BANK FOR INTERNATIONAL SETTLEMENTS

TENTH ANNUAL REPORT

1st APRIL 1939 — 31st MARCH 1940

BASLE

27th May 1940

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TENTH ANNUAL REPORT

TO THE ANNUAL GENERAL MEETING OF THE BANK FOR INTERNATIONAL SETTLEMENTS

Basle, 27th May 1940.

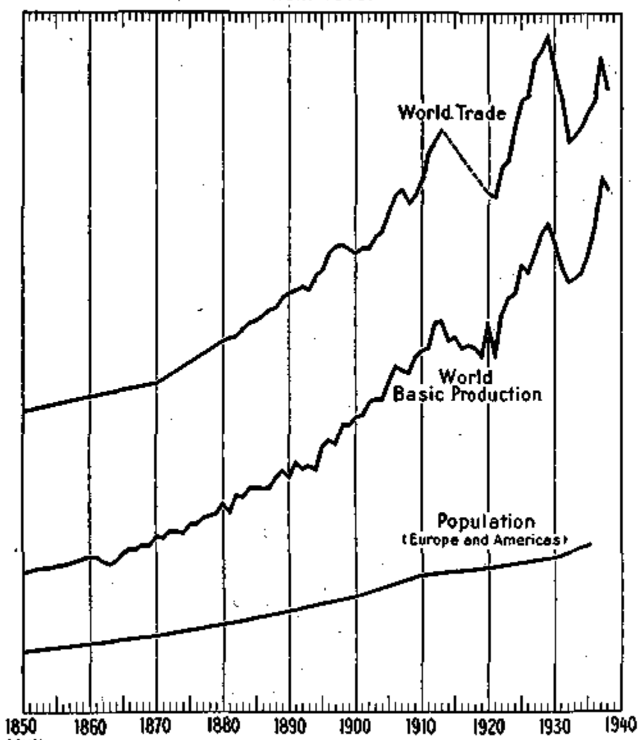
Gentlemen,

I have the honour to submit to you the Annual Report of the Bank for International Settlements for the tenth financial year, beginning 1st April 1939 and ending 31st March 1940. The results of the year's business operations are set out in detail in chapter VII. Notwithstanding the repercussions on the Bank's activity of the outbreak of hostilities, the net earnings, after provision for contingencies, have been sufficient for the Board to recommend to this General Meeting an annual dividend of 6 per cent. without drawing on the Special Reserve Fund.

The balance-sheet total has declined from 606.5 million Swiss gold francs on 31st March 1939 to 469.9 million Swiss gold francs on 31st March 1940. In a large measure this reduction in the balance-sheet may be explained by a tendency among the various central banks, in present disturbed conditions, to maintain their foreign reserves either in gold or as direct deposits with banks in the markets where payments have to be made. It is satisfactory that the Bank for International Settlements has been able to meet all its obligations without difficulty and still to maintain a high degree of liquidity. Having assumed my position as President of the Bank on 1st January 1940, I may be permitted to say that the ease with which the Bank for International Settlements has passed through a difficult period reflects great credit on the skill and foresight of my predecessor, Dr. J. W. Beyen, and his collaborators in the Management of the Bank.

The war of 1914-18 interrupted a long upward movement in world production and trade that had gathered momentum from the middle of the nineteenth century when, in addition to technical improvements in production, transport on a large scale over land and by sea was made possible by rapidly expanding railway facilities and steamship services. The value and volume of international trade increased about five times between 1850 and 1914. The average annual increase of about 3 per cent. in the world output of goods and services is borne out by more careful investigations of statistical material of the period up to 1914, including recent estimates of the long-term trend in national income. As during the same time world population increased at the rate of

World Trade and Basic Production
from 1850.



Sources: Trade - Prof. E. Wagemann
Production - Carl Snyder
Population - B. I. S. estimates

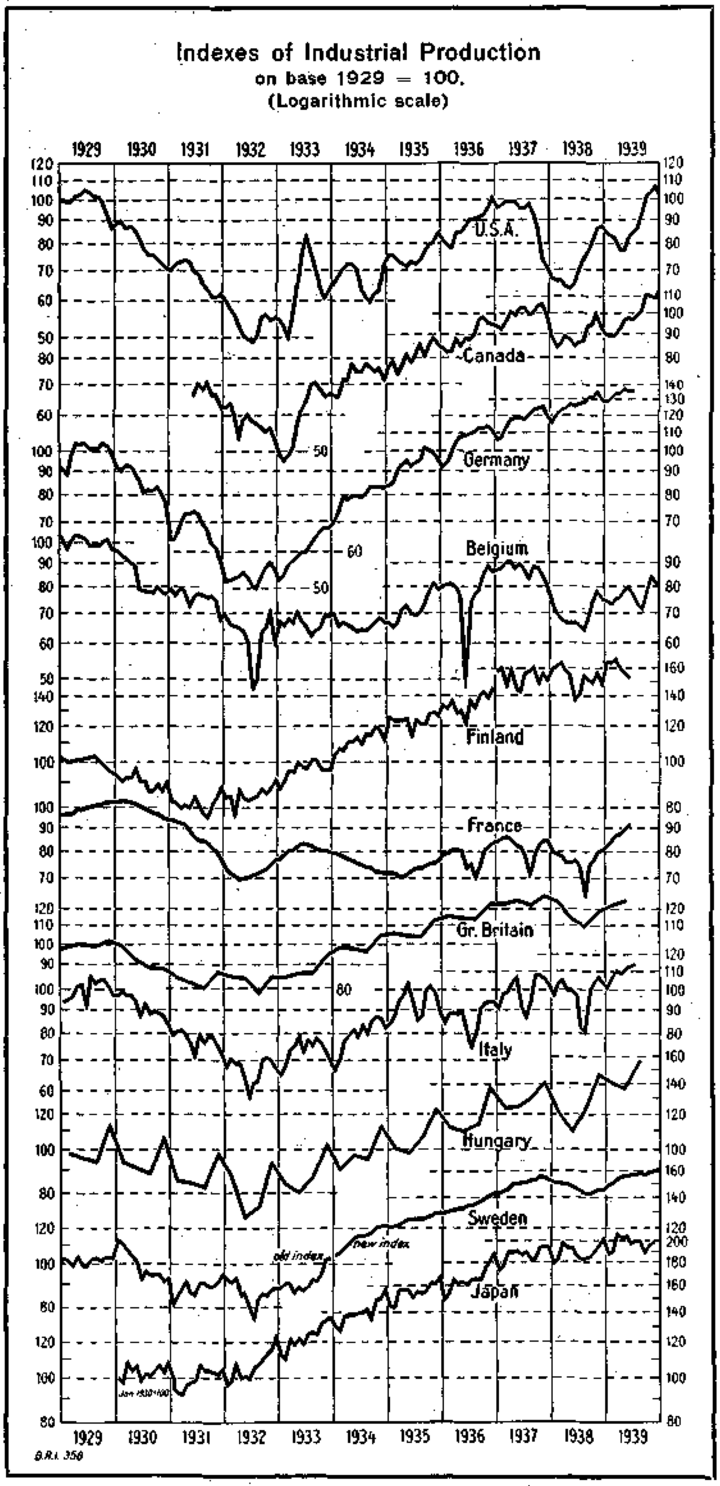
0.8 to 1 per cent. per annum, there was over the period a margin for a steady improvement in the standard of living. In some countries real wages were trebled between 1850 and 1914. This improvement was built on the basis of the international gold standard, the relative freedom of trade and the intensification of international lending both at short and at long term.

Despite all efforts to maintain output during 1914–18, world production declined markedly in those years, as may be seen from the graph. The greater scarcity of goods produced together with the large requirements for the pursuit of the war caused a substantial reduction in the standard of living of the average citizen, obscured to some extent by higher income in terms of money. When the war was over the natural tendency was to revert as far as possible to pre-war conditions and reconstruction became the goal of economic and monetary policy. In a fair measure this objective was realised: budgets were balanced; the international gold standard was restored; foreign trade was largely freed from prohibitions and quantitative restrictions; and international lending soon attained a considerable volume (although under different forms and in new directions). To all outward appearance the basis was created for a further advance in prosperity. Indeed, the national income of the world — even after making allowance for an increase in commodity prices — soon surpassed the 1913 figures and the volume of world trade in 1929 was about 30 per cent. above the pre-war level.

World Income and Trade		1913	1929	1937
World income(1)	in 1,000 millions of current dollars (2)	100–110	205-215	200-210
Value of world exports and imports	in 1,000 millions of current dollars (2)	40.6	68.3	53.8
Volume of world exports and imports	index numbers: 1913 = 100	100	130	126

(1) Estimate made at the B. I. S.
(2) In 1913 and 1929 one ounce fine gold equivalent to $ 20.67 and in 1937 to $ 35.00.

The progress which had thus been achieved was impressive, but it was not to last. The decline in the autumn of 1929 was probably at first merely an example of an ordinary downward turn in the business cycle, but it released depressing forces which soon became overwhelming and brought upon the world a financial crisis and a series of monetary convulsions such as had never before been known in times of peace. Regarded historically the consequent setback in material progress was *of crucial importance*, and it is to be hoped that further attempts will be made to analyse the causes of the great depression of 1930–33. In some respects this depression led to even greater disturbance in international financial relations than the war of 1914–18 had done. The losses sustained by bankers and investors on their foreign holdings were greater after 1930 than after 1918. As a result the international credit system was largely put out of action — there has been an almost complete cessation of long-term foreign investment and a gradual liquidation of a great mass of short-term credits often at considerable loss. Foreign trade has been hampered by

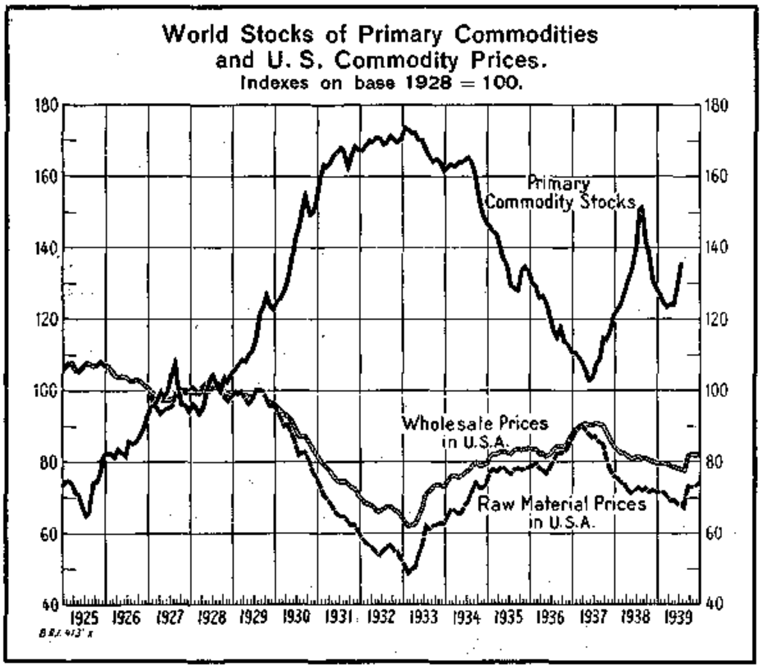


a formidable network of restrictions — partly commercial, partly of a monetary character — and the economic and financial policies pursued by the various governments have conformed less and less to a coherent international pattern. The result has been a diversity of the economic development in different countries, which stands in sharp contrast to the more uniform tendencies in the 'twenties, although the world was then recovering from the effects of a great war.

The United States, with about 40 per cent. of the world's industrial production, 40 per cent. of the consumption of industrial raw materials and 40 per cent. of the world's national income, was harder hit by the 1930-33 depression than almost any other country and also experienced the greatest difficulties in restoring the balance necessary for a new advance in prosperity. On the other hand, there were countries which within a few years managed to increase their industrial production well above the previous record of 1929 through having attained at an early date an equilibrium in their domestic cost and price structure and in their relation to other countries. In the United Kingdom the combined effect of the depreciation of sterling (whatever its consequences may have been in other ways), of the balanced budget and of the decrease in interest rates through the great conversion of War Loan in 1932 provided a firm basis for recovery; and the stability of exchange rates within the sterling area greatly assisted the recovery of foreign trade of the countries concerned. State intervention not only designed to stimulate business activity but planned to be the dominant factor in an increase of national production and the absorption of unemployment was the characteristic policy of several governments, particularly in Germany and Italy. By the end of 1936, after the devaluation of the gold bloc (France, Holland, Italy and Switzerland) and the simultaneous conclusion of the Tripartite Agreement, a new equilibrium in the world's monetary conditions seemed within reach and a rapid improvement in trade set in over a wide area, only to be interrupted by the abrupt setback emanating from the United States in the autumn of 1937. Notwithstanding these and other vicissitudes which affected economic life, the volume of world production had made great progress from 1933, as may be seen from the graph of basic production on page 6 and that of industrial production on page 7.

The increase in output was, however, only partly available for an improvement in the standard of living: a rapid rise in the outlay for armaments absorbed particularly from 1936 onwards an ever-increasing share of the national income; but precisely because of the greater volume of production the mounting requirements could generally be met without an actual reduction in the goods and services available for ordinary consumption.

Total world expenditure on armaments is estimated to have been at the annual rate of some $20,000 million in the first half of 1939. To this must be added the unknown amounts expended by the various governments on stocks of essential commodities. It is in many respects surprising that so much public spending, when current gold production was at a record level and interest rates lower than at any time since the 'nineties of the last century, did not bring about any appreciable rise in commodity prices.



In the United States wholesale prices of commodities, after advancing in 1936–37, declined in August 1939 to the average of 1934. The supply of goods was evidently sufficient to meet all demands without strain on the markets. As far as raw materials were concerned the capacity of the producing areas was not fully utilised, as is evidenced, inter alia, by the restriction schemes in force and by the rapid advance in output whenever the production or export quotas were increased in response to growing demand as, e. g., in the winter of 1936–37. Semi-manufactures and finished goods could also be supplied in greater quantities as a result of technical progress and the unused industrial capacity still found in many countries. The weakening of commodity prices in the United States during the first eight months of 1939 naturally produced a strain on European countries in which business was on the up grade, and where domestic causes were therefore against a price fall.

Including the United States world industrial production in the first half of 1939 had barely recovered to the 1929 level; excluding the United States it was about 12 per cent. higher. In the United States the business curve receded slightly up to the summer of 1939, but from then on an unmistakable increase in activity was noticeable. American imports of raw materials, although somewhat higher than in 1938, remained in the first half of 1939 well below the level of the 1936–37 boom, and this failure to stage a real recovery had its repercussions on the fortunes of primary producers, who were gradually forced to intensify the curtailment of their own purchases from industrial countries. In this and other ways the recession on the world markets reacted on the economies of individual countries in Europe, an interesting example being that of Sweden because of the marked difference in the rate of domestic and export activities in 1938.

The combination of expanding domestic industries and contracting export activity had the effect one would expect, an increase in the import surplus, as shown by the second table on the following page.

Sweden. Indexes of industrial production.*

Indexes on base 1935 = 100	Domestic industries		Export industries	Other (unclassified) industries	All industries
	Con-sumption industries	Capital goods industries			
1933	84	64	76	78	74
1935	100	100	100	100	100
1936	106	110	111	107	109
1937	115	125	128	123	122
1938	119	131	113	125	123

* The annual figures of the Swedish Board of Trade, which are more comprehensive than the monthly index of the Federation of Swedish Industries used for the graph on page 7.

The Swedish development was notable in that the upward trend of the country's economy had gone on almost uninterruptedly since 1933, i. e. for five years, when in 1938 the recession came on the world markets. It was feared in Sweden that the time would be ripe for a setback of domestic activity according to the ordinary behaviour of the business cycle. But even the adverse effects from abroad did not retard progress — and in this connection it should be remembered that the increase in Swedish armament expenditure was at a lower rate than in most other countries. It would seem as if Sweden had been able to maintain a proper balance in its cost and price structure, including the cost of wages and of capital, with the result that investment in housing and other capital assets remained at a high level.

Sweden. Foreign trade.

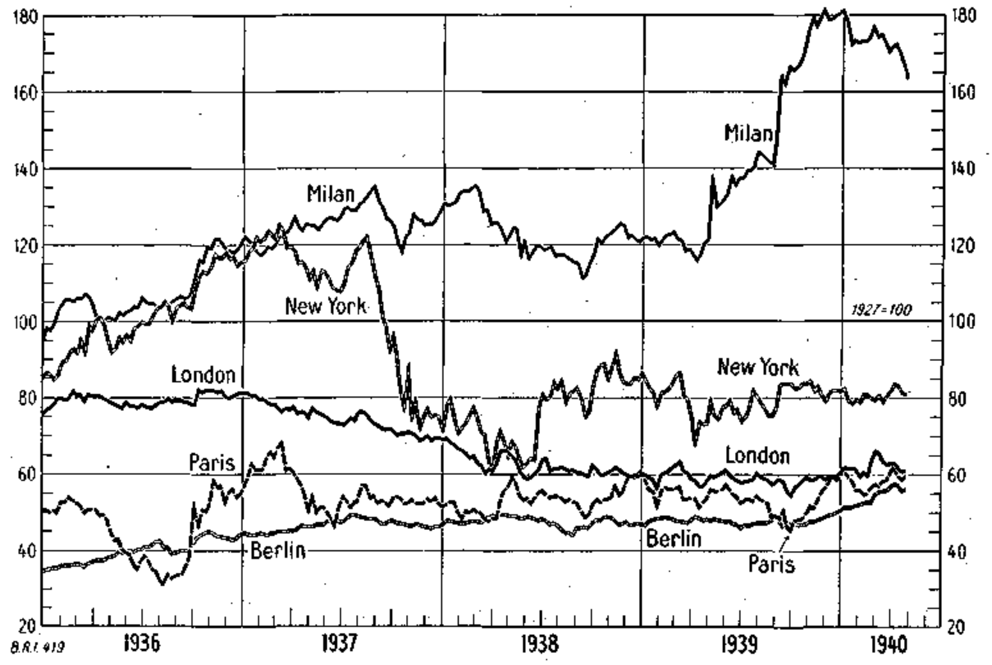
Million Kr.	Exports	Imports	Balance
1936	1,514	1,633	— 119
1937	2,000	2,123	— 123
1938	1,843	2,082	— 239

Elsewhere in Europe, with few exceptions, armament expenditure increased at a progressive rate. It is vain to speculate on the question whether this increase in public spending did more to stimulate or to distort the general growth in industrial activity which became noticeable in the early part of 1939. It is remarkable to note the extent to which an intensification of armament production in many countries proved compatible with higher private investments, for instance in housing.

The outbreak of war came at a time when business in most countries was on the upturn with a rise in consumption, production and investment; and business sentiment — apart from the fear of war — was certainly tending towards a more hopeful mood. Psychologically the fear of war had exerted a depressing influence not so much on industry and trade as on the stock exchanges, where quotations in many countries tended to fall until August 1939.

At the beginning of the war the attitude of investors suddenly changed; there was, particularly in New York, an upward movement in share quotations

Stock Exchange Quotations.
(Indexes of American Economic News Service, 1927 = 100)



during the first half of September, to be followed by a weakening as hopes of a war boom in the United States based on large foreign orders gave way to a more cautious outlook.

The transition from a peace to a war economy, which in 1914–15 had been gradual, characterised by the catch-word "business as usual", was speeded up in the autumn of 1939 through the immediate introduction of far-reaching measures mostly prepared in advance. This preparedness together with the high state of liquidity on the money markets made it, on the one hand, unnecessary to issue emergency decrees instituting general debt moratoria as had been the case on the outbreak of war in 1914. But it meant, on the other hand, that in many countries exchange restrictions, as well as export and import prohibitions covering a wide range of commodities, were at once put into force with important effects not only on foreign trade but also on the various domestic economies.

The essential features of war economy so closely studied during and after the last war and now again brought to the fore are simple enough. The fundamental problem arises from the fact that the needs of the state increase twofold or more at a time when the real output of goods and services is reduced by the withdrawal of men through mobilisation and by the obstacles placed in the way of foreign trade. Some compensation can no doubt be achieved through more intensive work by those behind the front, taking up unemployed factors, enlisting more women in occupations outside the home, further utilisation of available men and machines, and through a postponement of the maintenance and replacement of assets not directly needed for war purposes. Moreover, foreign assets — whether gold, foreign exchange or investments — may be drawn upon to offset a decline in exports and other deficiencies arising in the balance of payments. As, however, no country wants to eat into its accumulated capital more than is indispensable, great efforts are made to maintain exports at the highest possible level. Production for export purposes presupposes, however, in most cases permission to obtain the necessary allocation of workers and raw materials and thus becomes an element in the general war organisation, subject to the discretionary decisions of the authorities. In terms of real economy the problem consists in the most useful disposal of limited resources for one major goal, the attainment of which necessarily involves a reduction in the standard of living. From a financial point of view different methods are available to the government for obtaining command of the necessary resources — higher taxation, borrowing of genuine savings, mobilisation of foreign resources, other forms of requisitioning and finally inflation. Anxiety to avoid inflation is, of course, universal. The following extract from the Annual Report of the Bank of Canada is typical of the consideration which in this connection is uppermost in people's minds: "Recollecting the effect of developments of an inflationary character during and after the war of 1914–18, various countries have expressed the intention of doing everything possible to avoid a repetition of inflation during the present struggle. The success of such an effort in any country where it is made will, no doubt, largely depend upon the degree of public understanding and acceptance of the fact that the direct form of sacrifice is more equitable, and in the long run less costly, than any other method of dealing with the financial problems of a war."

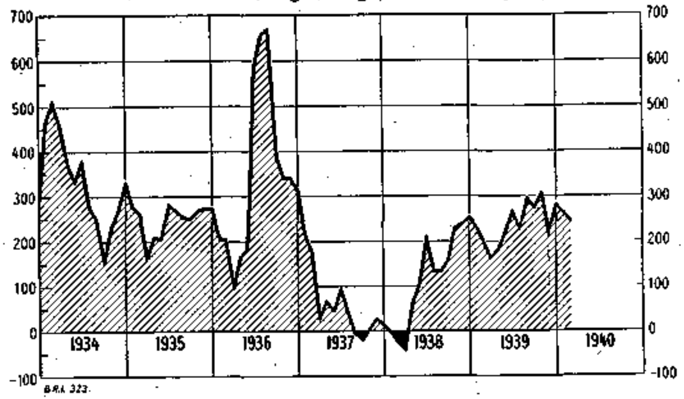
In individual countries — and not among the belligerents only but also among the neutrals in Europe — the volume of government expenditure rose rapidly from the autumn of 1939, creating pressing problems of financing the resulting deficits by new taxation and by borrowing. In Switzerland, for example, the 1938 budget closed at an expenditure level of Sw. fcs 518 million, the 1939 budget at Sw. fcs 633 million, while it is expected that the mobilisation and national defence expenditure from September 1939 to the end of June 1940 will amount to Sw. fcs 2,500 million, or about the same sum as the total mobilisation expenditure of the four years 1914–18. Present engines of war are much more costly than those in use in 1914–18; and, even if the industrial output behind the front has increased by perhaps 25 to 50 per cent. through an advance in technical efficiency and a greater degree of industrialisation, the effort demanded to finance war and mobilisation is on a formidable scale. In the various countries very much the same problems are being discussed: how is it possible to restrain private consumption in order to set resources free for the immense needs of the government?

