly oriented towards domestic objectives, must be emphasised because of its implications for future management. It is evident that the dollar was overvalued and the Deutsche Mark undervalued, but the crisis cannot be explained without the added influence of the previous huge interest arbitrage flows. This may be seen by comparison with the yen; although it was much more undervalued than the Deutsche Mark, the yen was not subjected to significant speculative pressure until after 15th August.

None the less, a dollar crisis would probably not have been far off in any case. The US trade balance had taken a sharp turn for the worse in 1968 and 1969, largely owing to the inflation associated with the Vietnam war. After a modest pick-up in the recession year of 1970, it became known in late May 1971 that the trade balance had registered an actual deficit in April. As this adverse trend was confirmed in subsequent months, confidence in the dollar was increasingly shaken. The flight from the currency reached such proportions in the first half of August that the President announced the suspension of convertibility of the dollar on 15th August. By that time US reserve assets had fallen to $12 milliard and official liabilities had shot up to about $40 milliard. With reference to the suspension of the dollar's convertibility, former Secretary of the Treasury, John B. Connally, said recently, "we should have done what we did long before we did it." This succinct summing-up expresses a widely-held view.

For analytical completeness and for their relevance to future monetary arrangements, it is important to see clearly the several forces that continuously eroded the US reserve position over the previous two decades. To be sure, excess demand and domestic inflation were significant causes from 1966 on. However, these factors do not explain the substantial deterioration of the US reserve position which had previously taken place. Three other conditions prevailed which fill out the picture. Firstly, the rest of the world's need for increased reserves — quite essential to support fixed exchange rates with the growth of trade and payments — was bound to leave the predominant reserve currency country with an almost continuous deficit, since new monetary gold ran far short of even the minimum demand for increased global reserves. Secondly, the Bretton Woods rules did not enforce parity adjustment on the few countries which, for one reason or another, drifted into a position of excessive surplus, thereby adding to the adverse trend in the dollar's position. And, thirdly, new monetary gold, at its existing official value of $35 per fine ounce, did not even meet the demand for gold reserves by the rest of the world and the difference was made up by converting dollars for gold at the US Treasury.

The first and third of these conditions raised the dilemma of either a general increase in the official value of gold or a fundamental change in the Bretton Woods system. The relative overvaluation of the dollar and the undervaluation of several other currencies set the stage for a realignment in the structure of exchange rates.

After the suspension of dollar convertibility all the major currencies except the French franc were left to float in the market — though the Bank of Japan held to its fixed rate for another two weeks.

The actions of 15th August, including the imposition of a 10 per cent. surcharge on imports, were at first a shock to the spirit of international co-operation that had been nurtured with considerable success in the post-war period. Within the EEC efforts were made to fix a new pattern of intra-Community exchange rates with a view to a joint float against the dollar. These did not succeed, however, apart from the Benelux agreement to float together. And although all the other major countries favoured rapid negotiation of a new structure of fixed rates, the United States was for a time reluctant to participate. However, this attitude soon changed, as the adverse impact of floating rates on business confidence became clear. After some hard bargaining, a realignment of exchange parities was agreed to on 18th December, including a proposed devaluation of the dollar by 7.9 per cent. and revaluation of several other currencies.

This Smithsonian agreement brought several immediate benefits. Perhaps most importantly, it reaffirmed that the major countries were prepared to face the problems of international monetary and economic management in a spirit of co-operation and compromise. Secondly, it ended the confusions of the floating rates episode, with whatever ill effects they might have produced in the longer term. And, thirdly, it provided for a major adjustment to improve the previous state of severe imbalances in trade and payments.

But the Smithsonian agreement left other important matters to be taken up in the context of the "reform of the monetary system". As the scope and content of this reform are still nebulous, however, it is not clear to what extent it may concern the rules of the Bretton Woods system as distinct from the behaviour of currencies within those rules. Hence, certain subjects seem bound to arise in the negotiations.

One of these is the restoration of dollar convertibility, since the essential change from the Bretton Woods system which has occurred is that other currencies are now pegged to an inconvertible dollar. Dollar convertibility is considered desirable so that the United States should be subject to balance-of-payments discipline as other countries are and so that all other countries should have some freedom over the composition of their reserves. For the United States, however, the problems will be to secure adequate reserves to support a return to convertibility and to establish rather concrete safeguards against excessive surpluses elsewhere. Yet the United States should have a constructive approach in this matter, as permanent dollar inconvertibility could split the world into restrictive monetary blocs.

The whole problem of reserves and the forms they are to take will also be an important area of discussion. It has frequently been said that the rôle of gold is likely to decline and the rôle of SDRs to increase. This is easy enough to see if what is meant is that deficits and surpluses will be settled to an increasing extent in SDRs and to a decreasing extent in gold. But the essential rôle of gold in the system at present is not its use as a means of settlement but its use as the standard for the parities of currencies, and as the guarantee of value for the SDR itself and for creditor and debtor positions in the IMF. It seems unlikely that the rôle of gold in these respects will be changed in the near future.