The present war started before the debts incurred in 1914–18 had been repaid, with the result that certain countries entered the war with a heavy public indebtedness amounting in some cases to a year's national income or even more. Rates of taxation have been raised to heights never known before, but few countries in Europe were, even so, able to cover by taxation more than one-half of their total expenditure in the first half-year of war. The need for borrowing is great; and capital which formerly went into private investments is now required by the governments. This is of greatest importance for the building industry, which in recent years has provided one of the main outlets for current savings, being in many countries responsible for as much as one-half of the annual increment in the formation of capital assets. In 1914–18 the activity of the building industry was reduced in Great Britain by about 40 per cent. and it is expected that the reduction will be at least as large in the present emergency. The stoppage of so much building naturally exerts a depressing influence on the national economy, counterbalancing up to a point the expansionist influence of the government's deficit spending, most noticeable in its effect on the armament industries. Financially, the diversion to the Treasuries of resources previously available for building presents few problems, but, economically, the transfer of workers from the building trades, which usually allow relatively high rates of remuneration, to other trades with generally lower rates of pay is no easy matter (quite apart from the difficulties involved, especially for skilled workers, in a change of trade and removal from one locality to another). The case of the building trade is a good example of the interplay between financial and economic adjustments; it also illustrates the difference between the war economies in Europe and the peace economy of the United States, as there can be little doubt that the American business trend will depend in a large measure upon the behaviour of the building industry.

It is true, of course, that increased orders from Europe will affect the armament and some other industries in the United States, such as the manufacturers of tools and machinery, and that a variety of goods will be exported to a great number of countries, among which those of Latin America may assume special importance. These additions to the United States export trade may be by no means negligible; to the extent to which payments will be made by the utilisation of balances obtained from gold or by other means involving a net increase in the active purchasing power on the American market, the impetus to recovery produced by the export trade is likely to be somewhat enhanced. But, even so, the economy of the United States with a national income of over $70,000 million can hardly be dominated by the magnitude of the rise in exports, total exports amounting to around $2,000 million in the six months to February 1940 as compared with $1,500 million in the corresponding six months of 1938–39. That the peak of the first upswing after the outbreak of war was reached as early as December 1939 would seem to indicate that the influence of war orders is limited and that the American economy is still essentially a peace economy.

The outlay for national defence by the United States Government itself increased from $1,140 million in 1938–39 to an estimated amount of $1,359 million in 1939–40 and $1,539 million was originally proposed in the budget for 1940–41 to which supplementary credits of more than $1,000 million have been

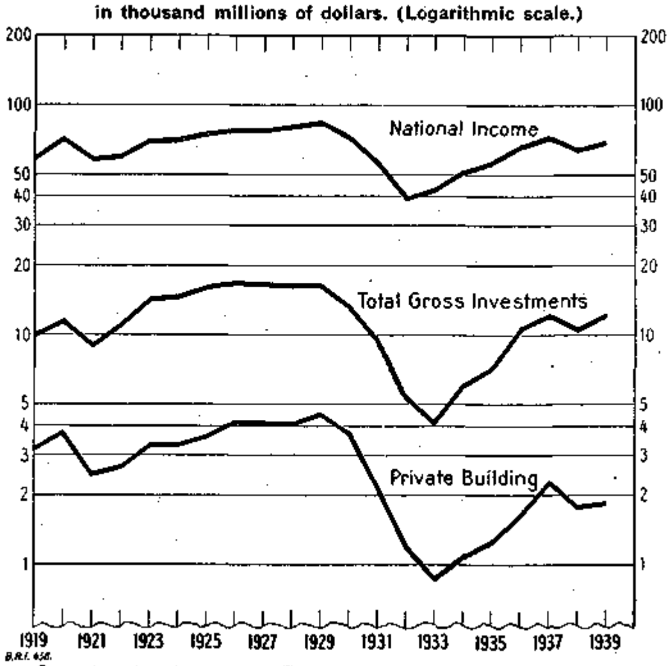
U. S. Treasury Net Cash Expenditures.
Three months' moving average, in millions of dollars.



This graph is based on statistics of "net cash outgo" published in the U. S. Treasury monthly bulletin.

added — all these increases affecting very much the same industries as those stimulated by European orders and thus liable to intensify a specific lack of balance in the American economy. As a reduction in the current relief expenditure in the United States budget for 1940–41 was planned, the net amount of deficit spending should not be higher on balance by the full increase in defence expenditure. Experience has proved however that monetary measures such as the depreciation of the dollar, cheap money and deficit spending have not been sufficient by themselves to achieve or even to support effectively a sustained recovery. Such measures can be of lasting effect only in so far as they (among other factors of an economic character) influence the continuing flow of private funds into durable producers' goods and into housing.

U. S. National Income and Gross Investments
in thousand millions of dollars. (Logarithmic scale.)



Gross Investments represent Federal Reserve estimates of expenditure on durable goods, except for consumers' equipment.

The capital formation as shown in the graph represents value figures and it may be asked to what extent an adjustment should be made for price changes in comparing, for instance, the trend in 1939 with that of the years 1926 to 1929. American wholesale prices in 1939 were about 20 per cent. less than in 1929 but wage rates were 10 to 20 per cent. higher; and such indexes as exist of costs of construction seem to indicate a level as high in 1939 as in the year 1929 notwithstanding the shrinkage in the volume of investments. The reduction in new capital formation from the 'twenties to the 'thirties has been attributed in much recent discussion to greater maturity of the American economy and the argument runs that, with the growing measure in which natural resources have been exploited (disappearance of the "frontier") and with a reduced rate of increase in population through the virtual stoppage of immigration, a less rapid expansion of capital assets by private initiative is only to be expected. The total of existing structures, buildings and machinery more nearly meets requirements than formerly, it is said, and the pressure to expansion is, therefore, less. Another view of the situation is obtained, however, if comparison be made with some of the "older" countries of Europe where the "frontier" vanished long ago. In the United Kingdom, Sweden and Switzerland — as referred to above — one-half of the gross capital formation consists of housing while such investments in the United States amount to barely one-quarter of the corresponding total even at the low rate of total American investments in recent years. When current savings are used less for developing the railroad, power and automobile industries or for constructing a network of motor roads, they may, as in many European countries, be more largely used to provide improved dwellings. Great attention is being given in the United States to the possibilities of increased building activity, notably in the field of moderately-priced houses for which costs of production and terms of financing are, of course, of particular importance. In general the upswing in the autumn of 1939 was characterised by little increase in wage costs, in that respect contrasting sharply with the tendencies during the short-lived boom of 1936–37.

The Latin American countries and primary producers in other parts of the world — which with the United States comprise about 50 per cent. of the world's productive capacity — are relatively slightly affected by the dislocation of the war, being able to obtain generally higher prices for their export products. The monetary reserves of these countries were strengthened in the winter of 1939–40 and market quotations of their foreign obligations improved. In so far as it will be possible during the war to refer to a world market or a gold level of commodity prices, the reference must be to conditions prevailing outside the more or less distorted markets in Europe. Even if the world — so closely interconnected through modern means of communication — cannot be rigidly divided into two distinct halves, the difference will be considerable between relatively free economies overseas and the conditions in those countries (mostly in Europe) which for emergency purposes tend towards an increased control of production, of domestic and foreign trade and of commodity prices.

One problem which necessarily arises in this connection is the extent to which the ordinary system of providing an inducement to activity by a rise in prices and wages can be replaced by a more direct organisation of production. In 1914–18 the familiar price mechanism was allowed to work, with its incentive to economic exertion and its restrictive effects on consumption — but the result was inflation. In practice some compromise will very likely have to be found between reliance on direct control and provision of stimulus by higher remuneration, but the compromise need not be the same in different countries. As far as imported goods are concerned the "economic price" will as a rule have to be paid, although in several instances governments grant subsidies (with or without rationing) to reduce prices of imported commodities, to the immediate advantage of the consumers.

The system of direct control has also been applied on the money and capital markets. The war of 1914–18 came after a long period of growing demand for capital and rising interest rates — and during the war rates continued to rise. The present war has come after years of cheap money and, so far at least, cheap money has generally been maintained despite the war. The reservation of current savings for the needs of the government is largely effected by direct restriction of lending for other purposes instead of by higher rates and, at the same time, the rationing of commodities, which involves reduced opportunities for spending, probably helps to further the flow of private savings to the public coffers. At the end of April 1940 only four countries had increased their official discount rates above the level of the summer of 1939 — Sweden by ½ per cent., the Netherlands and Norway by 1 per cent. and Denmark by 2 per cent. In these four countries, as in most others, the note circulation had risen as a result of the demand for cash on the part of the public, to be held in readiness for emergency. A more real demand for credit facilities — apart from the pressing needs of the government — has also made itself felt in connection with increased cash payments for imported commodities, the holding of reserve stocks and the financing of an extension of plant and equipment, especially in war industries.

Foreign trade is being more and more paid for on a cash basis. The cash principle of the United States "cash and carry" legislation corresponds in fact to a general tendency intensified by the widespread introduction of clearings and, of course, by the general state of uncertainty. Gold as the accepted medium for settling international balances has naturally acquired increased importance, and this development in the methods of effecting international payments is to some extent reflected in the activity of the Bank for International Settlements. Normal credit relations naturally persist between countries politically connected as, for instance, colonies and mother countries, as well as between foreign subsidiaries and the parent firms at home. Mention should also be made of the credits granted on the basis of special arrangements as, e. g., by the Export-Import Bank of the United States, which is able to lend on extended terms funds obtained from public sources. On a smaller scale the Bank for International Settlements has continued to arrange for certain self-liquidating credits of a commercial character, through the intermediary of Central Banks, and is, in this connection, glad to reproduce the following statement from the Annual Report of the Swiss National Bank: "Thanks to the co-operation of banks of issue with the Bank for International Settlements, the Swiss National Bank has been able to obtain from that institution advances in foreign currencies which it has transferred to exporters against provision of suitable cover. Since in each case the amount of the loan expressed in foreign currencies was immediately converted by the exporter into Swiss francs at the rate of the day, and since, for the repayment of the Swiss National Bank, he made use of the foreign currency received in settlement of his invoice, exchange risks were avoided."

The outbreak of hostilities has brought to an end business between countries at war with each other. Trading with the Enemy Acts and the various other measures for waging economic warfare as announced by the belligerent nations have curtailed or stopped business in many other directions. The policy of the Bank for International Settlements has been and is to confine its activities strictly to transactions whereby no question can possibly arise of conferring economic or financial advantages on any belligerent nation. A letter setting out the principles which the Bank felt itself under obligation to observe was directed to all clients in December and has received general approval as giving expression to a policy of scrupulous neutrality.

II. EXCHANGE RATES, FOREIGN TRADE AND PRICE MOVEMENTS.

1. EXCHANGE RATES.

In the foreign exchange markets as in other fields the increasing international tension and finally the outbreak of hostilities in September divide the year 1939 into two distinct periods. The first seven and a half months were characterised by a remarkable stability of exchange rates; at no time since 1931 have the principal currencies of the world and the other currencies attached to them shown less fluctuation. The few exceptions — as in China and Peru — did not affect the general rule which was observed despite vast movements of funds due in particular to the repatriation of capital to France and the continued transfer of liquid resources to the United States. In those countries not then subject to exchange control a high degree of international liquidity in the face of adverse circumstances was ensured by the intervention of central banks and exchange funds. But in August the strain became too great and in the course of a few days the whole aspect of the exchange markets was reversed. The support was withdrawn from sterling and the rate depreciated by 14 per cent. against the dollar, followed by a number of the associated currencies. Exchange control was introduced in September 1939 both in the United Kingdom and in France; and in the following months other currencies which had previously been freely traded adopted similar measures. By the end of March 1940 only four of the world's principal exchanges were free from official regulations — the dollar, belga, florin and Swiss franc.

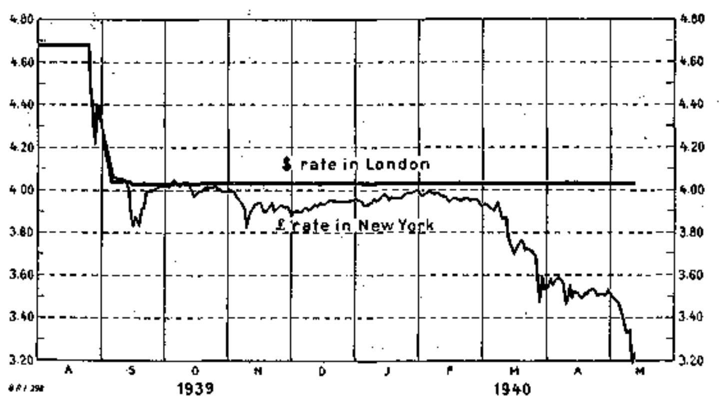
The stability of sterling, maintained from near the beginning of 1939 to the last week in August, was directly due to intervention by the Exchange Equalisation Account: for the first time since 1931 the pound was rigidly held — until the morning of 25th August the dollar rate was maintained at \$4.68¼-½. But the pound was not free from pressure, being, in fact, exposed to the drain from an adverse balance of payments (burdened by additional imports for armaments), continued depression in the raw-material-producing areas of the sterling group, the movement of central bank reserves from London, repatriation of capital to France and the transfer of refugee funds to New York. One of the objectives in pegging the pound was to eliminate the encouragement to outside speculation given by a gradually depreciating currency. The authorities were aided in their policy by the ban on foreign security issues re-introduced in December 1938 and by measures taken in January 1939 placing unofficial restrictions on speculation in gold and foreign exchange, particularly in the sphere of forward transactions. Further, the international assets of the Exchange Equalisation Account were replenished by a transfer of £350 million gold (at the current price) from the Bank of England.

Thus armed, the Account met demands for foreign currencies in the spot market and was reported to have operated in the forward market for dollars in order to maintain the discount on forward sterling as near as possible to the difference in short-term interest rates in London and New

York. In the spring the liquidation of maturing forward gold contracts, which under the unofficial restrictions could not be renewed, helped to support the pound to the extent to which gold positions were not replaced by positions in other currencies or new gold contracts in Amsterdam. In addition, the flow of short-term funds turned against the dollar at the end of June and for the first few days of July, when the U. S. Senate temporarily refused to extend the duration of the American Stabilization Fund. Over the period as a whole, however, the pressure against sterling was persistent. The return flow of capital from the London market to France, which began in November 1938 and continued, after a slight interruption at the outbreak of war, until the end of the year, was accentuated during periods of political crisis, and the same applied to the flight of refugee funds to New York. As the political tension increased after the middle of August, the demand for foreign exchange made upon Exchange Account increased to amounts estimated at over £10 million a day. On 24th August bank rate was raised from 2 to 4 per cent. and the next day the Exchange Equalisation Account withdrew from the market and allowed sterling to find its own level. From $4.68 the dollar rate moved in one day to $4.40 and reached $4.27 by the end of the month. An official ban on foreign security dealings was put into effect on 26th August. Following England's declaration of war on Sunday, 3rd September, foreign exchange control was established on Monday, under the provisions of the Defence (Finance) Regulations.

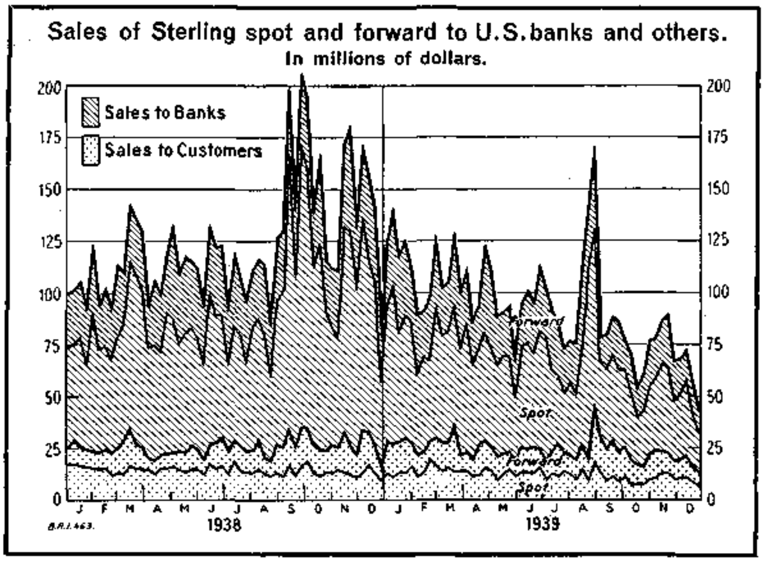
The foreign exchange control limited dealings to authorised banks and bankers, set out the conditions under which foreign exchange could be purchased, specified conditions for trading in gold and authorised the Bank of England to establish official rates for foreign currencies. Against the dollar the Bank originally fixed a buying rate of $4.06 and a selling rate of $4.02; in the middle of September the buying rate was changed to $4.04, and early in January 1940 the buying rate was increased to $4.03½ and the selling rate lowered to $4.02½. On the free markets in other countries rates for sterling were, however, quoted on the basis of the daily supply and demand. The supply in these markets was derived from two sources: (i) balances in the United Kingdom, which non-resident holders were permitted to transfer freely to residents or other non-residents; practically the whole of such balances dated from before the war; (ii) balances arising

Sterling-dollar rate in London and New York.



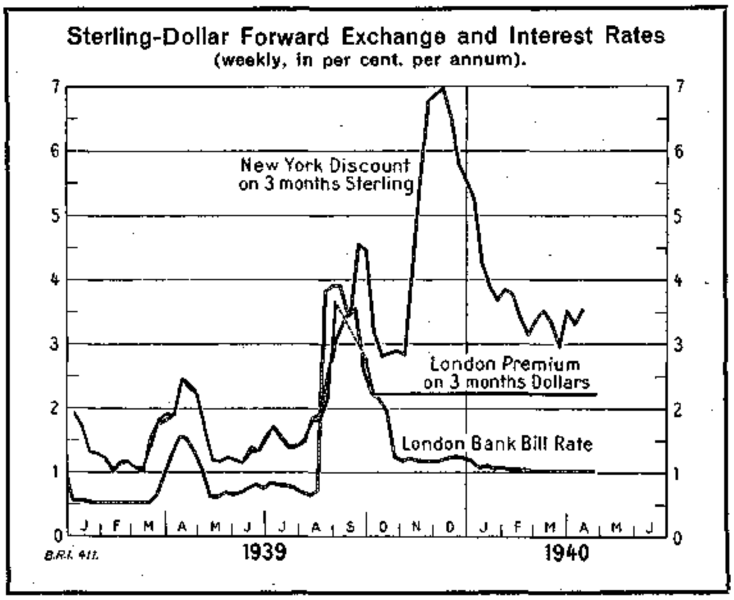
from payments to non-residents in sterling for imports into the United Kingdom. The demand came from non-residents who had sterling payments to make and who were not debarred by clearings and other arrangements between their own countries and the United Kingdom from payments in "free" sterling. When exports from the United Kingdom are paid for with sterling bought in the free market no foreign assets accrue to the British exchange control. To reduce the consequent indirect drain steps have been taken to extend the area of clearing agreements and to limit the sale of British goods against sterling acquired in free markets. By an amendment to the exchange regulations in March 1940 it was made compulsory for exporters from the controlled sterling area of certain commodities (whisky, furs, tin, rubber, jute and jute manufactures) to any of a number of countries (Belgium, Holland and Switzerland, North and South America excluding Canada, the Argentine and Uruguay) to insist on being paid either in foreign currency or in sterling bought at the official rate. Australia and Canada took similar measures, applying however to all exports to non-sterling countries.

The free sterling markets have been characterised by sizeable fluctuations, the rate declining rapidly in March 1940 to around $3.50 in April and again falling abruptly in May. But these markets provide only a small fraction of the total turnover of sterling, being estimated at 10 per cent. towards the end of 1939. As the accompanying chart illustrates, the turnover of sterling in the United States (largely the New York market), as indicated by sales made by banks and bankers, declined from a level averaging more than $100 million weekly in the first eight months of 1939 to roughly $60 million weekly after the introduction of restrictions. Sales from one bank to another were particularly affected, while sales to non-banking customers, who for the most part represent the ultimate users of the exchange, even increased during the period of sterling depreciation at the end of August and during the decline in the free rate in mid-September. The figures include, however, not only sales at free rates but also sales made to customers by American banks where official exchange had to be obtained.



Through the working of the free market the London control has been able to avoid blocking foreign balances held in the British market, while not permitting their transfer at official rates. Foreign holders of sterling balances have thus been entitled to leave the market but only at an unfavourable exchange rate. Comparison between the position of London in 1914 and in 1939 shows that in 1914 the foreign liquid assets of Great Britain consisted of £38 million gold in the Bank of England, about £120 million gold coins in circulation and short-term sterling acceptance claims on the rest of the world believed to have been at least equal to the short-term liabilities on foreign account. At the outbreak of war in 1939 the combined gold reserves of the Bank of England and the Exchange Equalisation Account were broadly estimated (in the Federal Reserve Bulletin for December 1939) at about £500 million, i. e. substantially more than in 1914; moreover, the massive transfer of funds in 1938 and the first seven months of 1939 had no doubt greatly reduced the total amount of foreign volatile funds in London, but the effect of this reduction on the net balance of London's foreign short-term assets and liabilities cannot, in the absence of more complete information, be indicated. In September 1939 practically all the gold held by the Bank of England was transferred to the Exchange Equalisation Account and thus made directly available for use.

Since short-term funds in New York continued to earn practically no interest during the past year, the forward discount on sterling (premium on the dollar) may be compared with a London interest rate. For this purpose the bankers' three-month deposit rate, which generally rules higher than the bill rate, would be more suitable, but a series of quotations is not available. The chart reveals how the discrepancy between forward and interest rates went from under $^1/_2$ per cent. in March to nearly one per cent. in April 1939 when the pound was under accentuated pressure, despite reported forward operations by the British control. It also shows clearly the effects of the exchange control on the forward market: in London, permitted transactions were put through at a fixed charge; in New York, speculative anticipations dominated the narrow free market, and the discount during the November weakness of the spot free rate produced a much wider reaction in the forward market than the greater decline of March 1940.



As long as the sterling-dollar rate was kept stable by the intervention of the

Percentage changes in value of sterling-area currencies.

Country	London Rate against £				New York Rate against $ in $ per unit		
	Units of currency per £ unless otherwise indicated	Aug. 24 1939	Dec. 30 1939	Percentage change	Aug. 24 1939	Dec. 30 1939	Percentage change
British Empire							
Australia	100 A. £	125.0.0	125.0.0	—	3.74 1/2	3.16 5/8	— 15.5
British India . .	per Rupee	17 15/16 d.	18 d.	+ 0.3	0.3502	0.3020	— 13.8
Eire	100 £	100.0.0	100.0.0	—	4.68 1/8	3.95 3/4	— 15.5
New Zealand . .	100 N. Z. £	124.7.6	124.7.6	—	3.77 1/4	3.19	— 15.4
Straits Settlements . .	per S. S. $	28 1/8 d.	28 3/16 d.	+ 0.2	0.5497	0.4656	— 15.3
Union of South Africa .	100 S. A. £	100.5.0	100.5.0	—	4.67 1/2	3.94 3/4	— 15.6
Non-sterling area							
Canada (and Newfoundland) .	Can. $	4.68 1/2	4.45 (1)	+ 5.3	0.99 5/16	0.88 3/4	— 10.6
Hong Kong . . .	per H.K.$	14 5/8 d.	15 d.	+ 2.6	0.2847	0.2472	— 13.2
Other sterling area							
France	Fr. franc	176 23/32	176 1/2	+ 0.1	0.0264 15/16	0.0224 5/8	— 15.2
Egypt	100 E. £	97 1/2	97 1/2	—	4.80 1/8	4.05 7/8	— 15.5
Denmark	D. Kr.	22.40	20.38	+ 9.9	0.2090	0.1933	— 7.5
Norway	N. Kr.	19.90	17.70 (1)	+ 12.4	0.2351 1/2	0.2273	— 3.3
Sweden	S. Kr.	19.40	16.90 (1)	+ 14.8	0.2413 1/2	0.2383	— 1.3
Finland	Markka	226 5/8	210	+ 7.9	0.02065	0.02	— 3.1
Estonia	E. Kr.	17 3/4	16 1/8	+ 10.1	0.2574	0.2381	— 7.5
Latvia	Lat	24 3/4	20 1/2	+ 17.1	0.1891	0.1930	+ 2.1
Portugal	Escudo	110 3/16	108	+ 2.0	0.0428	0.0370	— 13.6
Greece	Drachma	540	535	+ 0.9	0.0085 7/8	0.0073	— 15.0
Turkey	T. £	5.83	5.10	+ 14.3	0.8029	0.7760	— 3.4
Yugoslavia . . .	Dinar	205	200 (2)	+ 2.5	0.0231	0.0235	+ 1.7
Japan	per Yen	14 d.	14 15/16 d.	+ 2.2	0.2731	0.2349	— 14.0
Argentina . . .	free Peso	20	17.75 (1)	+ 12.7	0.2350	0.2275	— 3.2
Uruguay	per free Peso	18 1/2 d.	22 d.	+ 18.9	0.3775	0.3750	— 0.7
Bolivia	controlled Boliviano	142 3/16	143 1/4	— 0.7	0.0329	0.0276	— 16.1

(1) Official rates (middle). (2) Trade payment rate.

NOTE— An attempt has been made to find comparable quotations for the various currencies associated with the sterling area but, while it has been possible to do so within a single market for the two dates indicated, quotations for an individual currency as between New York and London on the same date are not always comparable.

Rates in terms of sterling are London quotations. Except for the currencies of the sterling-area Dominions, middle rates have been chosen whenever possible; where a nominal sellers' rate only was available for one date, sellers' rates have been taken throughout. In the case of the Argentine peso, the free rate on 24th August has been compared with the official London rate of 30th December.

Dollar quotations are New York closing cable rates, where such were available. The Estonian crown rate is derived from dollar quotations of the Estonian National Bank; in the case of the Egyptian and Turkish pounds and the lat, rates were computed from London cross rates.

Owing to incomparability of London and New York rates, the percentage appreciation in London and depreciation in New York for certain currencies are not always consistent with the depreciation of the pound over the indicated period either in New York (15.5 per cent.) or in London (14 per cent.).

Exchange Equalisation Account the various currencies in the sterling area remained stable also in terms of gold. There was consequently a fixed relationship between the sterling area currencies, linked in a fixed ratio to the pound because of ties of Empire, trade or finance, and the gold currencies headed by the dollar. When sterling depreciated in August 1939 the currencies of the sterling area did not all follow the same course; in some instances their sterling rate was kept unchanged; in others allegiance was shifted to the dollar; and there were other changes. An attempt is made in the table on the preceding page to set out as clearly as possible the diversity of movements in relation to the exchange value of sterling and the dollar; it is necessary to underline, however, that owing to the quotation of different rates for sterling in the official and free markets and also the quotation of multiple rates for some other currencies the situation is one of great complexity.

The developments may be summarised as follows:

(i) The link with sterling was maintained by the Empire adherents of the sterling area, and also by France, Egypt and Greece. In the Empire, including all Dominions, Crown colonies, dependencies, mandated states and protectorates (with the exception of Canada, Newfoundland and Hong Kong), a currency free inside the area was in fact created, surrounded by foreign exchange restrictions. In Egypt foreign exchange restrictions similar to those in the United Kingdom were put into effect. Moreover the monetary agreement with France provided for a fixed rate between the pound and the franc.

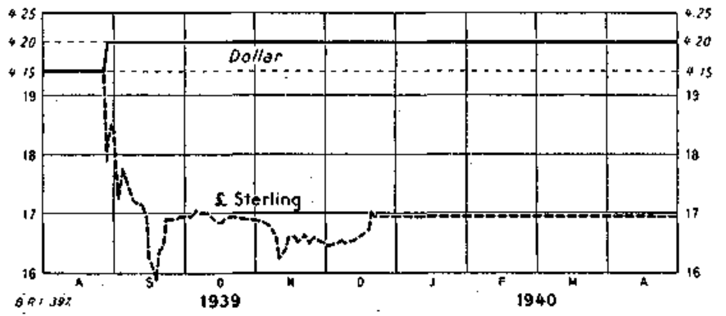
(ii) Canada, Newfoundland and Hong Kong, which though belonging to the British Empire have not been members of the sterling area because of their close trading and financial relations with other countries, allowed appreciations of their currencies against sterling by 5.3 per cent. in the case of the first two, and 2.6 per cent. for the last-named. In the free market in New York the Canadian and Hong Kong dollars fluctuated with the pound sterling, but within a narrower range of depreciation. Canada and Newfoundland established a complete system of foreign exchange regulations, and certain restrictions were also introduced in Hong Kong.

(iii) Japan permitted the yen to follow the depreciation of sterling in the London market, but after some hesitation in September established a link to the dollar of \$0.23 7/16 in order that the currency should not fluctuate against gold currencies with the free pound.

(iv) Portugal similarly permitted the escudo at first to follow the pound sterling in the official market, but formed a link with the dollar at Esc. 27.50 during the November weakness of the free pound in the New York market.

(v) Among the Scandinavian and Baltic countries diverse movements occurred. The Swedish crown remained practically stable in terms of the dollar, being depreciated by only 1.3 per cent., while the Norwegian and Finnish currencies were lowered by about 3 per cent. and the Danish and Estonian by 7½ per cent. In September the Estonian and Latvian currencies

Quotations of Swedish crown in New York and in London.



were linked to the Swedish crown. In all these countries fixed dollar rates were quoted, and as regards Sweden and Norway fixed rates were also quoted for "special pounds" after the introduction of clearing arrangements with the United Kingdom. In Denmark a fixed sterling rate was quoted by the exchange control although no trade agreement was concluded with the United Kingdom. In Finland the outbreak of hostilities created a special position. The Finnish mark depreciated from approximately 50 to the dollar to 57 in early January and to 62 in February. Finland and Sweden applied certain limited and unofficial exchange restrictions from the outbreak of the war, to be followed in both countries by complete exchange control in the course of the winter. It may be mentioned that by special provisions the Bank for International Settlements was exempted from the Swedish restrictions on gold and exchange transactions.

(vi) Turkey permitted some depreciation of the Turkish pound against the dollar, but the Yugoslavian currency link to sterling was broken at the end of August in favour of a dollar rate of Dinars 55.

(vii) Uruguay, after breaking with sterling in mid-September, more than restored the dollar value of her currency, while the Argentine, also shifting the peso to a dollar basis, permitted a slight depreciation against the latter currency, amounting, in the case of officially determined rates, to 2.7 per cent. Thus the Argentine has maintained (from 22nd September 1939) four different rates: an official buying rate at 3.36 pesos per dollar, an official selling rate of 3.73 for goods essential as regards popular consumption and industrial activity; another official selling rate of 4.23 pesos for certain other goods and services; and a free market rate of 4.39 pesos (quotation in December 1939). Corresponding sterling rates were calculated on the basis of the official London rate of $4.02 to the pound. In Bolivia the sterling peg was abandoned in favour of the dollar at the lowest point of the November decline of free sterling in New York, with the result that at the end of the year, after free sterling had recovered, the controlled rate had depreciated in terms of both currencies.

From May 1938 to the outbreak of the war the French franc was maintained within a narrow range in terms of sterling, but the French authorities permitted certain fluctuations, particularly when the pound was under pressure in times of political crises. In contrast to London there have for several years been virtually no foreign funds held in the Paris market; and the

French people have repatriated substantial amounts from abroad, especially in periods of political tension when the pound was weak because of a flow of funds from London. During December 1938 the exchange value of the franc improved from 178.90 to 176.83 and thereafter fluctuated for the most part between 176 and 177 until the depreciation of the pound, beginning 25th August 1939, when the franc reached its highest value in terms of sterling at $175^3/_{16}$. With the outbreak of war the franc was subjected to exchange restrictions and pegged in terms of sterling at a middle rate of $176^5/_8$. The maintenance of this level involved a depreciation of the franc against the dollar between 24th August and mid-September from 37.75 francs per dollar to 43.80, or by 14 per cent., in the official market, while quotations in the free market in New York tended to remain lower.

The French foreign exchange control, established by decree of 9th September, provided for the general prohibition of the export of capital from France, the authorisation of a list of banks to purchase foreign exchange, the restriction of sales to the Bank of France (later the Control Office), the control of all dealings in gold by the Bank of France, and the repatriation or declaration of foreign assets owned by residents in France prior to 15th November (later 15th January 1940). Gradually the exchange regulations in France and in Great Britain were eased as between the two countries, sterling being made more freely available in Paris, and francs in London, with care being taken to see that transfers could not be made from one market to the other in order to circumvent the regulations existing in the former. In London, steps were taken to prevent sales of gold held by French nationals there against other currencies than sterling or francs. Finally, on 4th December, an Anglo-French monetary and economic agreement provided for the maintenance of the existing franc-sterling rate unchanged for the duration of the war and for six months after the conclusion of the peace treaty, for the free use of the currency of the other country and its acquisition against the domestic currency without recourse to gold. Sterling held by the Bank of France could be used for purchases of raw materials in the British Empire, and further sterling requirements of France would be fulfilled against French francs supplied to the United Kingdom for the use of the British Expeditionary Force and other expenditure in the French Empire. In addition, the two governments agreed to divide equitably their expenditure in gold and dollars and to refrain from contracting credits or floating a loan abroad without preliminary agreement with each other. Finally each party undertook to refrain from imposing new restrictions on imports from the other country in order to protect its own market or for any monetary reason.

The repatriation of capital to the French market, which had begun on a large scale in November 1938, continued during 1939 with the exception of a few days at the outbreak of war in early September. In consequence the French monetary authorities were able to increase their gold holdings; in order to aid in providing the Stabilisation Fund with the francs needed to purchase incoming gold two transfers of gold of Frs. 5,000 million each were made from the Fund to the Bank of France (on 20th April and 28th July 1939). Using the data of the gold holdings in the Stabilisation Fund, which were published after a three months' interval beginning in March 1939 and discontinued after August, the table has been compiled, the amounts being shown in U. S. dollars since gold on the books of the Bank of France was carried during the period at one valuation and gold in the Fund at varying daily prices.

French gold reserves.

End of Month	Bank of France	Stabilisation Fund*	Total
	in millions of dollars		
1938 October . .	2,435	103	2,538
November. .	2,435	130	2,565
December .	2,435	331	2,766
1939 January . .	2,435	381	2,816
February . .	2,435	465	2,900
March . . .	2,435	559	2,994
April	2,574	455	3,029
May	2,574	477	3,051
June	2,574	**	**
July	2,574	**	**
August . . .	2,714	**	**

* Includes gold in Rentes Fund. ** Not available.

In a speech on 13th December 1939 the Finance Minister stated that in the ten months prior to the war (i.e. November 1938 to August 1939) the repatriation of capital resulted in a gain of gold by the French authorities amounting to Fr.fcs 26,000 million. From this figure it may be estimated that the aggregate holdings of the Bank of France and the Stabilisation Fund had risen probably to $3,300 million at the end of August, which would mean that the inflow of gold in June, July and August had averaged about $85 million per month. During the political crisis of the summer, as well as during the tension of March 1939, the flow of capital to Paris was accelerated rather than reversed.

Shortly after the outbreak of the war, the return flow of capital was resumed, although a part of the gain in foreign assets was offset by heavily increased purchases of supplies from abroad. In the speech of 13th December the Finance Minister made known that transfers of gold and exchange to France had amounted to Fr. fcs 10,000 million since the beginning of the war. Further, in execution of the decree of 9th September 1939 regarding the declaration of holdings abroad, an additional Fr. fcs 24 milliard of capital, consisting of securities and instruments denominated in foreign currencies, had been repatriated either by deposit with banks in France or by actual importation, without involving a foreign exchange transaction.

In the same speech it was further stated that the return flow of capital to France had come to an end. With the expiry on 15th January 1940 of the period during which assets abroad had to be declared, if they had not been repatriated, the support for the franc arising from voluntary repatriations of funds from abroad ceased to be a factor of importance.

On 11th September 1939 the Secretary of the United States Treasury explained that the monetary agreement established by the Tripartite Declaration made by France, the United Kingdom and the United States in 1936 remained in operation; and, in particular, that the new exchange rates applied by France and the United Kingdom did not constitute "competitive depreciation".

Of the free currencies outside the sterling area the U. S. dollar was exceptionally strong during the whole year 1939 and has remained so in 1940. This strength was not primarily connected with the current items in the balance of payments (for the current surplus fell from $1,026 million in 1938 to $727 million in 1939) but was the result of an intense flow of capital funds to the United States. The following table gives from the beginning of 1938 the monthly figures of the merchandise export surplus, the amount of

Net movements of U. S. A. merchandise, capital and gold 1938–1939.

Date	Excess of Exports	Reported Capital Inflow(¹)	Reported Gain of Gold(²)	"Balancing Item"
	in millions of dollars			
Year 1937 . . .	265	802	1,385	318
1938 January	118	— 43	1	— 74
February	99	— 83	— 10	— 26
March	102	— 77*	52	27
April	115	— 1	70	— 44
May	109	— 96	— 1	— 14
June	87	— 65*	40	18
July	87	— 46	43	2
August	65	67*	137	5
September	79	386	508	43
October	100	219	452	133
November	76	37*	170	57
December	98	70	178	10
Year 1938 . . .	1,134	369	1,640	137
1939 January	35	73*	170	62
February	61	133	175	— 19
March.	77	149	376	150
April	45	345	491	101
May	47	91*	178	40
June	57	23	136	56
July	61	42*	115	12
August	75	228	412	109
September	107	92	329	130
October	117	— 97*	149	129
November	57	17	259	185
December	121	17	250	112
Year 1939 . . .	859	1,114	3,040	1,067

(¹) As reported by banks, bankers, brokers and dealers in the United States on a weekly basis and divided roughly into months (months consisting of five weeks marked with asterisk).

(²) Includes net gain or loss in gold from abroad through exports, imports and changes in gold under earmark in the United States, but excludes the relatively unimportant changes in gold held abroad by the Stabilization Fund. The lag between purchase and payment for gold bought abroad and its import, which takes place usually afterwards and in the case of the Stabilization Fund may take place some time afterwards, introduces, however, a random element into the timing of the "balancing item". So, of course, does the fact that exports and imports may not be paid for in the same month as they are shipped or received.

reported capital inflow and the reported gain of gold from abroad, as well as, in the last column, a "balancing item", which, in fact, represents a net aggregation of heterogeneous items, partly current (such as immigrant remittances, dividends and other "invisibles") and partly capital, i. e. most of the "residual" in the balance of payments estimates (see page 84 below).

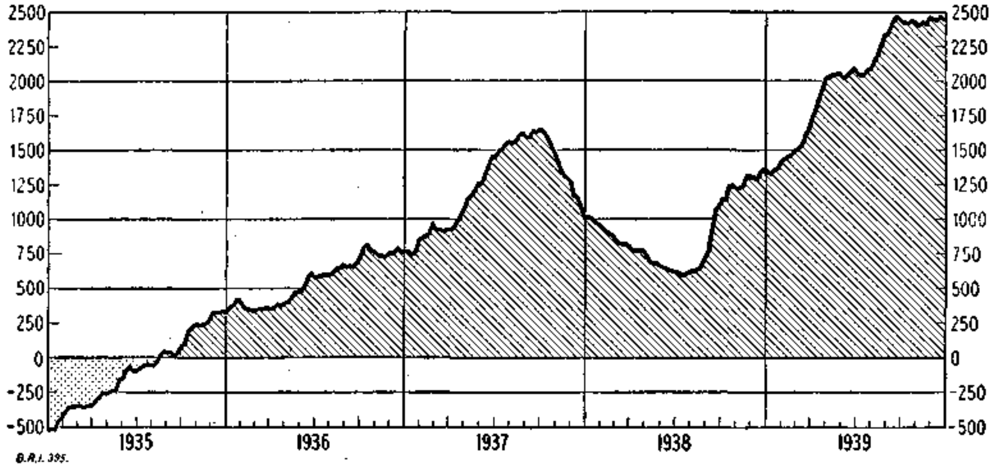
In the first place it is interesting to note that for the first seven months of 1938 capital flowed from the American market to Europe. This flow is largely explained by the 1937–38 depression in the United States, which had the usual effect of driving out capital. It may perhaps be worth noting that still in the first half of 1938 political tension in the international sphere did not markedly influence the currents of capital movements.

In this respect a great change occurred in the summer of 1938 in connection with the tension leading up to and following the Munich settlement. From then onwards a persistent stream of funds has moved from Europe to the United States, intensified in times of acute unrest but never really reversed up to the outbreak of the war in 1939. In no month from August 1938 has the net gain of gold by the United States fallen below the $100 million mark. In April 1939 the gain of gold reached the exceptional figure of $491 million in one month.

In the "balancing item" are included monthly movements of dollar notes to Europe for hoarding purposes. Net shipments of United States currency to Europe, as reported by large New York City banks, totalled $100 million in 1939, of which $26 million was shipped in March and $46 million in April, the highest monthly figures ever recorded. During the next four months net shipments averaged about $2.5 million a month. They declined somewhat immediately following the outbreak of war, but in December increased to $6.3 million and averaged $ 5 million in January and February 1940. Practically all of this currency was sent to the three money-refugee centres in Europe at that time — the Netherlands, Switzerland and Belgium.

The part of the "balancing item" which represents credits and debits in the current balance of payments has very likely remained comparatively stable over the period 1938–39. The changes in this item are therefore mostly due to variations in the inflow of capital, reflecting perhaps partly evasions of the exchange controls instituted in certain countries, partly official transactions, but mostly the continued transfer of assets to the United States from countries not subject to exchange regulations. As may be seen from the table on the preceding page, the inflow of funds revealed by the "balancing item" continued at a high rate during the last quarter of 1939. On the other hand, the inward movement of reported capital came to a halt at the end of September; foreign holdings of balances in the United States were then reduced, mainly because funds were used for payments on the American market. At the same time securities were sold by private British and French holders, who were able to profit not only from the rise on the American stock exchanges but also from the depreciation of their currencies against the dollar. The marked reduction in central bank balances in New York, which had reached their highest level in mid-September,

Net Short-Term Dollar Position of Foreigners
as reported by Banks and Bankers in the U. S. A.
in millions of dollars.

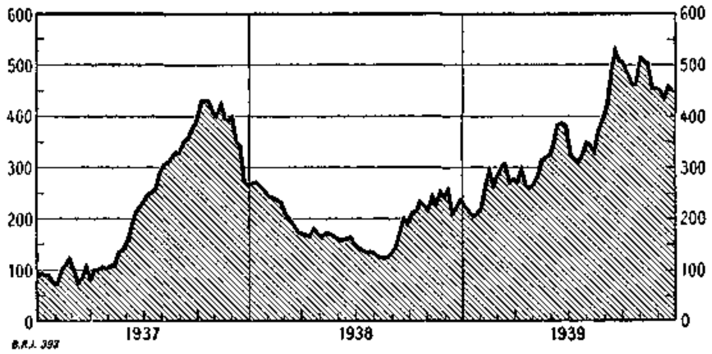


This position is derived from reported statistics of banks and bankers in the United States and consists of the reported short-term liabilities in dollars to foreigners minus reported short-term claims plus the difference between outstanding contracts to sell dollars forward to foreigners and outstanding contracts to purchase. In so far as foreigners' holdings of short-term dollar assets escape the surveillance of the reporting system, the actual foreign position in dollars may exceed reported amounts.

is attributable in small part, perhaps, to the liquidation of outstanding forward contracts, but mainly to heavy government payments for imports from the United States, including advances of funds to American companies to finance an expansion of their productive facilities for aeroplanes and other military needs.

In contrast to August 1914, when the outbreak of war in Europe completely disrupted the New York market and drove sterling to a rate of more than $7.00, as New York banks bid for sterling to meet the country's maturing obligations in London, this time the advent of war occasioned no unusual pressure in the New York market. When sterling depreciated in the autumn of 1939, the New York banks organised a foreign exchange committee under the leadership of the Federal Reserve Bank of New York for the purpose of dealing in concert with the problems facing the market as they arose.

Foreign Central Bank Balances in U. S. A.
in millions of dollars.

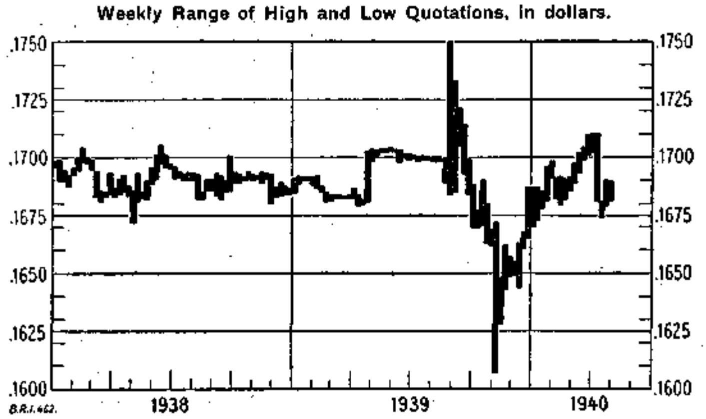


The data, which include both deposits and short-term assets, are estimated on the basis of published changes in these funds since the end of 1934 and an estimated amount of balances held with the Federal Reserve Banks at the end of 1934. Changes in central bank funds with other New York banks and bankers since June 1938 are included from that date, but no allowance has been made for the amount of these funds as on 30th June, 1938.