Also in the field of reserves, there is the question of the dollar. One view is that the practice of holding dollars in reserves has outlived its usefulness and should be stopped by agreement. As the dollar is likely to remain the major intervention currency, however, and as many countries are quite happy to hold dollars in substantial amounts, it is not evident that such a change in the status of the dollar is feasible — or that it would constitute a reform. None the less, it would be in the general interest that there be a degree of deliberate management over the future growth of reserves in dollars.

A third area of discussion will be the part to be played in the adjustment process by changes in exchange rates. There is little disposition in the official world to depart from the rule of fixed exchange parities, to be changed only in the event of fundamental disequilibrium. But there is, happily, a recognition that changes in parities, when required, should be made more promptly than in the past and that, somehow or other, they should be smoother and less painful.

To a large extent this is a matter of attitudes. And it is to be hoped that, after the experiences of the past few years, parity adjustments, even with the help of an interval of temporary floating, will be looked upon less as a sin and more as a contribution to achieving such basic objectives as sustainable full employment and the maintenance of freedom in trade and payments. Of course, some changes in parities in the past have given rise to acute internal political difficulties. But have these not been due in large measure to oft-reiterated assertions by the authorities themselves, in situations of transparent fundamental disequilibrium, that the currency would never be devalued or revalued, as the case might be? Is it not possible instead for statesmen to guide public opinion to see the advantages of restoring the exchange parity to equilibrium, and in the process to make life less uncomfortable for themselves?

A significant step already taken in international monetary arrangements has been the decision of the members of the European Economic Community to work towards a monetary union. Certain aspects of this matter had already been negotiated before the 1971 crisis and the events of last summer have given a spur to their implementation.

While still of limited scope, the intra-Community measures adopted have broken new ground in three respects. Firstly, the possible exchange margins between any two Community currencies, which were twice as wide as their margins vis-à-vis the dollar, are now the same. Secondly, the central banks of the Community countries, which formerly intervened on the exchange market only in dollars, will henceforth intervene in each other's currencies as well. Finally, whereas day-to-day deficits and surpluses were formerly settled in dollars, with other reserve assets used only exceptionally, the Community countries have now adopted the principle of settling periodically among themselves by means of a predetermined package of reserve assets including dollars, gold, SDRs and reserve positions in the IMF.

How these arrangements will develop remains to be seen. But, at least, they introduce a new factor that may figure in the negotiations on the future of the monetary system, as they provide for a supplementary mechanism of intervention and settlement and for strengthening exchange rate relationships among an important group of countries.

René Larre

General Manager

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AT 31st MARCH 1972

BALANCE SHEET

ASSETS

(Before and after

		Gold francs
Gold		4,252,402,814
Cash on hand and on sight account with banks		75,445,317
Treasury bills		1,117,052,605
Time deposits and advances		
Gold		
Not exceeding 3 months	252,042,834	
Currencies		
Not exceeding 3 months	8,660,895,553	
Over 3 months	4,119,054,768	
		13,031,993,155
Securities at term		
Gold		
Not exceeding 3 months	41,333,328	
Over 3 months	237,825,165	
Currencies		
Not exceeding 3 months	9,187,134,469	
Over 3 months	1,418,020,413	
		10,884,313,375
Miscellaneous		943,690
Land, buildings and equipment		1
		29,362,151,157

The gold franc is the equivalent of 0.290 322 58... grammes fine gold — Article 4 of the Statutes.

MEMORANDUM ACCOUNTS	Gold francs
a. Forward gold operations:	
Net balance: gold payable (currencies to be received)	393,075,329
b. Funds, bills and other securities administered or held by the Bank for account of third parties:	
Earmarked gold	969,089,272
Bank balances	19,399,296
Bills and other securities	399,463,462

AT 31st MARCH 1972

allocation of the year's Net Profit) LIABILITIES

		Before allocation Gold francs	After allocation Gold francs
Capital			
Authorised: 600,000 shares, each of 2,500 gold francs ...	1,500,000,000		
Issued: 481,125 shares	1,202,812,500		
of which 25% paid up		300,703,125	*300,703,125*
Reserves			
Legal Reserve Fund	30,070,313		*30,070,313*
General Reserve Fund	144,133,210		*205,133,210*
Special Dividend Reserve Fund	36,807,964		*61,207,964*
Free Reserve Fund	120,200,000		*156,800,000*
		331,211,487	*453,211,487*
Deposits *(gold)*			
Central banks			
Sight	3,052,089,200		
Not exceeding 3 months	111,953,071		
Over 3 months	369,109,135		
Other depositors			
Sight	166,881,545		
		3,700,032,951	*3,700,032,951*
Deposits (currencies)			
Central banks			
Sight	46,432,491		
Not exceeding 3 months	21,292,188,676		
Over 3 months	2,253,106,985		
Other depositors			
Sight	22,170,678		
Not exceeding 3 months	475,175,947		
Over 3 months	128,133,537		
		24,217,208,314	*24,217,208,314*
Notes			
Over 3 months		483,677,691	*483,677,691*
Miscellaneous		98,419,824	*98,419,824*
Provision for Building Purposes		82,065,109	*82,065,109*
Profit and Loss Account		148,832,656	—
Dividend payable on 1st July 1972		—	*26,832,656*
		29,362,151,157	*29,362,151,157*

REPORT OF THE AUDITORS TO THE BOARD OF DIRECTORS AND TO THE GENERAL MEETING OF THE BANK FOR INTERNATIONAL SETTLEMENTS, BASLE

In our opinion the Balance Sheet and the Profit and Loss Account give a true and fair view of the state of the Bank's affairs at 31st March 1972 and of its profit for the year ended on that date. We have obtained all the information and explanations which we have required. The Bank has kept proper books, and the Balance Sheet and the Profit and Loss Account are in agreement with them and with the information and explanations given us.