In Europe the belga was in 1939, as in the previous year, subject to heavy pressure both in the spring and in the autumn, but the two attacks were successfully countered. An interesting feature of the developments in both cases was a widening of the gold points beyond the normal margin. The pressure in the spring began in mid-February, when the Spaak Government resigned, and lasted until April when a new government was formed after the holding of a general election. In the meantime the National Bank sustained a recorded loss of gold and foreign exchange amounting to B. fcs 4,400 million or more than 20 per cent. of the Bank's reserves. The main reason for the pressure was the disturbed political situation in Belgium related to the apprehensions felt with regard to the budget deficit; the acute tension in European politics and internal demands for detaching the belga from gold and linking it to sterling, however, were important contributory factors. The new government formed in April was granted powers to restore by decree the budget position and to obtain certain advances from the National Bank, the Finance Minister specifically disavowing any intention to devalue the belga. As a result the attack came to an abrupt halt and the rate of the belga improved from the gold export point of \$0.1680 to the import point of about \$0.1703 (the parity being \$0.1695). For a time the National Bank refused to grant import licences for gold to private arbitrageurs and in that way kept the rate above the gold import point in order to penalise speculators, but from 4th May the Bank's gold and foreign exchange holdings rose rapidly.

The depreciation of the pound at the end of August produced a sharp rise in the value of the belga to \$0.1750, difficulties in shipping gold at the outbreak of the war making the old gold points inoperative for the time being. By 21st September the gold and foreign exchange holdings of the National Bank had risen to B.fcs 22,800 million, or B.fcs 5,300 million higher than on 27th April 1939. In the last week of September pressure on the belga again set in as a result of internal banking difficulties, renewed apprehensions with regard to the budget position, particularly in view of the high mobilisation costs, and also the growing tension with regard to the external position of the country. The belga was allowed to fall well below the pre-war gold point of \$0.1680, but it should be observed that the real cost of shipping gold had risen sharply with the need of covering war risk at high premiums and also that the Belgian authorities were obliged to support their currency in the New York market rather than in London. On 10th November the belga reached \$0.1610, representing a margin

Belga Exchange in New York.
Weekly Range of High and Low Quotations, in dollars.



from the gold parity of slightly more than 5 per cent., but it was thereafter supported at a somewhat higher level. By the end of December the drain of funds from the Belgian market dried up, and in January a marked improvement in the belga took place, accompanied by a reduction in bank rate from 2½ to 2 per cent.

The Netherlands guilder and the Swiss franc, which bear no statutory relation to gold but are allowed to fluctuate between very narrow limits in terms of gold value, were both exposed to heavy pressure in the spring of 1939, as may be seen from the following table of published gold and foreign exchange losses by the central banks in the two countries:

Monthly change in reported holdings of gold and foreign exchange.

In millions of national currency units	Swiss National Bank	Nederlandsche Bank (¹)
	Swiss francs	Dutch guilders
1939 January	— 24.9	— 0.4
February	— 72.5	— 30.0
March	— 166.4	— 121.9*
April	— 171.2	— 100.4
May	+ 2.9	— 0.0
June	+ 4.6	— 54.4*
July	— 6.6	— 26.6*
August	— 27.9	— 0.3
September	— 2.5	— 25.0*
October	— 18.7	+ 3.5
November	— 34.3	— 79.2
December	— 28.4	— 15.1*
Year	— 546.0	— 449.7

(¹) Weekly statements ending Tuesday divided roughly into months. Months marked with asterisk contain 5 weeks.

In the Netherlands a loss of gold was also sustained by the Equalisation Fund, as may be concluded from the reduction of Fl. 90 million in the advances of the Nederlandsche Bank from 20th February to 27th March 1939, it being presumed that this movement represented a reduction in the advances to the Equalisation Fund previously made for the purpose of buying gold. In the course of the year the guilder was subject to a variety of external and internal influences: political difficulties internally in connection with the resignation of the Colijn Government in June and the long drawn-out crisis until the formation of the new government in August, the failure of the Amsterdam banking firm Mendelssohn, also in August, rumours of possible aggression against the Netherlands, the difficulty of placing a government loan of Fl. 300 million in December — these and other developments disturbed the exchange market. The value of the guilder was, however, strongly defended and never allowed to fall by more than 22 per cent. from the former gold parity. Under the influence of rearmament needs and export difficulties in the autumn the balance of trade turned more passive, but thanks to a growing demand for primary products an increase occurred in the export surplus of the Netherlands Indies with profits accruing to the mother country. Already in the first months of the war difficulties were experienced in maintaining communication, and thus shipping gold, between the mother country and the Netherlands Indies, and the latter declared an embargo on gold. Shortly thereafter separate quotations for the East Indies guilder appeared with a slight discount from those for the Netherlands guilder. On 27th October the British authorities declared the guilder of the Netherlands East Indies a separate currency for the purpose of their foreign exchange control.

The pressure to which the Swiss franc was subject in the first four months of the year as a result of an outflow of funds from the Swiss market, partly connected with the sale of Swiss securities by foreigners, led to a loss of over Sw. fcs 400 million in gold and foreign exchange by the National Bank. From May onwards the market remained calm and only a relatively slight demand for foreign exchange arose at the end of August and the beginning of September. Towards the end of October the National Bank had again to intervene in the exchange market, mainly because of the increased import surplus, which rose to Sw. fcs 304 million in the last quarter of 1939 as against Sw. fcs 44 million in the corresponding period of the previous year. From the beginning of August to the end of December the total amount of gold and foreign exchange ceded by the National Bank to finance imports and capital transfers amounted to Sw. fcs 112 million; but it should be added that in the middle of October Switzerland received from France some Sw. fcs 75 million as repayments on loan account.

The value of the franc was allowed to fall by 31.25 per cent. in relation to the former gold parity as compared with a level of about 30 per cent. fixed in the instructions given by the Federal Council on 27th September 1936. The President of the Board of the Swiss National Bank explained at the Annual Meeting in 1940 that the slight extra depreciation had been permitted in order to aid the export industries and to counteract in some measure the depreciation of the sterling rate in the unofficial market.

Quotations for the Reichsmark continued steady in terms of gold throughout the year with occasional erratic quotations as, for instance, in the New York market during the last weeks before the opening of hostilities in September. Since the outbreak of war no rates have been quoted for the Reichsmark or for any other types of mark in London and Paris or, because of the difficulties of communication, in New York. The so-called registered mark, the valuation of which abroad depends upon the possibilities in various countries for using this type of funds, declined considerably during the course of the year. On the London market, for example, the discount of the registered mark from the free Reichsmark increased from 56½ per cent. at the end of 1938 to 67¾ on 30th August 1939. In Switzerland, 100 registered marks cost on the same dates Sw.fcs 76.25 and Sw.fcs 56.50, corresponding to discounts of about 57 and 68 per cent. respectively. By April 1940 the rate stood at about Sw.fcs 36.

Between 22nd September and 15th October 1939 Danzig gulden were exchanged for Reichsmarks at the rate of 70 Pfennigs per gulden as compared with the previously quoted rate of 42 Pfennigs. In the territories of Poland incorporated into Germany the Reichsmark was introduced at a rate of 1 Reichsmark against 2 zlotys. Exceptions were, however, made for some of the larger denominations of notes, and zloty coins of a value of less than Zl. 0.05 continued in circulation as the equivalent of Pfennig coins. In the part of Poland administered by the Governor General it was finally decided to retain the zloty as currency and to form a new bank of issue, which began operations in April 1940. In the clearing between the Governor-Generalship and Germany an exchange rate of 1 Reichsmark to 2 zlotys was fixed.

In September 1939 the rate of the lira was lowered by roughly 4 per cent. in relation to the dollar, presumably to offset to some extent the effects of the depreciation of sterling and of the French franc. On 1st December an important step was taken by the National Institute for Foreign Exchange to ease somewhat the consequences of the Italian exchange restrictions: the banks authorised by the Institute were permitted to sell or buy forward foreign exchange at rates to be fixed as occasion required on the basis of the forward quotations of the currencies in question on the international markets. The authorisation applies to foreign exchange operations relating to commercial transactions, the settlement of which does not pass through clearings, and it is limited to free currencies or such as have recently been subjected to partial control, *i. e.* sterling and French franc. The following currencies are quoted under this measure: dollar, Swiss franc, florin, belga, Swedish crown, sterling and French franc. It is considered that these further facilities, which represent in practice an extension of the exchange guarantee hitherto confined to certain currencies, will affect a figure corresponding to slightly more than one-third of the value of Italian foreign trade in 1938.

In the Danubian and Balkan countries the exchange position is usually complicated by the quotation of multiple rates, the fixing of special rates in clearing arrangements and the obligations imposed upon exporters and other receivers of foreign currencies to sell part of their exchange to the government control office at official rates, while being free to dispose of the remainder at unofficial market rates or at high premiums, sometimes quoted also by government agencies. As a result the effective rate of exchange received by an exporter is generally an average between the rates obtained for different parts of the amounts sold by him.

In Roumania the exchange regulations were subject to many changes in the course of the year. In October 1939 the foreign exchange control was transferred from the National Bank to a new Foreign Trade Office under the Ministry of Economic Affairs. At the same time exporters were required to deliver to the National Bank, for the account of the Foreign Trade Office, only 30 per cent. (instead of previously 100 per cent.) of all free foreign exchange acquired by them, being entitled to sell the remainder on the bourse, through authorised banks, within fifteen days. On the part sold to the National Bank the statutory premium of 38 per cent. was obtained and on the remainder a varying premium averaging about 90 per cent.; the net result of the change was to widen the depreciation of the leu in relation to countries with which Roumania had no clearings or payments agreements.

During the negotiation of a German-Roumanian trade agreement in December the rate adopted for the clearing was altered from Lei 40.50 to 49 for purchases (50 for sales), with the exception of proceeds of oil, cereals and timber which were to be discounted at the National Bank, 50 per cent.

at Lei 40.50 and 50 per cent. at Lei 49, giving an average rate of Lei 44.75. In mid-March a new clearing agreement was negotiated between Roumania and Italy. A series of exchange rates were established to replace the former quotation of Lei 7.17 per lira, which, however, remained in effect for all exports and imports contracted for prior to 25th March, except for Roumanian state payments. These latter were made into the clearing at Lei 8.25, which was the rate also applied to 50 per cent. of the value of Roumanian oil exports to Italy. All other Roumanian exports after 25th March were to carry a rate of 9.50, i. e. that at which payment was made for ordinary Italian exports to Roumania. For certain special Italian exports, such as silk and linen yarns etc., payment was required in freely convertible exchange.

At the end of 1939 some further changes were made in the quotations for free currencies, but these remained in force only for about two months. From 2nd March 1940 a completely new régime of foreign exchange control was introduced, abolishing free sales of convertible currencies and eliminating completely compensation dealings. At the same time the National Bank raised the rates for exchanges other than those of countries with which Roumania has clearing agreements by 50 per cent. over its former quotations including the 38 per cent. premium, the result being a further slight depreciation from the suspended bourse quotations.

In Yugoslavia a special committee on foreign exchange policy, consisting of representatives of the National Bank and the Ministers of Finance, of Trade and Industry and of Foreign Affairs with an executive office (called "The Foreign Exchange Board"), was established from 1st July 1939 to direct the foreign exchange transactions still actually carried out by the National Bank. This committee decided to abolish the compulsory sale at the official rate to the National Bank of 25 per cent. of convertible foreign exchange derived from exports. At the end of August the dinar was detached from sterling and linked to the dollar at a rate of Din. 55 to the dollar.

In the German-Yugoslav trade agreement no fixed rate between the Reichsmark and the dinar had been specified, the actual rate being subject to market fluctuations. In January 1939 the rate fell from Din. 14.30–70 to Din. 13.80 for RM 1; it was, however, decided by a German-Yugoslav commission associated with trade negotiations to fix the rate at Din. 14½ as from 20th June 1939. The agreement also provided that the rate was not to fluctuate by more than Din. 0.20. After the beginning of the European war a new account was introduced into the German-Yugoslav clearing, and with the reduction of the balances in Yugoslavia's favour the dinar depreciated against the Reichsmark to 14.80.

Under the French-Yugoslav payments agreement of 30th December 1939, it was provided that payments for French imports from Yugoslavia would be credited to various accounts in fixed proportions, and that the dinar counterpart of the portion credited to the "public debt" account would be paid to Yugoslav exporters at varying rates of exchange. These rates, determined by French bondholders' representatives after consultation with the Yugoslav

Export Office, were announced by the French Ministry of Finance on 27th February 1940 as follows (in dinars per 100 francs): for hemp, lumber, pulpwood, staves and woodpulp, 129; for slaughter horses, live sheep, mutton, hides and skins, 130; for eggs, poultry, prunes and prune jam, 133.33; for live cattle, beef, live hogs, pork and pork products, 140; and for all other products, 125. The official open market rate is 101 dinars for 100 francs.

In Hungary the foreign exchange regulations and restrictions were strengthened under a law passed in August granting increased powers to the National Bank to protect the currency. On the depreciation of sterling the National Bank increased the premium paid for "free" currencies (the Swiss franc, the French franc, sterling, dollar, etc.) in order to counteract the effects of the depreciation of the sterling-area currencies on the Hungarian trade position. The enhanced premium was not applied to currencies of countries with which Hungary had clearing agreements, of which the Reichsmark is by far the most important from a commercial point of view; after various negotiations it was finally agreed to restore the rates of premium in force prior to August instead of making corresponding adjustments in the rates for the pengö used in clearings. It was, however, found possible to allow the sale of part of the proceeds from exports in "free" currencies at an increased premium in order to ensure that such exports would be maintained on an equally profitable basis and in that way the country's requirements of "free" currencies for necessary imports of raw materials and for other purposes would be met.

In Bulgaria the problem of obtaining freely disposable exchange led the National Bank to widen the former premium of 35 per cent. over the official rates, constituting de facto recognition of the leva's depreciation, with the added provision that 75 per cent. of the proceeds of exports should be sold to the National Bank.

Among other European countries with controlled currencies, Lithuania, after tightening her foreign exchange control in January 1939 and instituting a system of import restrictions in September, was faced with a new currency problem when she obtained the city of Vilna on 28th October. At the nominal parity in force before September a lita was worth approximately Zl. 0.80, but the increase in the circulation of zlotys during September made it undesirable to apply this rate. Various measures were attempted; in the end different rates were used according to the purposes for which zlotys were converted into litas. Bank claims, mortgages, service contracts, etc. were converted at the rate of 1 for 1. Salaries, prices of bread and other necessities, as well as bank notes in limited amounts, were converted at the rate of Litas 1 for Zl. 2, while amounts of zloty notes above the prescribed limits, bank deposits and other unguaranteed claims were converted at Litas 1 for Zl. 2.50.

In Spain strict exchange control was instituted, the peseta being pegged in the official market at 9 to the dollar and 42¼ to the pound, with charitable and family remittances in foreign exchange receiving a privileged rate (actually 25 per cent. more in Spanish currency). At the end of August 1939 the dollar rate was raised to 9.9, depreciating the peseta by 10 per cent. and giving an official sterling rate of 40.15 pesetas to the pound. In November a decree issued by the Ministry of Economic Affairs required foreign assets to be sold abroad and the proceeds delivered to the Foreign Exchange Office, special rates being fixed to favour charitable remittances. In December the Foreign Exchange Office was detached from the Bank of Spain and established as the Spanish Institute of Foreign Exchange with a capital of pesetas 20 million, placed under the Ministry of Trade and Industry and granted a monopoly on all purchases and sales of foreign exchange.

Far Eastern Currencies. The transfer of the allegiance of the Japanese yen from sterling to the dollar in September 1939, involving a depreciation of about 14 per cent. in gold value, applied indirectly to the various currencies linked to the yen, including the Manchukuo yuan and the Tientsin yuan. The latter was subject to heavy fluctuations in value in terms of the depreciating Chungking dollar, going from a 30 per cent. discount in March 1939 to a premium in the autumn of the year and finally, in December 1939, again to a discount. Moreover, on 16th May 1939 the Huah-Hsing Commercial Bank opened in Shanghai under a charter from the Nanking "Reformed" Government and the notes of this Bank are acceptable as legal tender for payments under the jurisdiction of the Nanking Government. This currency was created to facilitate export and import financing and was to be linked at par with the Chungking dollar. Several months after its establishment, however, it was stabilised at the rate of 6d. because of the fluctuations of the National currency. The development of note circulation in the Far East is illustrated in the following table:

Note Circulation in the Far East.

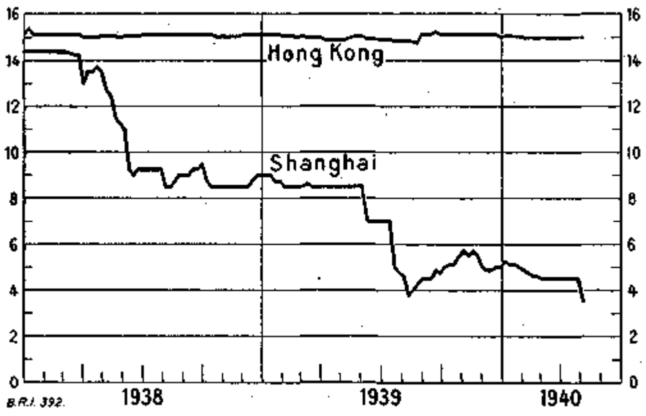
In millions of yen or yuan respectively	1934	1935	1936	1937	1938	1939
Bank of Japan	1,627	1,727	1,866	2,305	2,755	3,818
Bank of Chosen	192	221	211	280	322	451
Bank of Taiwan	63	70	79	112	140	173
Central Bank of Manchukuo .	168	179	254	307	426	670
Federal Reserve Bank of China	—	—	—	—	140	380
Bank of Inner Mongolia . .	—	—	—	—	35	60
Huah-Hsing Commercial Bank	—	—	—	—	—	5(²)
Four leading Chinese Banks .	396	668	1,242	1,639	1,727(¹)	2,627(¹)

(¹) End of June. (²) End of January 1940.

In Japan imports have continued to be strictly controlled and gold to the extent of U. S. $165.6 million was shipped in 1939 to San Francisco to sustain the value of the yen. Exchange restrictions were introduced in the Japanese-controlled Tientsin area on 11th March 1939 and reinforced on 17th July in an attempt to ensure the conversion of proceeds of exports into the yuan of the Federal Reserve Bank of North China at the official rather than the market rate.

The "**Shanghai dollar**" (or yuan of the National Chungking Government) depreciated sharply during 1939 despite the support received from the establishment in March of a Stabilisation Fund with assets obtained from British and Chinese sources. On 7th June 1939 the Fund withdrew its support to conserve its assets, which had been depleted, but presumably not exhausted, by sales of foreign exchange to provide for heavy Chinese imports, for an outflow of capital to Hong Kong and for the redemption of yuan notes purchased in the Japanese-controlled areas. At the end of June the National Government adopted a series of further measures designed to arrest the import of luxuries, to restrict the withdrawal of yuan balances and to ensure that the proceeds from exports would accrue to the monetary authorities. In the middle of July a new slump occurred, however; while the yuan had been held at 8d. from June 1938 to May 1939 it fell to 6d. in June 1939 and to 3¼d. in August. With the outbreak of war in Europe foreign demand for Chinese goods increased, new ports were being developed in territory under Chinese control and a return flow of capital set in from Hong Kong, with the result that the yuan recovered for a time in November to 5¼d., although it again weakened later. In March 1940 the currency received indirect support by a loan from the United States Export-Import Bank amounting to $20 million. But early in May, after the rate had been stable at 4⅛ d. for some months, renewed weakness occasioned the withdrawal of official support and the yuan fell to 3⅛ d.

Sterling quotations of Shanghai and Hong Kong dollars (in pence).



The **Hong Kong dollar**, which is backed by considerable sterling resources and followed sterling in the autumn of 1939, was not, however, included in the free area of the sterling control, but even so the local authorities in early September restricted dealings in other than sterling currencies. A separate **Ceylon rupee**, distinct from but equal to the Indian rupee, was established under the Ceylon Currency Ordinance of May 1939. Finally, in the Near East the **Iran rial** was officially devalued by 40 per cent. from the gold rial on 21st December 1939.

Latin American Currencies. The currencies of the countries of Latin America during the first seven months of the year were under the influence of the raw-material depression which set in in the autumn of 1937, and during the last few months of the year were affected by the European war. In a number of instances — particularly in Mexico and Cuba — the currencies fluctuated in response to special circumstances. In general, however, the South American countries producing raw materials experienced some improvement in their balance-of-payments position as a result of the war, while Central America was adversely affected.

The Mexican peso, which had depreciated in 1938 by 28 per cent., was held at a rate of about 5 to the U. S. dollar from July 1938 to June 1939 with the aid of import restrictions. At the end of the latter month the United States Senate approved a proposal to repeal the Treasury's power to purchase foreign silver, and the Treasury, which feared that foreign silver would be offered to it in increasing amounts while the new legislation was being discussed, lowered its price for foreign silver on 27th June from 43 to 40 cents an ounce, on the next day to 38½ cents and again on the following day to 38 cents. Immediately the Bank of Mexico was exposed to heavy demands for foreign exchange (Mexican silver exports, it should be remembered, amount on an average to some 80 million ounces annually, constituting an important item in the Mexican trade balance). The Bank withdrew from the exchange market during the morning of 27th June and the rate on the dollar quickly rose to 5.70. Although the power of the U. S. Treasury to purchase foreign silver was maintained by Congress, the American purchase price was further reduced to 36 ¾ cents and on 10th July to 35 cents an ounce, where it has since been held. At the end of July the Mexican peso was quoted at 6 to the dollar.

With the declaration of war in Europe the prospects for Mexican exports of oil, copper and other minerals rose and with them the Mexican peso. In October and November the average rate was 4.86, or stronger than at any time since the spring of 1938. In November, moreover, the Mexican Government abolished the 4 per cent. tax which had been imposed on capital exports in 1936. Disappointment over the course of exports produced, however, a reaction in December when the rate moved back to 6, at which level the Bank of Mexico undertook to hold it steady.

In Cuba silver also played an important rôle in currency developments. The Cuban peso, which circulates side by side with the U. S. dollar as legal tender, became subject to a sharp depreciation in the course of 1939. For some time the Cuban Government has been buying silver, coining it and putting the silver coins or silver certificates into circulation with a profit of $11 to 12 million on each $20 million issued. The resulting expansion in the silver circulation, coupled with poor markets for Cuban exports drove the discount on the peso against the dollar to about 4 per cent. in March and nearly 6 per cent. at the end of May. In order to ensure the supply of U. S. dollars for the Cuban Government to meet its debt service a Stabilisation Fund was set up in June and exporters of sugar and syrup (for refinement in the United States) were required to deliver 20 per cent. (later increased to 30 per cent.) of the export value of their shipments. When at the end of June the President asked the Cuban Congress for authorisation to coin an additional amount of 15 million pesos, the discount rose to 16 per cent. The outbreak of the war, followed by a strong hoarding demand for sugar in the

United States which drove the New York price for raw sugar from $0.0290 a pound at the end of August to $0.0367½ at the end of September, gave support to the peso and quotations for the free peso in New York rose to less than 9 per cent. discount. With the decline of the sugar price in November a discount of 13 per cent. was quoted, to be reduced to 8 per cent. after the advent of the sugar-grinding season in January 1940.

In Brazil the exchange system introduced in April 1939 has remained in force, under which an official rate of 16.5 milreis is fixed for the dollar and several market rates are also quoted, the latter being maintained within a range of 19–22 milreis for the dollar. Special rates continue to be applied for tourists, transfer of dividends, etc. In recent years Brazil has diversified her production and is probably now more able to meet the difficulties of a war period in Europe than she was in 1914–18. Under an arrangement concluded in 1937, the Brazilian Government began to purchase gold from the U. S. Treasury Department and acquired $6 million by two equal purchases in the autumn of 1939. With the aid of a credit from the Export-Import Bank amounting to $2.3 million Brazil bought a number of freight ships in the United States. A further credit guaranteed by the Export-Import Bank enabled certain exchange arrears accruing to American exporters to the amount of $19.2 million to be liquidated. On the basis of this improvement in the exchange position and a simultaneous improvement in the balance of trade the Brazilian Government offered to resume from 1st April 1940 partial foreign debt service under a modified version of the Aranha Plan of 1934, which had been suspended in November 1937, and to free other blocked milreis held by foreign owners of direct investments in Brazil.

The Peruvian sol continued to depreciate during most of 1939 as it had done in the previous year and the controlled exchange rate reached an average of 5.76 to the dollar in December 1939, as compared with an average of just under 4 in 1937. A sharp recovery brought the rate in the middle of January almost to 5, but it relapsed again to 5¾ in March 1940.

Buoyant sales of cocoa and coffee enabled Ecuador to eliminate import restriction as from 1st January 1940 after the free rate for the sucre, which had been weak since the fall of 1937, improved during the last five months of 1939.

In Bolivia the currency depreciated in sympathy with sterling in the autumn of 1939, after which the official rate was attached to the dollar in September. The country's balance of payments was, however, supported by the proceeds from higher tin prices, and it is noteworthy that in the unofficial market, which was opened in August 1939, the boliviano appreciated from an average rate of 52 to the dollar in September to 40 in January 1940.

The values of other South American currencies were, as stated above, little changed in the course of the year, notwithstanding the shift in allegiance of the Argentine and Uruguayan currencies from the pound to the dollar. Prices for a number of South American products improved, partly as a result of better business conditions in the United States. The effect of the European war was, on the one hand, to strengthen the demand for certain products (e. g. meat, hides, sugar, wool, oil and tin); on the other hand, it arrested the export trade with Germany amounting to about 10 per cent. of South American exports in 1938. Moreover, increased costs of transport and other difficulties brought about a rise in the price of many imported articles. Although exaggerated hopes of a rise in prices and a growing export volume have naturally been disappointed the general situation on balance is not unfavourable. Payment on foreign debt service of Brazil and Colombia was resumed on a limited scale. In Chile and Uruguay an actual improvement in the exchange position occurred and the fall in the currencies of Bolivia, Ecuador and Peru, which had been in progress almost continuously since the end of 1937, was brought to a halt.

In Central America the influence of the war was adverse because of its effect in raising prices of imports and cutting off European markets for highly specialised export products, without much opportunity being present for the expansion of sales in the United States. Some additional revenue is expected in these countries from diverted tourist travel originating in the United States. While most of the countries concerned succeeded in maintaining their exchange rates, the cordoba depreciated on the curb market in Nicaragua from an average of 5.13 to the dollar in January 1939 to 6 a year later.

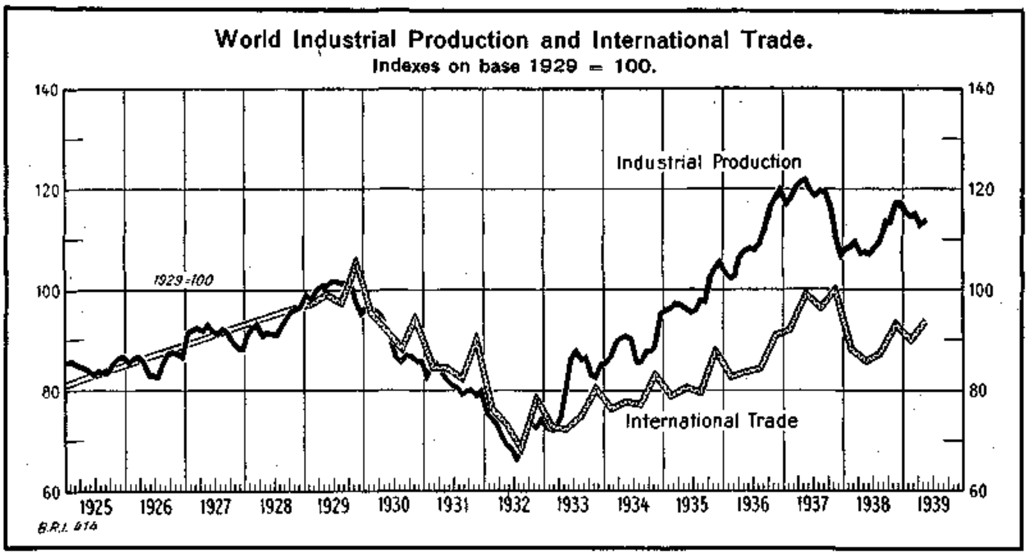
Since 1931 one of the greatest difficulties in the exchange markets has been the erratic movements of large amounts of highly volatile funds. In this respect a decisive change occurred in the autumn of 1939. Capital movements were made more difficult through the imposition of exchange restrictions; furthermore the amounts of foreign capital held in various European markets had been heavily reduced by the massive outflow of recent years.

On the other hand, disposal of exchange to pay for necessary imports has gained in importance and long-term investments are being mobilised to provide liquid funds for commercial needs. Movements of gold and capital will be more closely related to currents of goods and services and in that way have a greater effect on the distribution of active purchasing power and thus also on cost and price relations. For the time being the exchange markets are largely dominated by controlled rates which most likely will remain in force for the duration of hostilities. The adjustments necessary when peace returns will, however, have to take account of the fundamental changes in relative cost and price structures, which have already begun to be noticeable as a result of domestic and foreign influences in various countries.

2. FOREIGN TRADE.

The improvement in international trade, which continued from the depths of the depression in 1932 up to the boom of 1937, suffered a setback in 1938 when the volume of goods exchanged dropped by about 8 per cent. Full statistical data are not available for 1939 as several countries discontinued the publication of their returns in the autumn, but the data for the first eight months of the year show a certain advance in the volume compared with the corresponding months of the previous year. The advance became of importance in the spring and summer of 1939 under the influence of better business in the United States (reflected in higher imports) and increased purchases by European governments for the constitution of reserve stocks. After the outbreak of war in September commercial relations were largely interrupted by various war measures, blockades, delays in ports, circuitous routes, etc., causing a decline in the aggregate volume even though in certain directions the exchange of goods was intensified. During the war of 1914–18 the volume of international trade declined in sympathy with the decrease in world production, as may be seen from the graph on page 6, and a similar contraction may again be experienced.

There is, in general, a high degree of correspondence between the indexes of world production and of international trade — two indexes which, of course, are calculated on the basis of wholly independent sets of data. Indeed, from 1850 to 1929 the growth of world trade (as well as the decline during the war period 1914–18) was very much at the same rate as that of world industrial production; and the decline from 1929 to 1932 was also in the same proportion for the two indexes. Compare the graph on page 6, to which reference has just been made, with the following graph, for the years since 1929:



Since 1932 the recovery in world industrial production has been at a higher rate than the improvement in international trade, which means that the advance in the domestic activity of the various economies has been greater than in the exchange of goods between them. The failure of foreign trade to keep pace with domestic production is no doubt mainly the result of increased protection, autarkic tendencies, monetary difficulties especially affecting international transactions and a virtual cessation of foreign lending; but it may also be connected with a natural increase in the ability of many individual countries to meet their requirements in a higher degree from domestic production. It is, however, unlikely that such tendencies even if intensified by the present war will actually diminish world trade in the long run. The volume of international trade in 1938–39 — despite the setback from the previous boom year — was still some 15 per cent. higher than in 1913, and everything points to the conclusion that international trade will continue to advance whenever there is an increase in production and general well-being.

The close relationship between domestic production and foreign trade may also be illustrated by the following extract from a table in the "Review of World Trade 1938" published by the Economic Intelligence Service of the League of Nations:

Percentage distribution of the value of international trade.

By continental groups	Imports		Exports		Total	
	1929	1938	1929	1938	1929	1938
Europe (including U.S.S.R.)	55.5	57.3	48.8	47.0	52.4	52.3
North America	16.1	10.9	19.5	17.7	17.7	14.2
Latin America	7.7	7.6	9.6	9.4	8.6	8.4
Africa	4.8	6.3	4.5	6.6	4.6	6.5
Asia (excluding U.S.S.R.) .	13.2	14.8	14.9	15.8	14.0	15.3
Oceania	2.7	3.1	2.7	3.5	2.7	3.3
Total . . .	100	100	100	100	100	100

The most important change in world imports was the decline in the share of North America from 16.1 per cent. in 1929 to 13.9 per cent. in 1937 and 10.9 per cent. in 1938. The setback in the latter year was due chiefly to the industrial recession in the United States and the resulting decline in American imports, particularly of raw materials. Europe's share in total international trade was the same in 1938 as in 1929 but, while European imports had risen, exports had fallen. The setback in 1938 was less marked in Europe than in other continents, but in the early months of 1939 European imports somewhat declined, though a greater decrease was recorded by the Latin American countries. These countries, which had profited from the high prices of primary products in the boom year of 1937 and, on the basis of their greater purchasing power, had substantially increased their imports, found themselves compelled, when raw material prices fell, to impose a severe contraction of imports in order to protect their currency position. During the first six months of 1939 the dollar value of their total imports was 14 per cent. below that for the corresponding months of the previous year. The table further shows the remarkable increases in the shares of Africa (as a result of the more remunerative gold production in Transvaal), Asia (not least in the Far East, in spite of the state of warfare in China) and Oceania.

For most countries on the continent of Europe the development of German trade in recent years has been of outstanding importance. For the first time since 1934 Germany had an import surplus in 1938, amounting to RM 192.4 million, which led to an increase in the debt due by Germany to other countries. In the last annual report of the German Reichsbank it is mentioned that in 1939 an export surplus was again achieved. Even after the outbreak of hostilities Germany increased its exports to those countries with which its trade was maintained and the debt on Germany's clearing accounts was considerably reduced in the last months of 1939. Trade with south-eastern Europe more than doubled between 1929 and 1938, amounting in the latter year to about 10 per cent. of Germany's foreign trade. For the Danubian and Balkan countries Germany has become the main field for imports and exports (especially since the incorporation of Czecho-Slovakia).

Of their imports, those obtained from Germany ranged from a minimum of 30 per cent. for Greece to a maximum of 65 per cent. for Bulgaria. As regards exports, Bulgaria sent to Germany 68 per cent., i. e. the highest percentage among the countries in question, while Roumania — the country with the smallest percentage of exports going to Germany — still sold 32 per cent. to her. In recent years Germany also played an important part with regard to Danubian imports of non-European raw materials, which were largely obtained over Hamburg and other German ports, from which they were transported by river, canal or rail to the Balkan countries. Even though these countries had to pay world prices for these raw materials in "free" currencies, all other expenses such as harbour costs, railway freights, canal charges or commissions could be paid through the German clearing. As the import of raw materials over Hamburg and other German ports has been arrested since the outbreak of hostilities, these countries have now to procure their supplies of foreign raw materials through other channels, with the result that their net

Balkan and Danubian Countries – foreign trade surplus (+) or deficit (—).

In millions of national currency units	Bulgaria	Greece	Yugo-slavia	Hungary	Rou-mania	Turkey
	leva	drachma	dinar	pengő	leu	£T
1938 January–March	+ 467	— 815	— 138	+ 38	— 349	— 1
April–June	— 236	— 2,644	— 120	+ 14	+ 101	— 19
July–September	— 371	— 1,959	— 37	+ 43	+ 988	— 13
October–December . .	+ 783	+ 806	+ 367	+ 10	+ 2,026	+ 28
1939 January–March	— 230	— 719	— 175	+ 20	— 352	— 0
April–June	— 363	— 2,122	+ 61	+ 18	+ 539	— 10
July–September	+ 74	— 1,401	+ 140	+ 34	+ 810	— 4
October–December . .	+ 1,387	+ 1,168	+ 738	+ 43	+ 2,921	+ 24
1940 January-March	+ 169	— 201	+ 435	.	+ 2,293	+ 21

outlay in "free" currencies has risen. The necessity of obtaining sufficient foreign "free" currencies to pay for raw materials has in many respects affected the trade and currency policy of the Danubian and Balkan countries and the blocking of old trade routes has made them seek other intermediaries, as, for instance, Italy. An interesting aspect of the foreign trade of this group of countries is that not less than 80 per cent. of their total foreign trade is transported by ships, including transport on the Danube.

The import surplus of Italy was also reduced from 1938 to 1939. Total imports fell from Lit. 10.9 to about 10 milliard, while total exports rose from Lit. 8.0 to 8.5 milliard. In 1939 exports were equivalent to 84.4 per cent. of imports — the highest percentage relation attained since the beginning of the century with the sole exception of the year 1931. The decline in imports is due in part to a contraction of the volume but also to a fall in the prices of many of the raw materials imported. The higher export figure is the result of larger sales of finished products and some semi-manufactures, which together represent three-fifths of total exports. The changes due to the present economic policy are reflected in a reduction in the imports of mechanical products and foodstuffs, while at the same time exports of mechanical and chemical products have risen.

For France information regarding the trade balance is available only for the first seven months of the year, during which the import surplus was Fr. fcs 5,627 million as compared with Fr. fcs 7,977 million in the corresponding months of 1938. Imports increased in value by 6 per cent. (as a result of the depreciation of the franc) but fell in volume by 12 per cent., less raw material being imported owing mainly to an increase in the output of French mines. On the other hand, exports rose in value by 28 per cent. and in volume by 5 per cent. The exchange of goods between the mother country and the colonies showed a distinct advance both in value and in volume, French imports from the colonies increasing by over Fr. fcs 1 milliard and exports to the colonies by Fr. fcs 1,430 million.

The import surplus of the United Kingdom increased by only £14 million from 1938 to 1939, despite the sharp decrease of exports in the four months of war in the latter year.

U. K. Foreign trade in 1938 and 1939.

In millions of £ sterling	January-August			September-December			Whole year		
	1938	1939	Change	1938	1939	Change	1938	1939	Change
Retained imports	571	567	— 4	287	273	— 14	858	840	— 18
Exports	307	314	+ 7	164	125	— 39	471	439	— 32
Import surplus	264	253	— 11	123	148	+ 25	387	401	+ 14

The fall in imports on the year is accounted for by a decline in food, drink and tobacco — reflecting lower prices — while that of exports, concentrated in the period after the beginning of the war, occurred for the most part under the heading of manufactures. Actual purchases from abroad in the last four months of the year were far larger than the import figures reveal. In the case of aeroplanes, for example, orders were placed and partly paid for before production had been completed and long before delivery could be effected. In connection with large-scale purchases of raw materials and foodstuffs from overseas, particularly within the Empire, payment was made and goods were stored in the exporting countries, in a number of instances, pending the availability of shipping.

In the first four months of 1940, the import surplus rose to £237 million compared with £116 million in 1939. Exports rose by 9 per cent. in value, but the increase in imports amounted to 45 per cent.

Among the remaining European countries, Denmark, Norway, the Netherlands, Sweden and Switzerland all had higher import surpluses in 1939 than in 1938, the main reason being increased imports in the last quarter of the year.

Various Countries — foreign trade surplus (+) or deficit (—).

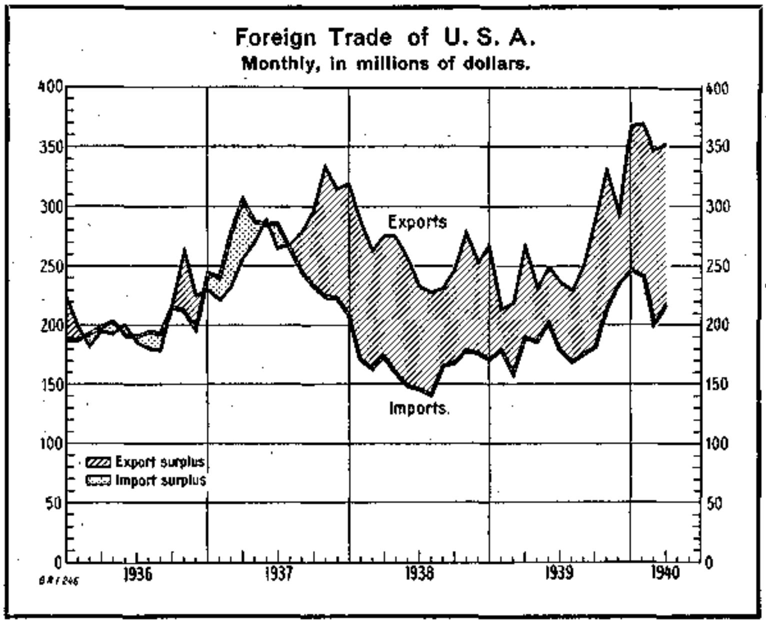
In millions of national currency units	Belgium	Denmark	Netherlands	Norway	Sweden	Switzerland
	B. fcs	D. Kr.	Fl.	N. Kr.	S. Kr.	Sw. fcs
1938 January–March	— 581	— 69	— 103	— 94	— 68	— 94
April–June	— 638	+ 29	— 99	— 133	— 27	— 69
July–September	— 468	— 9	— 83	— 106	— 53	— 84
October–December	+ 214	— 41	— 90	— 69	— 90	— 44
1939 January–March	— 468	— 35	— 92	— 106	— 116	— 68
April–June	+ 390	— 15	— 112	— 133	— 115	— 123
July–September	+ 1,118	— 21	— 113	— 109	— 124	— 111
October–December	+ 1,024	— 96	— 233	— 205	— 256	— 304
1940 January–March	+ 1,726	+ 2	— 191	— 176	— 151	— 283

Part of the increase in value represented an increase in the volume of goods imported to add to stocks; another considerable part represented the higher prices of imported goods, especially when delivered in the country of destination. Belgium, on the other hand, turned an import surplus of B.fcs 1,399 million for 1938 into an export surplus of B.fcs 1,952 million in 1939. The greater part of this improvement was due to a decline in imports, which fell by B.fcs 3,238 million from 1938 to 1939, while exports were well maintained, thanks largely to increased demand for iron, steel and coal by the belligerent countries and maintained demand by the neutrals whom the belligerents were unable fully to supply.

For the countries which were neutral in the winter of 1939–40 the conclusion of trade agreements with the belligerents on both sides were important means of maintaining as much of their foreign trade as possible. This network of agreements tended, however, to be one-sided in effect: special attention was naturally paid to the sinews of war — iron, steel and oil —

and to basic foodstuffs, while consumers' articles, especially those of a luxury character, had to assume a secondary place. In some instances new clearing agreements were made between belligerents and countries outside Europe, e. g. between the United Kingdom and the Argentine; and in addition ad hoc arrangements were made with the governments of some extra-European countries for the supply of special war materials, etc.

The foreign trade of the United States, which all through the spring and summer of 1939 remained at a relatively low level, increased sharply as a result of the war, exports rising at a rapid rate and imports also advancing in response to higher industrial activity at home.



Exports of American products had been maintained at a comparatively high level all through 1937 (notwithstanding the break in the boom in the autumn of that year) and the first half of 1938. Agricultural exports increased as a result of large crops in the years following the drought of 1936; demand from Europe continued practically undiminished and demand from raw-material-producing countries was strong after the expansion in their purchasing power engendered by the increased sales of primary products at high prices during the boom of 1936–37. Since in the course of 1938 a number of these countries took steps to curtail imports in order to prevent their trade balance from becoming too passive, American exports began to decline, and in the first five months of 1939 the export figures were continuously lower in value than in the corresponding period of the previous year.

The rise in American exports following the outbreak of the war carried their level at the turn of the year to the highest experienced for a decade. The most pronounced increases occurred in cotton, metals and manufactures and especially aeroplanes, motor trucks and machine tools, petroleum products and chemicals. Exports of farm products, apart from cotton, suffered reverses, tobacco and fruit being particularly affected.

Imports into the United States reached the high level of $300 million in March 1937. With the sudden collapse of the 1936–37 boom (largely associated with a rapid increase in inventories), American demand for overseas raw materials fell sharply, and in July 1938 imports were only $140 million. As business in the United States recovered during the latter half of 1938, imports rose gradually and reached $190 million in March 1939, but this level was hardly maintained in the following months. As the domestic and foreign demand for American products expanded after the outbreak of the war and industrial production rose to a record level in December 1939, imports also increased, though at a somewhat slower rate. After the turn of the year, however, accumulations of stocks came to a sudden halt and the resulting sharp decline in industrial production had its counterpart in somewhat reduced imports, which were nevertheless maintained above the $200 million mark. Imports of tin, wool and rubber were, for instance, in March 1940 above the level of the corresponding month of the previous year by not less than 97, 94 and 48 per cent. respectively.

The following table shows the net effect of these various changes in imports and exports on the trade balance of the United States.

United States foreign trade balance.

Surplus (+) or deficit (—)	1937	1938	1939	1940
	In millions of dollars			
January-March . .	— 113	+ 319	+ 173	+ 410
April-June	— 34	+ 311	+ 149	.
July-September .	+ 97	+ 231	+ 242	.
October-December	+ 315	+ 274	+ 295	.
Year	+ 265	+ 1,134	+ 858	.

Exceptionally high exports and a moderate level of imports combined to make the surplus of exports in January-March 1940 the greatest for any first quarter since 1921.

The geographical distribution of American export trade shifted slightly in favour of the western hemisphere during 1939 and particularly after the outbreak of war, although 64 per cent. of American exports in 1939, as contrasted with 66 per cent. the previous year, continued to be shipped across the Atlantic and Pacific Oceans. The increase which the export trade experienced after September did not occur in the direct trade with the United Kingdom and France (despite the large purchases of aircraft, metals and other war supplies by these countries) but was almost entirely the consequence of increased shipments to European neutrals and to countries outside Europe. Purchases of United States merchandise by the Scandinavian countries rose by no less than 67 per cent. over 1938; those by Canada increased by approximately 43 per cent.; and for Latin America the gain was 42 per cent. Direct shipments to Germany, already materially reduced during recent years, fell to negligible proportions.