Zurich, 26th April 1972. PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT

for the financial year ended 31st March 1972

		Gold francs
Net interest and other income		172,741,185
Less: Costs of administration:		
Board of Directors	265,915	
Management and Staff	12,561,590	
Office and other expenses	3,549,608	16,377,113
Net operating surplus		156,364,072
Less: Amount transferred to Provision for Exceptional Costs of Administration		7,531,416
Net Profit for the financial year ended 31st March 1972		148,832,656

The Board of Directors recommends to the Annual General Meeting that the Net Profit should be allocated in accordance with Article 51 of the Statutes as follows:

Dividend of 6% p.a. on paid-up capital		
37.50 gold francs per share on 464,725 shares for twelve months	17,427,187	
28.125 gold francs per share on 16,400 shares for nine months	461,250	17,888,437
		130,944,219
Additional dividend (statutory maximum) of 3% p.a. on paid-up capital		
18.75 gold francs per share on 464,725 shares for twelve months	8,713,594	
14.0625 gold francs per share on 16,400 shares for nine months	230,625	8,944,219
		122,000,000
Transfer to General Reserve Fund		61,000,000
		61,000,000
Transfer to Special Dividend Reserve Fund (statutory maximum)		24,400,000
		36,600,000
Transfer to Free Reserve Fund		36,600,000
		—

Movement on the paid-up Capital, Reserve Funds and Provisions

In gold francs

Paid-up Capital

Balance at 1st April 1971:	
464,725 shares, each of 2,500 gold francs, of which 25% is paid up ...	290,453,125
Add: 16,400 shares, each of 2,500 gold francs, of which 25% is paid up, issued during the financial year 1971–72	10,250,000
Balance at 31st March 1972 per Balance Sheet	300,703,125

Reserve Funds

(After allocation of the Net Profit)

	Legal Reserve Fund	General Reserve Fund	Special Dividend Reserve Fund	Free Reserve Fund
Balances at 1st April 1971	29,045,313	99,958,210	22,007,964	98,000,000
Add: Allocation in respect of the years:				
1970–71		37,000,000	14,800,000	22,200,000
1971–72		61,000,000	24,400,000	36,600,000
Allocation of the premium received on the issue of 16,400 new shares ...	1,025,000	7,175,000		
Balances at 31st March 1972 per Balance Sheet	30,070,313	205,133,210	61,207,964	156,800,000

Provision for Building Purposes

Balance at 1st April 1971	80,671,000
Add: Exchange difference	2,742,583
	83,413,583
Less: Amortisation of expenditure incurred during the financial year	1,348,474
Balance at 31st March 1972 per Balance Sheet	82,065,109

BOARD OF DIRECTORS

Dr. J. Zijlstra, Amsterdam	Chairman of the Board of Directors, President of the Bank
Henri Deroy, Paris	Vice-Chairman

Baron Ansiaux, Brussels
M. J. Babington Smith, London
Dr. Guido Carli, Rome
Dr. Leonhard Gleske, Bremen
Dr. Karl Klasen, Frankfurt a/M.
Dr. Donato Menichella, Rome
The Rt. Hon. Sir Leslie O'Brien, London
Dr. Edwin Stopper, Zurich
Robert Vandeputte, Brussels
Olivier Wormser, Paris
Per Åsbrink, Stockholm

Alternates

Dr. Paolo Baffi, Rome, or
Prof. Francesco Masera, Rome
Bernard Clappier, Paris, or
Marcel Théron, Paris
Dr. Otmar Emminger, Frankfurt a/M., or
Johannes Tüngeler, Frankfurt a/M.
Georges Janson, Brussels
C. J. Morse, London, or
M. J. Balfour, London

MANAGEMENT

René Larre	General Manager
Dr. Milton Gilbert	Economic Adviser, Head of the Monetary and Economic Department
Dr. Antonio d'Aroma	Secretary General, Head of Department
Dr. Hans H. Mandel	Head of the Banking Department
D. H. Macdonald	Manager
Henri Guisan	Legal Adviser
Dr. Antonio Rainoni	Manager
Maurice Toussaint	Manager

D. H. Stapleton	Assistant Manager
Prof. Dr. F. E. Klein	Assistant Manager
A. N. Barltrop	Sub-Manager
Dr. Warren D. McClam	Sub-Manager
M. G. Dealtry	Sub-Manager
Robert Chaptinel	Sub-Manager