Efforts to improve United States trade with Latin America took the form of loans from the Export-Import Bank, the planning of the Inter-American Bank and the pursuance of the government's trade agreements programme. The latter suffered a setback, however, when negotiations for trade agreements with the Argentine and Uruguay were broken off owing to disagreement over the possibility of changes in the United States regulations regarding the import of beef.

Canadian exports from the spring of 1939 attained a level above that of the previous year and were further stimulated from September onwards by large war orders and an increase in sales of wood and pulp, as Scandinavian shipments of these products were sharply reduced. In December 1939 exports of Canadian goods reached the highest level since November 1936 and the highest December figure since 1929. Imports were quickly affected by the rise in income level in Canada as well as the rise in world prices, but the export surplus was maintained or even slightly increased.

The war had an effect too on Latin American trade. As the various countries in Central and South America produce goods of very much the same type, there is little trade between them and their foreign trade consists in an exchange of raw materials for finished goods from highly-developed countries overseas. Although industrialisation in most Latin American countries has made some progress since 1914–18, these countries are still essentially dependent upon overseas trade for the sale of their surplus output of crude products and for the satisfaction of their requirements in manufactured articles.

The immediate effects of the war were, on the one hand, the loss of the important trade with Germany, and, on the other hand, increased exports of industrial raw materials and basic foodstuffs to other countries. The impact was not the same, however, on all countries in the area. The export trade of most of the Latin American Republics fares well or badly according to the demand and price for the single or the few products which make up the bulk of each country's foreign sales. After the first few weeks in September the increase in demand did not extend to the higher types of foodstuffs — coffee, tropical fruits and sugar; as a result several of these countries, particularly those of Central America, suffered from the increase in import prices without benefiting from a sustained improvement in their exports.

The Argentine, which has the most diversified export trade of the area, experienced a great increase in sales of meat, wool and wheat, as a consequence of the war. Already in the spring of 1939 when the harvest became available for sale, the import surplus of 1938 had given place to an export balance; but, contrary to the usual seasonal tendency, the four last months of the year produced a considerable export surplus, one-third of the year's total of 428 million pesos, and in January exports continued on a high level although still below the peak of 1937. Brazil compensated for the slackness in the coffee market by increased sales of cotton. Peru, Bolivia and Venezuela found ready outlets for tin, other non-ferrous metals and petroleum. Chile lost her German market for copper and was also affected by the policy of France and England of buying within their Empires, but made up to some extent by expanding sales of nitrates. Colombia, Haiti, Nicaragua and Cuba suffered reverses in their trade balances due to the loss of the German market, the inelasticity of the demand for their products elsewhere and the restrictions on imports of a "luxury" type in countries desirous of conserving foreign exchange.

As regards their import trade, the Latin American countries have felt the lack of shipping facilities in transoceanic traffic, although tonnage has remained comparatively plentiful for shipments to and from North America. The gap left by the disappearance of Germany as a supplier of finished goods was filled in the first instance by increased purchases from the United States, but lack of dollar exchange led more and more to attempts to maintain or expand imports from the United Kingdom, Italy and Japan. Thus, for example, the Argentine concluded a clearing agreement with the United Kingdom and a trade agreement with Japan.

In the Far East Japan's foreign trade benefited to some extent from an increase in demand associated with the war, but not in the same degree as in 1914-18, one reason being the reduced surplus of goods available for foreign consumption. The export surplus of all Japan (including Korea and Formosa) rose from Yen 58 million in 1938 to Yen 802 million in 1939, but the improvement in the trade balance in relation to countries outside the yen area (i. e. to other countries than Manchukuo and Northern China) amounted only to Yen 190 million, as shown by the following table:

Foreign trade balance — All Japan.

Export (+) or import (—) surplus	1937	1938	1939
	In millions of yen		
Yen Area	+ 326	+ 598	+ 1,152
Non-yen Area . .	— 963	— 540	— 350
Total	— 637	+ 58	+ 802

To Manchukuo, Japan has exported mainly goods for capital equipment and to China consumption goods (textiles and others). In September an attempt was made to reduce exports to the yen area since they are not productive of foreign exchange, but the restrictions imposed have not been fully effective. As regards the trade with countries outside the yen area, the deficit in relation to the United States was reduced by Yen 130 million, larger imports being more than counterbalanced by an increase of Yen 250 million in exports, due mainly to higher prices for raw silk. Exports to Latin America, British India and the Netherlands East Indies also increased, while sales to Europe fell.

The foreign trade of China increased markedly in 1939, imports rising more than exports. The Statistical Department of the Inspectorate-General of Customs gives the following trade figures both in terms of standard dollars and in gold units.

China — Foreign trade.

Year	Exports	Imports	Balance	Exports	Imports
	in millions of standard dollars			in millions of gold units	
1937	838.8	956.2	— 117.4	369.0	420.6
1938	763.7	895.2	— 131.5	331.7	389.5
1939	1,030.4	1,343.0	— 312.6	409.0	542.6

The currency changes which have occurred in China in recent years make it difficult to get a clear picture of the country's trade developments, but it appears certain that increases occurred from 1938 to 1939 in both the import and the export volume.

The foreign trade of Australia and New Zealand was also affected by the war, but the reactions were somewhat different in the two countries, owing to a divergence in local conditions. Australian exports of merchandise (as distinct from newly-produced gold) rose sharply above the figures for the previous year, beginning with the monthly returns for October. Sales of raw materials and foodstuffs, principally to Great Britain, accounted for the greater part of the increase in the volume of goods shipped. In addition substantial sales were made against which funds were placed to Australian account in London, but the goods in question did not enter into the export figures as they were stored in Australia pending shipment.

Goods were also bought from New Zealand by the British Government and payments in advance of delivery were made into the country's account in London, but reported exports failed to expand substantially during the final quarter of the year. The total volume of exports in 1939 as well as in 1938 (adjusted for price changes) was lower than the average for the five years 1933–37, the decline being due to increased domestic spending on public works and development of local industries, which diverted men and materials from the export trades.

As regards imports the first effect of the war was to make it more difficult to obtain deliveries, and in Australia the figures for the three months September–November 1939 are below those of the previous year. In January 1940 there was, however, a sharp rise in Australian imports by not less than 40 per cent. above the January figure for 1939. In New Zealand import difficulties also made themselves felt after the outbreak of war and in this country the control of imports, which had been introduced in the autumn of 1938, was made more effective. Developments are illustrated by the following figures.

New Zealand — Imports.

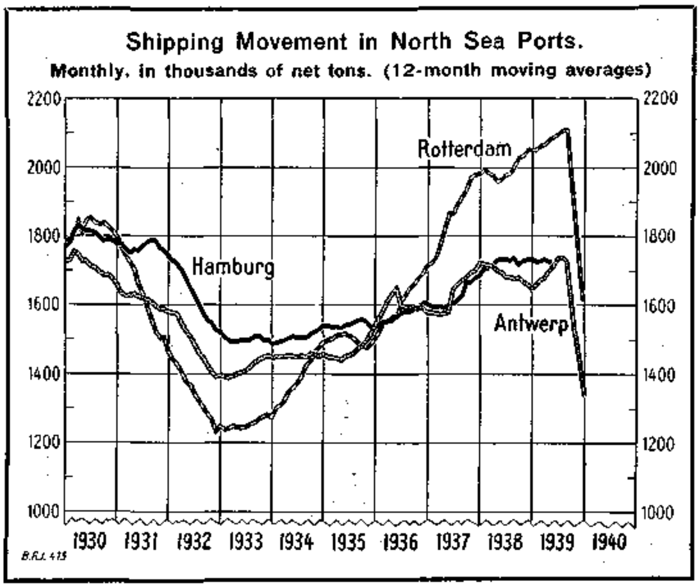
Periods	1938	1939	Difference
	In millions of £N.Z.		
First half-year . . .	27.1	28.2	+ 1.1
July–September . . .	14.5	11.9	— 2.6
October–December .	13.8	9.3	— 4.5
Total	55.4	49.4	— 6.0

The reduction in imports generally affected goods competing with local manufactures (such as wearing apparel and clothing, hardware and cutlery) and in addition motor vehicles and equipment required for public works.

It has been officially estimated that about £N.Z. 12 million of excess exports are required in a normal year to cover the invisible items in New Zealand's balance of payments including interest on public and private debts, etc. In 1938 the actual excess of exports was £N.Z. 3 million and in 1939

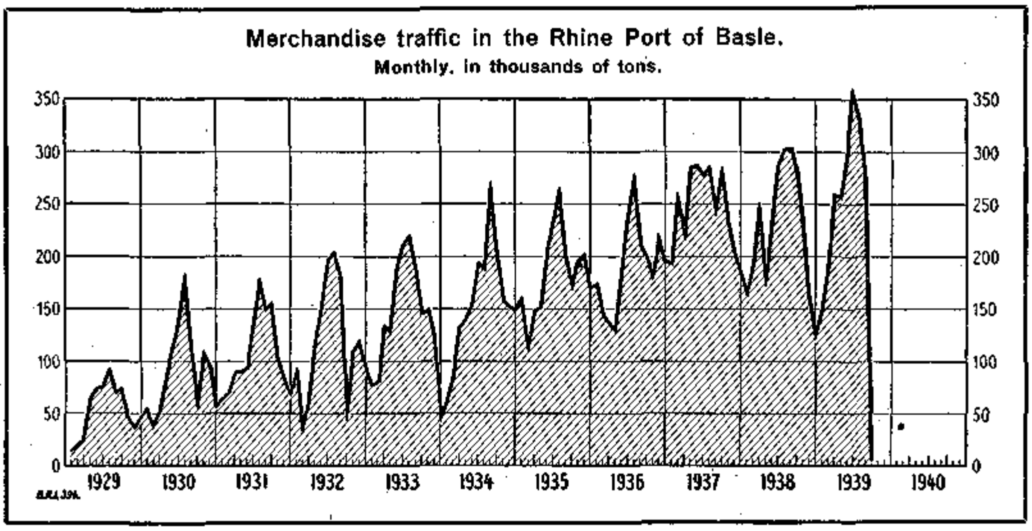
£N.Z. 8.6 million. Although the latter amount was still inadequate, the trading position after the outbreak of war has been much more favourable and overseas funds held by the New Zealand banks more than doubled in amount from September 1939 to March 1940.

Advance purchases by the United Kingdom in Australia and New Zealand are examples of the exceptional measures taken after the outbreak of the war constituting a departure from the normal practices of international trade. Perhaps the most noticeable of these departures from custom have been the changes in trade routes, in which certain ports, e. g. Genoa and Bordeaux, have gained in importance, while the traffic through Hamburg, Rotterdam and Antwerp, for example, fell abruptly in the last four months of 1939.



An even more striking example is provided by traffic through the port of Basle, which since 1929 has been developed to serve as the main import channel for bulky goods into Switzerland.

At the beginning of September 1939 all activity in the port of Basle was abruptly terminated and Swiss merchants had to make arrangements for the import of oil, coal, iron, steel, rubber, etc. over land. The general tendency



as a result of the war has been an increased importance in traffic by rail reflected in an improvement of the earning capacity of various railway systems. The consequence is, however, that transport costs account for more in the value of finished articles, and in the final analysis it is the consumer, whether an individual or a public body, who has to pay for the extra charges. But from the consumer's point of view more importance is generally attached, in times of emergency, to the possibility of obtaining the goods than to the price which has to be paid for them.

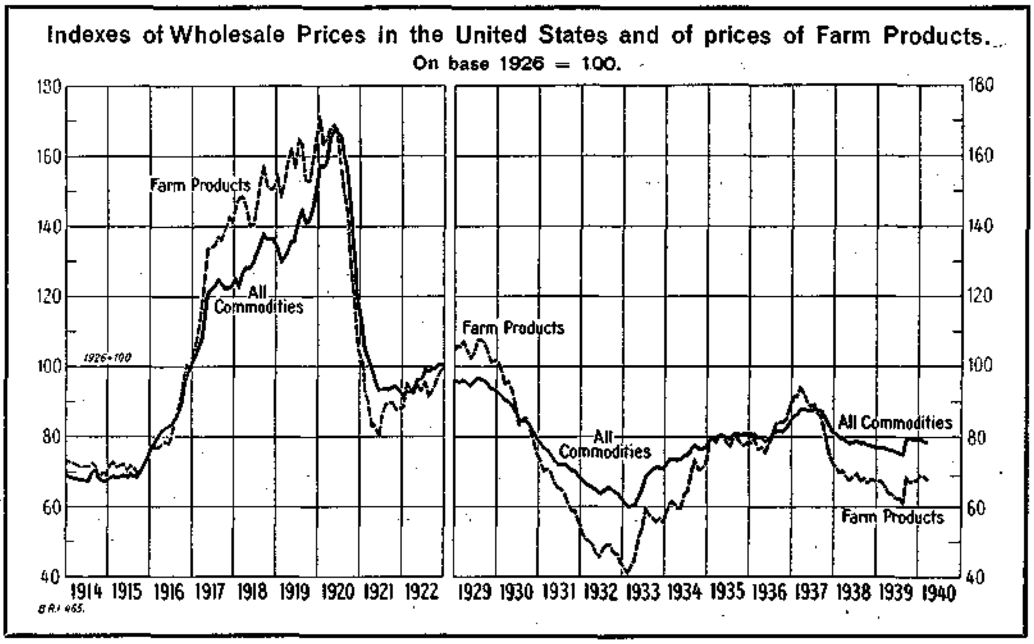
3. PRICE MOVEMENTS.

In the realm of prices the war did not cast its shadow before it. After the collapse of the short-lived boom of 1936–37 prices of commodities in general, and of raw materials in particular, showed on the whole a tendency to decline and continued to do so up to August 1939. It may be that in Europe mounting armament expenditure, government purchases of reserve stocks and sustained private investment exerted a stimulus towards higher prices, but any upward movement would appear to have been checked by the low level of industrial activity and poor demand for materials in the United States. As soon as war broke out prices rose outside Europe on the expectation of a high rate of consumption of raw materials and finished products for military purposes and of dislocations in the normal trade channels. In Europe itself the whole structure of costs and prices was even more affected by renewed currency depreciations, higher transport costs, increased taxation and the introduction of price control in countries which had previously maintained relatively free markets.

The initial impact of the war was, indeed, more pronounced than in 1914–15, when the public generally entertained the view that the war would be quickly ended. As far as free prices are concerned this is illustrated by the accompanying graph of developments in the United States, taken as representative of that half of the world which is not operating under conditions of war economy. It is interesting to note, in passing, that the level of wholesale prices in the summer of 1939 was only slightly higher than in 1914, despite the wartime inflation of 1916–20, the 1929 boom and the depreciation of the dollar in 1933–34.

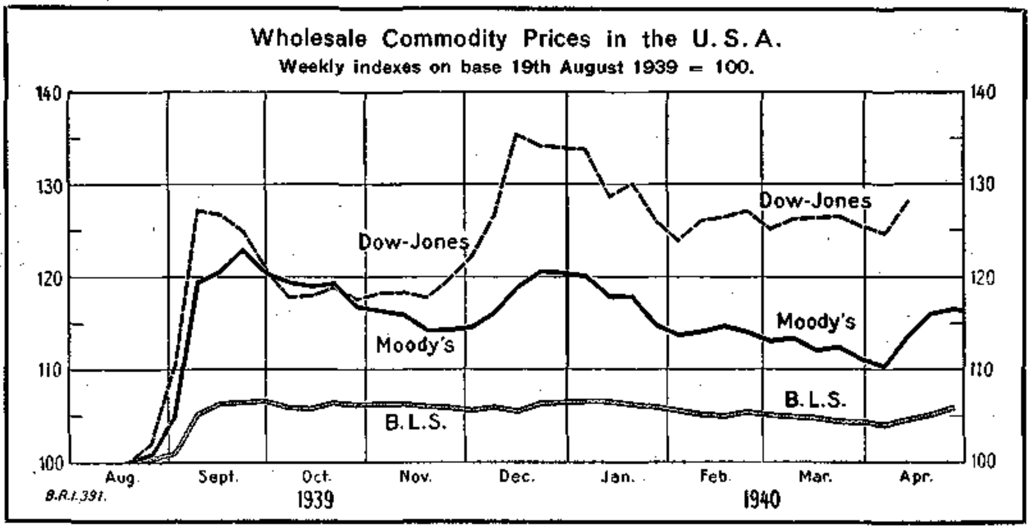
Under the pressure of large crops, wheat and corn in the summer of 1939 reached their lowest quotations since 1933; indeed the price of wheat in Liverpool, which is affected by the export subsidy from the United States, reached the record low level for modern times.

In the opening days of September 1939 such import commodities as tin, rubber and sugar rose in price in the United States owing to the expectation of difficulties in getting deliveries and to a desire to accumulate stocks — they had done so also in August 1914, when the increase was even higher. Among commodities normally exported from the United States — wheat, corn, lard,



oil and copper — a pronounced rise in prices set in, contrary to what happened in August 1914. A greater demand was expected from heavy purchases originating abroad and from recovery at home. Reference was made to the rise in American prices which had begun at the end of 1915 under the impetus of heavy exports to belligerent countries and it was also recalled that, in contrast to 1914 when there was a slump in business, the United States in the summer of 1939 was in the process of recovery from depression. Too little account was taken, however, of the increased efficiency of government controls, heavy producers' stocks weighing upon markets, excess capacity available in many lines of production and reserves which had already been accumulated in Europe.

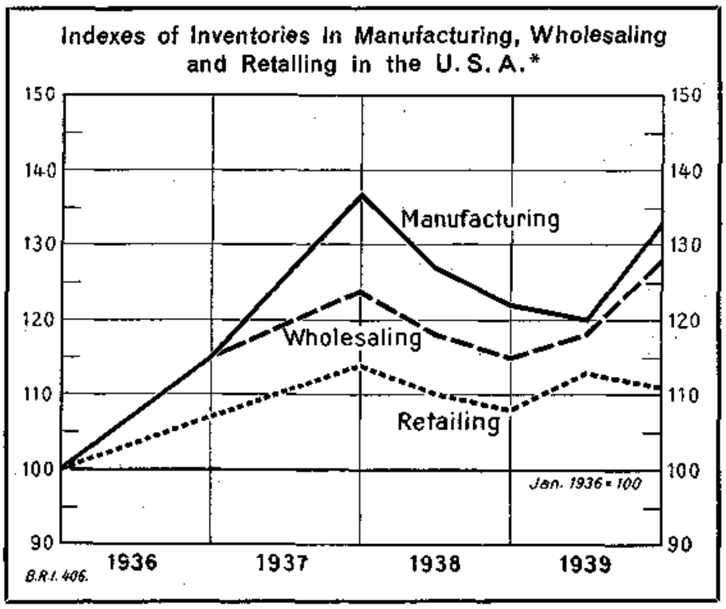
As is usually the case when prices suddenly change, the upward surge in the autumn of 1939 was characterised by a great diversity of movements in the quotations for individual commodities. The consequent lack of uniformity is visible from the graph, which reproduces the weekly movements of the price index of the Bureau of Labor Statistics (B. L. S.) covering 813 items, the sensitive index of Moody's Investors Service based on 15 commodities actively traded in and the Dow-Jones Futures index covering 11 products for which prices are quoted in organised futures markets, agricultural products having necessarily the largest representation. Striking is the extent to which these three indexes show widely varying fluctuations according to the character and the number of commodities on which they are based and the variations in emphasis given to the individual component prices. While in calmer periods different indexes often move in the same direction and with only slight deviations, in periods of sudden disturbances the utmost care must be taken when comparing changes in price levels of different countries, since most of the available indexes differ in scope and construction. Special care is required



when goods priced in some categories may have changed in quality and may not be freely available in customary quantities.

Already after the first two weeks of September 1939 the prospect of support to prices from foreign orders faded perceptibly and the sharp rise gave way to a gradual decline. In December, however, a rebound occurred in the more sensitive indexes only partly associated with the war: for the first time since early 1938, wheat prices advanced to $1 on the Chicago market because of a drought in the south-western areas of the United States, which was originally expected to reduce the 1940 winter wheat yield to 400 million bushels, the smallest since 1900, and owing to frost damage to Argentine crops; on 29th December, raw silk reached the highest level for ten years at $4.59 a pound, approximately three times the lowest price in 1938, on account of the slowness with which supplies came into sight in Japan, coupled with an active demand for textiles generally; cotton in New York rose to 11 cents, from 8½ cents a year earlier, in response to sharply increased consumption at home and abroad stimulated by the war. From the beginning of 1940, however, prices began to decline and in March, when the restocking movement had clearly come to an end, market quotations for many commodities, e. g. tin, hogs, coffee and sugar, were below those of August 1939.

At the beginning of the war prices of finished goods did not increase in the same measure or with the same uniformity as those of primary commodities. It was soon realised that belligerent purchases in the United States would be deliberate and selective. While in the 1914–18 war French and British purchases had remained uncoordinated until 1917, this time they were placed in the hands of a joint commission as early as October 1939. It was also found that the rush of domestic orders within the United States was in large measure for the purpose of building up stocks as a precaution against uncertainties in price and difficulties of supply. The cautious view thus taken was borne out not only by the rapid drop in the index of industrial production from 128 in December to 101 in April 1940 but also by a rise in the value of manufacturing



* Source: Dun's Review.

and wholesale inventories during the last half of 1939. Manufacturing and retailing inventories, however, were still below the level obtaining at the beginning of the previous year, and the less comprehensive monthly index of the National Industrial Conference Board indicated a decline in February 1940.

Turning to those countries outside Europe which are primarily raw-material-producing areas, very much the same tendencies are noticeable as in the United States but prices of finished articles have been subject to a more pronounced rise, these articles being in larger measure imported and therefore affected by the sharp increase in transport costs. Basic foodstuffs — grain and meat — rose in price immediately after the outbreak of war and maintained their gains. Higher-grade foodstuffs — coffee, cocoa, tropical fruits and sugar — also rose in price at first but did not hold the level attained. Textile raw materials were markedly influenced by the strong demand for war purposes: Indian and Egyptian cotton were sold in large quantities at advancing prices; Great Britain bought the entire wool output of the Empire at higher prices than those previously prevailing; silk prices also rose, as already mentioned; and partly under the influence of speculative demand the price of jute — the basic product for the making of sandbags — rose 150 per cent. between August 1939 and mid-February 1940 but later suffered a setback. Among the industrial raw materials, non-ferrous metals (tin, copper, zinc and lead) all moved sharply upward in price at the outbreak of war, except where official control came into operation. The import price of tin in the United States rose from 48¾ cents a pound to over 70 cents in the first three weeks of September; and the International Committee increased the quota for the third quarter of 1939 by successive steps from 45 to 120 per cent. After the inventory buying had come to an end and the American price had fallen below the pre-war level the quota for the first quarter of 1940 was reduced to 80 per cent. Rubber was similarly regulated in output and recorded a net gain in price up to the end of April 1940. There were also increases in oil prices, which were largest in producing areas with easy access to consumption outlets.

Price developments in Europe also reflect, of course, changes in supply and demand, but the ordinary conditions of the markets have been overshadowed by a series of dislocating factors, the most important of which may be summarised as follows:

(i) Sharp increase in transport costs, particularly in shipping freight rates but also in rail charges, higher premiums for marine and war risk insurance, heavy expenses occasioned by the delays in port, by reshipping and by the necessity of following circuitous routes;

(ii) Dislocation in peace-time trade channels due to Trading with the Enemy Acts, blockades, wartime trade agreements, government pre-emption of supply, official diversion of imports and the imposition of export and import prohibitions in order to conserve stocks or to reduce the outlay of foreign exchange;

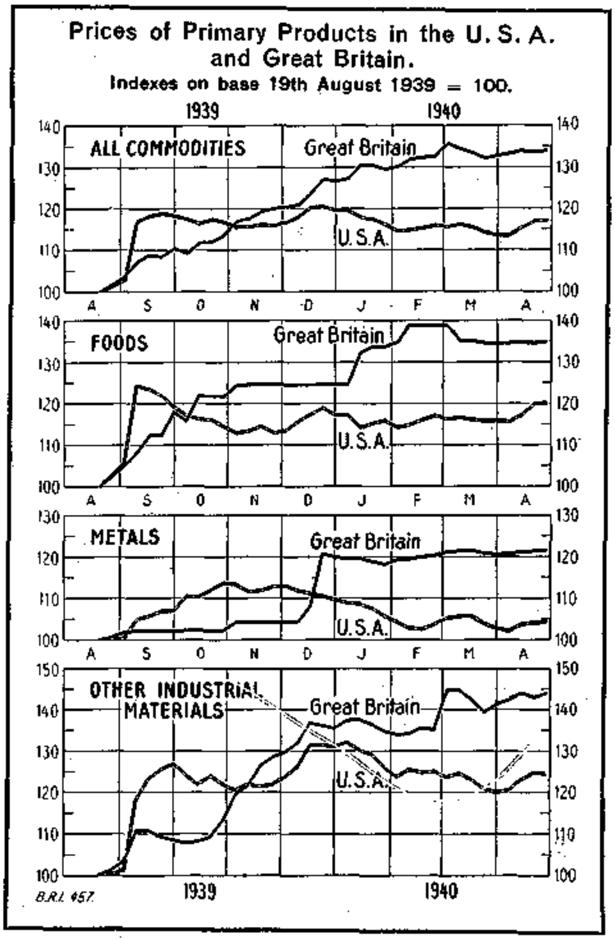
(iii) Changes in currency relationships in the form of fresh depreciations and the introduction of exchange control, the quotation of dual rates and the fixing of altered rates under clearing and payments agreements;

(iv) Changes in taxation, including customs duties, excise, sales and turnover taxes;

(v) Direct official interference in the mechanism of prices and of demand and supply through rationing and requisitioning, systems of permits and licences to buy and sell, the imposition of maximum and minimum prices as well as more thorough-going types of price control.

The disparities between developments of prices in "free" areas and in Europe may be illustrated by a comparison of indexes of roughly the same basic commodities in the United States and the United Kingdom. The accompanying graphs set forth the Bank of England weekly series of indexes for 15 comparable commodities in the two countries, a division being made into foodstuffs, metals and other industrial materials. They illustrate not only the disparate behaviour of the same groups of commodities in the two countries, but also the heterodox character of the price increases in different commodity groups within each country. Already in September American prices rose sharply when British prices were increasing considerably less, despite the depreciation of sterling, which in ordinary circumstances would have instantly affected prices of primary commodities entering predominantly into international trade. By the time American basic commodity prices had suffered a setback the rise in British quotations finally took hold and carried the British indexes far above the American. The initial slowness with which British indexes rose was no doubt in a large measure due to the official price control, while later on some commodity prices, and in particular those for cotton and silver, tended to fluctuate in response not to the official rate for dollars in London but to changes in the value of sterling as quoted in the free market in New York.

Other British prices than those of primary products also tended to rise under the influence of increased costs of production (as regards both materials and labour) and the general dislocation in industry and trade produced by the war effort, including the partial evacuation of certain closely-settled



areas. Wages were increased in many industries, partly as a result of the scarcity of skilled workers and partly in sympathy with the increase in the cost of living, which under a number of trade union agreements called for a compensatory increase in wages. The cost of living was, of course, affected by the country's dependence on imported foodstuffs, but measures were taken to control prices and to ration such commodities as butter, bacon, ham and sugar. At the beginning of December 1939 the retail food index had risen 14 per cent. above 1st September, but then became steady under the influence of subsidies applied to an "iron" ration comprising a limited number of foodstuffs and costing the government an average of £1 million weekly.

In France the publication of official price indexes was discontinued after the outbreak of war, but it is clear from the character of the measures taken to control price increases that a rise occurred between September 1939 and March 1940. In the summer of 1939 French prices were still on the whole below the general level of world prices calculated over the exchange and there was thus a margin of adjustment still in hand. When increased pay has been granted to workers in respect of overtime, contributions have been imposed to ensure at the same time an increase in revenue for the state and a contraction in monetary purchasing power. In Italy the regular publication of price indexes has also been discontinued, but at the meeting of the Central Committee for Corporations on 9th March 1940 it was stated that the cost of industrial production had risen markedly by reason of increases in costs of foreign products, among which coal had risen as much as 69 per cent. since August 1939. It was established that the cost-of-living index had increased 17 to 18 per cent. over the year to March and, at the same meeting, wage increases of 10 to 15 per cent. were agreed upon. The point was also made that the index numbers of prices in current use were not truly representative of the state of affairs and would be recalculated. The rise in prices which occurred reflected in particular extraordinary influences such as increased costs of transport of imported commodities and especially domestic influences such as the measures taken to protect and develop agriculture and generally to promote autarkic production and to improve the social position of the working class. Increased taxation also played a part, especially when in February 1940 the 2 per cent. sales tax levied only once on each commodity was replaced by a turnover tax at the same rate applicable to each wholesale and retail transaction.

In contrast to these developments, price indexes in Germany have shown a marked stability prior to and following the outbreak of war, no doubt under the influence of the thorough German price control, which had been established, basically in its present form, in 1936 but was modified in a number of respects upon the outbreak of war. Thus the scope of the system was enlarged since prices outside the control tended to advance. Rationing was introduced on a wide basis, including, in addition to foodstuffs, restrictions on the purchase of clothing and shoes. At the beginning of the war extra pay for overtime and night work was suspended and profits resulting from lower labour costs were either to be paid over as taxes or to be used in the reduction of prices paid by the government. Later, however, this order was in part rescinded and extra pay for overtime was granted anew, beginning with the eleventh instead of the ninth working hour per day. In the field of agricultural prices, which, because of the scattered and individual character of the producing

Wholesale Price Indexes.

1929 = 100	1938	1939		1940			Percentage change from	
	Dec.	Aug.	Dec.	Jan.	Feb.	March	August 1939 to Dec. 1939	August 1939 to March 1940
Albania	63	72	84	86	93	90	+ 17	+ 25
Belgium	71	70	93	97	99	99	+ 33	+ 41
Bulgaria	67	65	70	69	69	69	+ 8	+ 6
Denmark	102	103	132	143	150	154	+ 28	+ 49
Estonia	85	86	97	100	102	103	+ 13	+ 20
Germany	77	78	78	79	79	80	0	+ 3
Greece	120	119	133	135	136	.	+ 12	.
Hungary	85	86	89	92	93	94	+ 3	+ 9
Latvia	93	98	105	.	.	.	+ 7	.
Netherlands	71	71	85	86	88	88	+ 20	+ 24
Norway	101	101	120	122	128	135	+ 19	+ 34
Portugal	97	95	112	114	.	.	+ 18	.
Roumania	81	84	104	109	114	.	+ 24	.
Spain	134	137	147	.	.	.	+ 7	.
Sweden	91	95	114	117	119	121	+ 20	+ 27
Switzerland	75	76	89	90	92	94	+ 17	+ 24
United Kingdom	86	86	107	110	113	113	+ 24	+ 31
Yugoslavia	77	76	90	93	94	98	+ 18	+ 29
Canada	77	76	85	86	87	87	+ 12	+ 14
U.S.A.	81	79	83	83	82	82	+ 5	+ 4
Argentine	107	107	126	130	128	129	+ 18	+ 21
Peru	111	116	128	128	129	128	+ 10	+ 10
South Africa	.	86	93	94	95	96	+ 8	+ 12
Australia	94	89	93	92	91	93	+ 4	+ 4
China	159	253	355	375	432	447	+ 40	+ 77
India	67	71	97	92	89	86	+ 37	+ 21
Japan	116	124	143	146	144	142	+ 15	+ 15

units, are in general less amenable to control than prices of industrial products, the German price control has, nevertheless, been successful in keeping down most prices. Bread, flour, meat, sausages, sugar and potatoes have remained unchanged in price. Some upward adjustment has, however, been made in the price of milk and butter in order to ensure continuity of supplies.

The tables summarise developments in those countries, for which price indexes are still available, it being underlined once again that comparisons must be made with great caution on account of the dissimilar character of the indexes in the different countries. As a rule the actual cost of living for the average income-receiver has risen to a greater extent than is shown by the usual cost-of-living index (which generally refers to the bare necessities of life for the lowest income levels) since consumers' products outside basic lists have been subject to more pronounced rises in price.

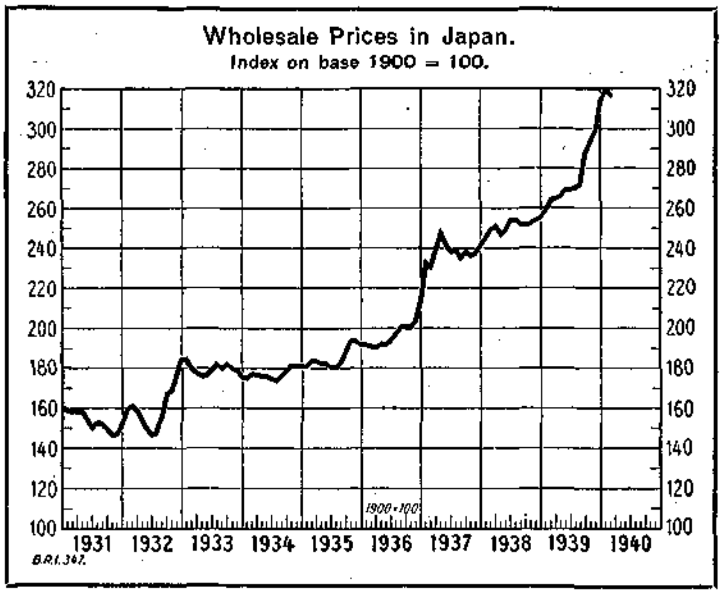
In the Balkan countries prices have generally tended to rise in response to a keen demand for their exportable products, recently coupled with bad prospects for the 1940 harvest. A severe winter, together with the overflowing of the Danube, reduced the acreage from which average grain yields may be expected, and several of the countries involved have already been forced to reduce exports of agricultural products in order to conserve adequate supplies for domestic use.

Cost-of-Living Indexes.

1929 = 100	1938	1939		1940			Percentage change from	
	Dec.	Aug.	Dec.	Jan.	Feb.	March	August 1939 to Dec. 1939	August 1939 to March 1940
Belgium	95	91	97	99	101	101	+ 7	+ 11
Bulgaria	62	62	63	63	64	64	+ 2	+ 3
Denmark	106	106	118	.	.	128	+ 11	+ 21
Estonia	93	94	99	107	109	112	+ 5	+ 19
Germany	81	83	82	82	83	84	— 1	+ 1
Greece (1)	130	128	133	134	134	135	+ 4	+ 5
Hungary	87	87	87	89	90	90	0	+ 3
Latvia (2)	86	92	89	86	91	95	— 3	+ 3
Lithuania	53	52	61	63	65	.	+ 17	.
Netherlands	82	81	87	87	88	.	+ 7	.
Norway	102	104	110	110	113	117	+ 6	+ 13
Portugal	83	81	83	83	83	82	+ 2	+ 1
Roumania (3)	126	131	149	153	159	166	+ 14	+ 27
United Kingdom	95	95	106	108	109	109	+ 12	+ 15
Sweden	98	99	105	.	.	109	+ 6	+ 10
Switzerland	85	85	88	90	90	90	+ 4	+ 6
Yugoslavia	70	69	78	80	85	87	+ 13	+ 26
Canada	83	83	85	85	.	.	+ 2	.
U. S. A.	86	84	85	85	86	85	+ 1	+ 1
Argentine	92	93	98	98	96	.	+ 5	.
Chile	168	170	180	177	178	181	+ 6	+ 6
Peru	95	97	99	100	100	101	+ 2	+ 4
Uruguay	99	102	107	107	107	.	+ 5	.
South Africa	93	93	94	95	96	96	+ 1	.
Australia	88	89	89	.	90	.	0	+ 1
China	134	187	272	291	325	329	+ 45	+ 76
Japan	117	123	132	136	138	140	+ 7	+ 14

(1) 1931 = 100. (2) 1930 = 100. (3) 1936 = 100.

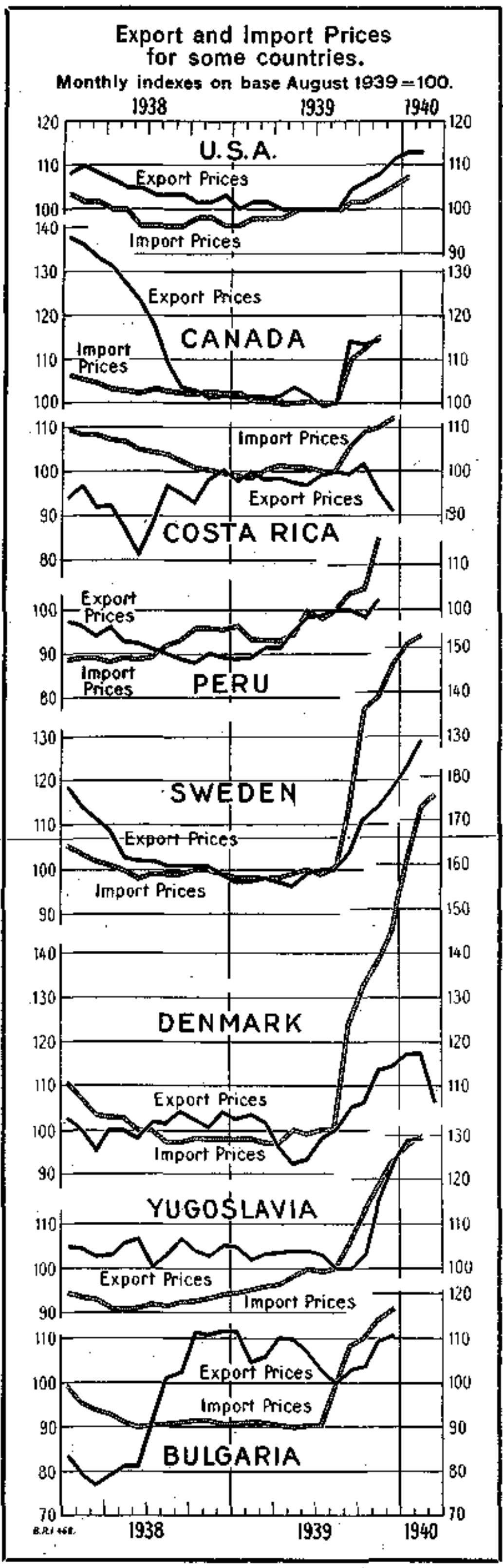
It will be seen from the above tables that the greatest price increases have occurred in the Far East. In Japan prices have been rising since the war in China began in 1937 and for a number of reasons the rise was accentuated with the outbreak of hostilities in Europe. The yen followed the decline of sterling and thus depreciated in relation to a large number of currencies; as import costs rose, some speculative activity made its appearance in the export markets and there was a failure of the rice crop in Formosa. In Shanghai the spiral increase in prices is largely attributable to the depreciation of the Chungking yuan, combined with the increased cost of many goods on world markets.



The disparate behaviour of price indexes in various countries was greatest in the early months of the war and a faint tendency appeared in the spring of 1940 for prices to establish themselves on the basis of a new relationship. As far as it went, this tendency may be said to indicate that, whatever disruptive forces were still operative, adjustments had been made in particular to the initial large-scale dislocating factors of currency depreciation and of increases in transportation costs.

The sudden changes in relative prices which have occurred since the outbreak of war have produced widely different effects on the fortunes of different countries. The relation of import to export prices — or the terms of trade — constitutes, so to say, a measure of the benefits which a country derives from its foreign trade at one time as compared with another. When a country's export prices rise in relation to its import prices, it is able to obtain a larger volume of imported commodities for a given volume of exports; and, vice versa, when its import prices rise more than its export prices a greater amount of exports is needed to obtain the same volume of imports.

The following graphs of monthly export and import prices reveal the considerable changes which have occurred in the terms of trade of different national economies since the middle of 1939. In some instances apparent changes are no doubt due to the construction of available indexes; the figures for the United States, for example, are derived from the value of all American foreign trade and show much less fluctuation than indexes based on the quoted prices of a limited selection of outstanding exports and imports (generally raw materials and agricultural products traded in active markets).



Export and Import Prices for some countries.
Monthly indexes on base August 1939=100.

Both import and export prices have risen since August 1939 in every country included in the graph, with the exception of the export prices in Costa Rica, but four-fifths of the export trade of this country consists of coffee and bananas. For Europe the rise in import prices greatly exceeds that of exports, while for the United States and in the raw-material-producing areas outside Europe the terms of trade have moved in the opposite direction.

Even within Europe broad differences in the development stand out. In the Balkan region the adverse movements of the terms of trade have been much less severe than in Scandinavia, partly because of the intense demand for Balkan exports and partly because of the relatively more moderate deterioration in transport conditions in this region. Differences are also noticeable within the same geographical area, as, for instance, between Denmark and Sweden. Imports rose considerably in price in both these countries, not least as a result of their higher freight and insurance charges, but the agricultural character of a considerable part of Denmark's imports (feeding stuffs from raw-material-producing areas) made for a steeper rise. Moreover, the fixing of maximum prices for butter, eggs and bacon in Great Britain, to which the major part of the Danish exports was directed, acted as a check on the country's export prices, while Swedish industrial raw materials were in good demand.

An important cause of changes in the terms of trade was the disparate movement of freight rates in different parts of the world. Freight rates have risen generally, but not through an increase in the total volume of world trade; as a result of blockades and other wartime measures the actual volume of goods exchanged between nations has fallen, as was the case in 1914–18. But losses at sea reduce the number of cargo boats available and delays, often serious, diminish the carrying capacity per ship. These factors do not act with the same intensity all over the world; while rates between the United States and the eastern ports of South America have increased only 10 per cent., rates for shipment from the United States to Scandinavia had risen by the beginning of 1940 by over 100 per cent. Often the increase is even greater: Pacific Coast time charters in the United States trebled in price between August and December 1939; rates for heavy grain shipments from New York to Antwerp–Rotterdam rose by 15 cents per 100 pounds in the summer of 1939 to 85–90 cents in mid-February 1940. Rates for oil and gasoline tankers — a specialised type of transport much in demand — rose fivefold in the United States between August and February.

Overall indexes of freight rates in Europe show even greater increases. Lloyd's List for the United Kingdom indicates a total rise of 400 per cent. between August 1939 and March 1940, with component continental increases ranging from 5½ fold, for freights between the United Kingdom and South America, to 3½ times, for freights to ports in the Pacific Ocean and Australia. The Danish freight index rose from 134 in August 1939 to 563 in February 1940; that in Sweden from 125 in August to 828 in March 1940.

A rise in costs affecting producers in general must as a rule be followed by a rise in prices, for the possibility of granting subsidies — open or veiled — is, after all, necessarily limited. Systems of price control, introduced since the outbreak of the war in a number of countries which previously adhered to the principles of free economies, can therefore either limit themselves to ensuring that prices are not raised more than changes in costs justify, or can be extended to regulate the cost of different factors of production. In the former case the simple aim of the price control (and this applies to most of the systems initiated since the war) is usually to prevent speculation, hoarding and profiteering in goods affecting the general standard of living and to keep prices and profits from rising unduly on supplies bought by the government. Such simple systems are found especially in neutral countries and in those far from the theatre of war, as in the Argentine, Australia, British India, Bulgaria, Estonia, Greece, etc.

In the more far-reaching systems of control, when the objective may be to prevent almost every rise in prices, the powers of the controlling body are necessarily extensive and include control over wage rates, over the allocation of workers between different plants and industries, over the right of firms to remain in or enter specific branches of production, and generally over the marketing of agricultural products. The most important element in this more extensive control is necessarily the fixing of wages and the distribution of the labour force. In this connection it is of interest to mention the German Price Commissioner, who is in possession of very wide powers but does not exercise supervision over salaries (as distinct from wages) nor over interest rates — these being practically the only limitations to his sphere of action. The technical measures adopted to enforce the control of prices are, of course, inextricably associated with the vast maze of export and import prohibitions, the granting of subsidies, the levying of special taxes and the application of direct restrictions on consumption. Rationing is generally applied in the first place to foodstuffs, but may also be extended to industrial raw materials when scarcity of supplies necessitates a planned allocation between different firms and industries. The different systems of rationing of consumers' goods may be as elaborate as in Germany or may be applied only to a limited number of foodstuffs and, for instance, to petrol for the private use of motor cars. In addition, consumption may be banned on certain days in the week through the introduction of meatless days or restrictions on the use of private motor cars.

One of the most usual forms of control is the "price stop", which forbids the increase of prices above the level prevailing on a fixed date except under certain conditions. Germany adopted this system by a law in 1936 and the base date still in effect is 17th October 1936: in England, the base date is 1st August 1939, in France, 1st September 1939 (decree of 9th September supplemented by that of 29th February 1940) and in Japan, 18th September 1939. Under this type of control the exceptions may, of course, become extremely important. In Germany, no price can be changed without preliminary approval by the Price Commissioner, while in England prices may be adjusted above the 1st August level when such adjustment is necessitated by the increased cost of materials (domestic or imported) or higher costs of selling or production, including wages, salaries, manufacturing expenses, insurance premium charges and advertising expenses. In France authority to increase prices could at first be granted, by way of exception, when such increases were "justified by the de facto conditions in which commercial concerns were carrying on business or by fluctuations in prices of imported raw materials"; but in a decree of 9th April 1940 it was laid down that, since prices in France had become adjusted to world prices, which in turn had levelled off in February, there should, from 1st May 1940 onwards, be no further increases, apart from exceptional cases in which authorisation might be granted, subject to certain conditions specified in the decree, "when the increase in cost price is the result of a rise in the price of imported raw materials and exceeds a minimum percentage, to be fixed according to the circumstances by the National Committee for Price Control."

The same result is achieved in a somewhat different fashion by the promulgation of maximum prices, which can be fixed more freely according to the conditions of production and the available supply than when reference is made to a given date in the past. Attempts are often made to fix "just" or normal, "fair" or natural prices on this basis. Finally, the experiment has been made, in a limited number of cases, of basing the selling price on the "average cost" of an industry, taking into consideration that different firms produce at different costs per unit of output, and that the "fair" return for the lower-cost producer may not be sufficient to cover the costs of another firm, which by reason of locality, size, etc. cannot produce as cheaply. This type of scheme is said to be operative with regard to a number of German industries and also under the iron and steel control in the United Kingdom.

When price control is adopted, the subsequent development depends largely upon the conditions of demand and supply in the market. When, for instance, the Netherlands and Switzerland introduced control of prices in the autumn of 1936 at the time of the depreciation of the gold-bloc currencies, they did so with a view to preventing a rise in the cost of living, which might have brought with it a rise in wages and other costs. Their intervention may be said to have been highly successful: only a slight rise in costs and prices occurred; and in that way the two countries were able to derive distinct benefits from the adjustment to their exchanges, which not only improved the competitive position of the export industries but helped to establish a better balance in the internal structure of costs and prices. Moreover, the control could gradually be eased and prices be allowed to find their natural level according to the conditions prevailing on the markets.

The position is very different under the strain of war when the supply of goods becomes progressively smaller while demand is increased by extraordinary requirements representing the needs of the state; for the monetary purchasing power in the hands of the public is abnormally expanded. Then it is difficult to stop at some "half-way house". Generally one measure leads to another: decrees are issued forbidding holders of goods to keep them off the market, to refuse the satisfaction of normal demands, or to raise prices indirectly through changes in the terms of sale customary in the trade or through a deterioration in the quality of the goods delivered. The authorities often find themselves compelled to step in and take over the total supply available, in which case the distribution is wholly in the hands of official bodies. In these circumstances the prices that are fixed have much less relation to the conditions of supply and demand than those which would obtain in a free market; and the normal functions of the price mechanism (increased prices acting as a stimulus to production and a check on consumption) are no longer fulfilled. Rising prices in wartime often present a real dilemma. On the one hand, price control is deemed essential to ensure that the necessities of life are kept within reach of the lower-income groups of the people; on the other hand, rising prices are not always a sign of speculation, hoarding or profiteering, but may reveal deeper maladjustments between production and consumption under the new conditions; and, as long as the price control concentrates wholly on the price phenomena themselves, it may be merely dealing with symptoms. This danger is, of course, generally realised: as far as monetary conditions are concerned, the obvious objective of official measures must be the prevention of an inflationary expansion of purchasing power in the hands of the public, which would render the effective control of the price level more difficult or indeed impossible.

III. PRODUCTION AND MOVEMENTS OF GOLD.

The gold production of the world attained a new record of 39.5 million fine ounces in 1939, 6 per cent. above the previous year and about double the production in 1929. In terms of U. S. dollars the current value rose from $397 million in 1929 to $1,382 million in 1939, i. e. by nearly 250 per cent., while commodity prices in the United States (almost the sole recipient of the new gold) in 1939 were still about 20 per cent. below 1929.

No new information has become available regarding gold production in the U. S. S. R., but it is assumed that the output has remained at about the same level as in the two previous years, for which estimates of 5 million ounces were given. More gold has been obtained from Eastern — particularly Indian — hoards; the supply from this source rose from $69 million in 1938 to $111 million in 1939, reflecting in the main speculative selling to take advantage of the high price of gold in rupees, sterling and silver.

While the aggregate supply of new monetary gold from current production and Eastern dehoarding (allowance being made for industrial demand) was fully $1,400 million in 1939, the net increase in the monetary gold stock of the United States amounted to $3,132 million — the highest amount ever received by a single country within a year. $727 million were needed to offset the estimated current surplus in the balance of payments and some $2,000 million were the counterpart to a heavy inflow of capital to the American market. Part of the gold shipped to the United States was from private hoards in Europe no longer considered sufficiently safe in the event of war. Conditions in Europe also led to an increase of $534 million during 1939 in the amount of gold earmarked, principally by European monetary authorities, with the Federal Reserve Banks.

France is reported to have had higher reserves at the end of 1939 than at the end of the previous year, the inflow of funds to the French market which began in the autumn of 1938 having continued with slight interruption throughout the year. The main loss of gold was sustained by the United Kingdom as a result of a growing deficit in the balance of payments and as a counterpart to an outflow of foreign funds from London not wholly stemmed by the exchange restrictions of September 1939. The Netherlands and Switzerland also lost gold heavily during the year, partly on account of an outflow of funds and partly to provide payments for a higher import surplus, especially in the autumn.

1. THE SUPPLY OF GOLD.

The continued increase in gold production can be seen from the following table:

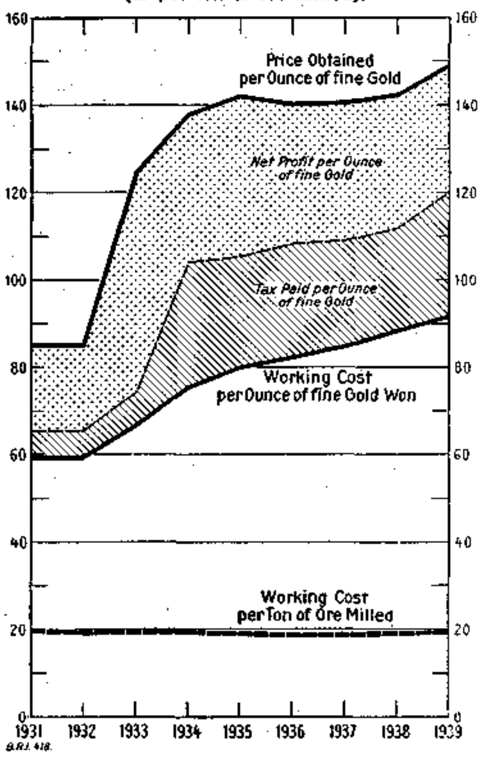
World Gold Production	1929	1932	1937	1938	1939
	in thousands of fine ounces				
Union of South Africa	10,412	11,559	11,735	12,160	12,821
Canada	1,928	3,044	4,096	4,715	5,092
U. S. S. R. (1)	707	1,938	5,000	5,000	5,000
United States	2,056	2,219	4,112	4,245	4,565
Australia	426	710	1,363	1,574	1,621
Philippines	152	230	692	844	1,015
Korea	138	276	735	850	950
Mexico	652	584	846	923	944
Japan	335	402	723	772	850
British West Africa . .	208	293	621	725	814
Rhodesia	562	581	808	815	803
Colombia	48	248	442	521	582
Belgian Congo	173	243	432	460	502
Chile	26	38	273	294	327
British India	364	330	332	322	316
Peru	121	86	214	254	270
New Guinea	(2)	(2)	217	242	246
Sweden	(2)	132	193	198	200
Roumania	71	103	167	172	175
New Zealand	120	166	168	151	166
Other countries	693	1,072	1,714	1,987	2,222
Total World Production	19,192	24,254	34,883	37,224	39,481
	in millions of dollars (3)				
Value of Total World Production	672	849	1,221	1,303	1,382

(1) Estimates. (2) Included in other countries.

(3) Dollars of present-day value equivalent to $35 per ounce of fine gold: the value of gold production in 1929 in the dollars then current (of $20.67 per ounce fine) was $397 million and in 1932 $501 million.

Gold production in South Africa is still more than twice as high as in any other country, but it now accounts for only about one-third of the aggregate world production as compared with one-half in 1929. The reasons for this regression in relative importance are partly the great advance in other countries — U. S. S. R., United States, Canada, Australia and a number of smaller producing areas — and partly the mining policy adopted in South Africa, according to which lower-grade ores have been milled in increasing quantities with a view to prolonging the lives of the mines. Notwithstanding the extension in the amount of ore handled, the working cost per ton of ore milled in South Africa has remained remarkably steady; the cost was, in fact, 19s. 3d. per ton in 1932 (the last year before the depreciation of the South African pound) and nearly the same, 19s. 5d., in 1939. The milling of more

Witwatersrand Mines Gold Production.
Working Revenue, Costs and Profit
in shillings per ounce of fine gold won
(or per ton of ore milled).



low-grade ore increases, however, the cost per fine ounce of gold, which rose from 59s. 3d. in 1932 to 91s. 8d. in 1939, i. e. by 55 per cent. As a result of the depreciation of the pound the price obtained per ounce of fine gold rose by 75 per cent. (from 85s. in 1932 to 149s. 2d. in 1939), and there was thus an improvement in the working profits per ounce of fine gold from 25s. 9d. in 1932 to 57s. 6d. in 1939. Although taxation per fine ounce increased from 6s. 3d. to 28s. 8d., there remained a net profit per ounce of fine gold of 28s. 10d. in 1939 as compared with 19s. 6d. in 1932.

The following rough analysis of the distribution of the amounts realised by gold sales is given by the Union Corporation in its Annual Report for large companies of the Witwatersrand affiliated to the Transvaal Chamber of Mines (accounting for practically the whole output of gold):

Distribution of amounts realised by gold sales:

	£ million	percentages
To the Community: working costs	56.6	61.3
To the Government: taxation and share of profits	12.7	13.7
To Shareholders: dividends	19.9	21.6
Miscellaneous (including capital expenditure provided out of current revenue)	3.1	3.4
Total	92.3	100.0

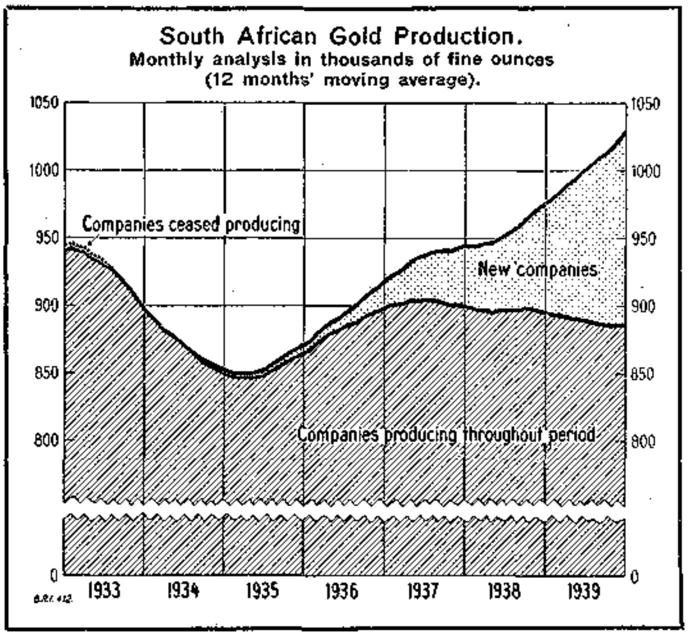
After the outbreak of war in September 1939 the market price of gold in London rose to 168s. per fine ounce, but the highest price received by the mines during this period was 150s. Under the Emergency Finance Regulations, issued after the declaration of war, gold producers in South Africa were required to offer for sale to the Union Treasury all gold produced. The Treasury was empowered to purchase such gold at a price which was not less than the market value of the gold on the day of purchase but did not exceed 150s. per ounce of fine gold. It was, however, claimed by the gold mining industry that this limitation in the price would have very serious effects. It was pointed out that, although the working cost per ton of ore milled had remained fairly constant in recent years, the working cost per ounce of gold had risen steadily, owing to the fall in the gold content of the ore milled, and was rising more rapidly under war conditions owing to the rise in cost of supplies. Besides the older mines which had only low-grade ore left, many new mines had been opened and some of these had been brought to production on the basis of the increased price of gold. Hitherto the form of taxation applied to the gold mining industry had been definitely designed to encourage the mining of low-grade ore. If the industry should be forced to adopt a high-grade ore policy through limitation of the price receivable for gold or through changes in the form of taxation and rising working costs, some mines would be compelled to close, while the lives of all mines would be greatly curtailed. In view of these representations the Minister of Finance in his budget speech for 1940 announced that the government had decided, as from 1st January 1940, to rescind its gold purchase scheme and instead impose an additional tax of 9 per cent. on the taxable income of the mines without any reduction for redemption, thus obtaining the amount in question (£3.5 million) in a form acceptable to the industry.

Under the mining policy adopted in South Africa the high gold price has thus led to no great immediate increase in the output but to an increased milling of lower-grade ore. The amount of ore milled by large mines of the Witwatersrand and Heidelberg districts rose from 34.9 million tons in 1932 to 58.3 million tons in 1939, and in order to cope with this increase in activity the average number of native and coloured workers in service was increased from 214,781 in 1932 to 314,222 in 1939 and the average number of whites from 23,051 in 1932 to 41,852 in 1939, constituting a new record for the industry.

During the year the Mozambique Convention for the recruitment of a maximum number of 80,000 East Coast natives was extended for a further period of five years by mutual agreement between the Portuguese and the Union Governments. Permission was further obtained for recruitment on a somewhat increased scale of tropical natives from British territories north of 22 degrees south. It is, however, reported by many mines that the native labour supply was inadequate during the latter part of the year in relation to the work in hand. Although the employment of native and coloured labour rose to a new record figure of 342,000 at the end of February 1940, the difficulty of the mining industry in satisfying its rapidly growing need for native labour is regarded as a serious problem for the future of the industry.

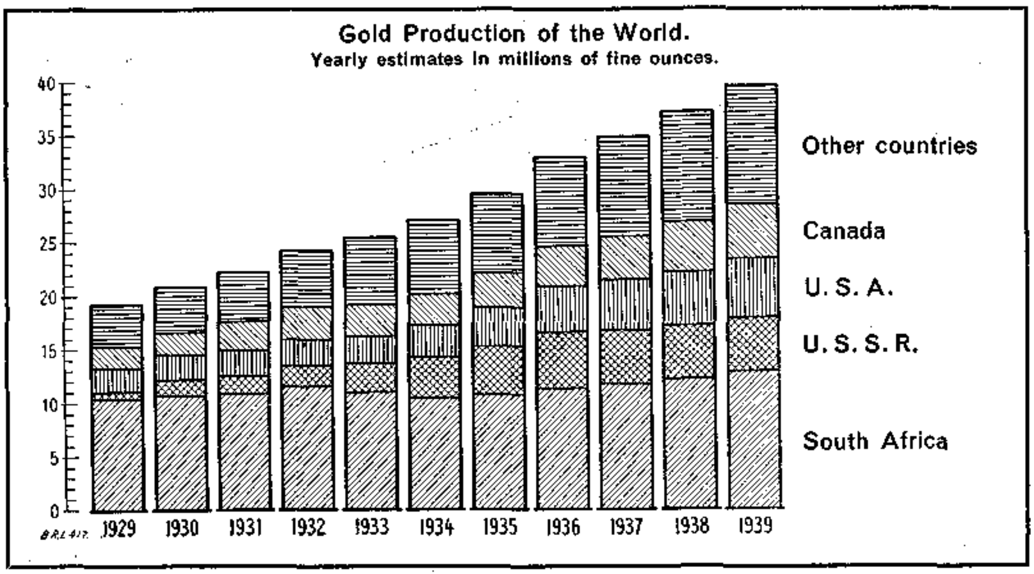
The South African gold production rose by 5.4 per cent. in 1939, a result which reflects the activity of newly-opened mines.

The first of the new mines started producing in July 1934, but production in the thirty-one old-established mines fell until early in 1935. In the next two years their production increased somewhat, but from the spring of 1937 to the present time a steady decline of the older mines has taken place. Meanwhile more new mines have come in, the latest, in November 1939, bringing the total of the new producers up to eleven. Included



among the "new companies" shown in the graph are also certain old companies (or amalgamations or reorganisations of old companies) which had for some time been moribund but restarted production as the rise in the price of gold began to make the working of their low-paying ore profitable. In the year 1939 these new or newly-opened mines produced 1,720,000 fine ounces, 14 per cent. of the total for the Rand.

Also in other producing areas new records were generally attained in 1939. In Canada gold mining continued to be the most important branch of the Canadian mineral industry, both with regard to the value of the production



and with regard to the number of men employed. In addition to the large output from mines and placer operations substantial quantities of gold are recovered in the treatment of base metal ores; in fact, the Noranda copper mine in northwest Quebec is Canada's third largest producer of gold.

Production in the United States increased by 7.5 per cent. in 1939 as compared with 3.2 per cent. in the previous year, the decline in commodity prices — evidence of a recession in general business — acting as a stimulant to gold production. In the Philippines the gold output advanced in 1939 at a rate of 20 per cent. — the highest rate of increase of any area in the world. For the U. S. S. R., as mentioned above, no precise information has been *available with regard to the output in recent years and any estimate* of the production is necessarily of a general nature. Most of the U. S. S. R. gold output is obtained from alluvial deposits and the results of working such deposits are, as past experience shows, readily subject to great variations; compare, for instance, the sudden increase and rapid exhaustion of the Australian and Californian goldfields around 1850. According to British statistics the import of gold from the U. S. S. R. into England amounted to 970,000 in the first eight months of 1939 against 3,160,000 ounces in 1938. Unofficial reports from the United States give the American import of Russian gold on indirect shipments through other countries at some 1,485,000 ounces in 1939.

Gold production in Australia, after rising rapidly from 1935 to 1938, has shown less advance in 1939, the increase being only 3 per cent. Production in Mexico has gone ahead, approaching the level of 1 million ounces. Noteworthy are the advances of the gold output in Korea and Japan by 11.8 and 10.1 per cent. respectively, the aggregate output of these areas amounting to 1,800,000 ounces, which contributed over one-third of the gold exported in 1939 from Japan to the United States in support of the yen. Gold production in Japan as well as in Korea is subsidised; and the governments in many other countries have likewise taken measures to stimulate gold production within their borders.

If the estimate of 5 million ounces for the U. S. S. R. production be accepted the following table shows the distribution of gold production as between different continents:

Gold Production by Continents	1929	1932	1939 (1)	Percentage change from 1929–1939
	in thousands of fine ounces			%
Africa	11,385	12,797	15,464	+ 36
North America	4,637	5,865	10,629	+ 129
Central America (2)	53	82	168	+ 217
South America	466	714	1,698	+ 264
Asia (3)	1,189	1,474	3,676	+ 209
Oceania	585	998	2,183	+ 273
Europe (3)	170	385	663	+ 290
U. S. S. R. (1)	707	1,938	5,000	+ 607
	19,192	24,254	39,481	+ 106

(1) Estimates. (2) Incl. West Indies. (3) Without Russia.

The share of North and South America in the world's gold production amounts to about 30 per cent. of the total, while the share of this continent in the world's silver production is about 75 per cent. The British proportion of world production has remained steady during the last five years at about 57 per cent.

The receipts of gold from hoards in Eastern countries, which had fallen to relatively insignificant figures in the years 1937 and 1938, recovered somewhat in 1939, especially as a result of speculative sales from Indian hoards. Egyptian gold exports in 1939 would seem to have been on a rather larger scale than in earlier years.

Receipts of gold from the East.

In millions of dollars (at $35 per fine ounce)	India[1]	China	Hong Kong	Total
1931	208	18	20	246
1932	320	39	19	378
1933	202	24	33	259
1934	220	18	22	260
1935	150	14	11	175
1936	109	12	10	131
1937	50	17	1	68
1938	55	0[2]	14	69
1939	110	1	0	111
Total	1,424	143	130	1,697

[1] Private holdings only. [2] A net import of $4 million.

It has been an interesting feature of Indian developments in 1939 that the demand for silver from Indian bazaars, which had fallen abruptly in 1938, suddenly recovered under the impetus of somewhat higher incomes in India and, during part of the year, a lower price for silver. The greater absorption of silver in India may be taken to show that the dehoarding of gold was not due to distress selling but was prompted mainly by the increase in the price of gold in terms of rupees, sterling and silver. The magnitude of remaining Indian gold hoards is not known and it is therefore impossible to say what further amounts may be obtained from this source. While the disgorging of gold from Indian hoards was a factor of some importance in the years 1931–34 (not least from a psychological point of view, when the world was still obsessed with fears of a scarcity of gold), the amounts involved were never great in comparison with other contributions to the gold supply. In the nine years 1931–39 the aggregate amount of gold obtained from Indian hoards was the equivalent of $1,400 million, which is about the figure of the gold production in 1939.

Little new information has been available as to the amounts of gold absorbed by the arts and industry. The United States' demand for industrial uses has no doubt increased but is still largely covered by the return of old gold in the form of scrap, coins, etc. Net industrial consumption was probably slight and may in some countries have been reduced by the difficulties of the war period.

In these circumstances the amount of gold available for monetary use in 1939 may be estimated at fully $1,400 million.

2. MOVEMENTS OF GOLD.

By far the chief recipient of gold in 1939 was the United States, where the gold stock rose by $3,132 million, i. e. by more than twice the amount of new monetary gold available during the year. The reported gold holdings of central banks and governments only partially reveal the movements which have occurred but still usefully serve as a starting-point for analysis:

Reported Gold Holdings (excluding Exchange Funds).

In millions of dollars	United States total gold stock	United Kingdom (showing transfer of gold from Bank of England)	Other countries	Total reported gold holdings [1]
End of 1938	14,512	2,690	7,998	25,200
,, ,, 1939	17,644	1	7,855	25,500
Difference . . .	+ 3,132	—2,689	— 143	+ 300

Changes in Gold Stock of United States:

Part of new monetary gold, say[2]. . . . . . . $ 1,200 million

Other additions, say . . . . $ 1,900 ,,

[1] Excluding gold in Exchange Funds and also the gold reserves of the U. S. S. R. regarding which no information has recently been obtained.

[2] Of the amount of newly-produced gold, $ 1,200 million, some 85 per cent. of the total, may be regarded as having been sold directly or indirectly to the United States.

Although the aggregate gold holdings of the "other countries" in the table changed relatively little during 1939, there were some important movements in a few individual countries. France gained gold over the year; statistics covering the holdings both of the Bank of France and of the Exchange Fund available up to May 1939 reveal that during the first five months of the year the total gold reserves rose by $285 million; acquisitions continued to be made until late in the year. In Europe an increase in gold reserves is also shown by Roumania ($19 million from domestic production). Outside Europe, the Argentine increased its gold reserves by $35 million, South Africa by $29 million, Canada by $22 million and Java by $10 million — increases reflecting an improvement in the trading position of the respective countries (for the Argentine and Java, especially in the second half of the year). The Bank of Canada explains in its annual report that its gold and foreign exchange holdings were increased partly to maintain a liquid reserve appropriate to its growing note and deposit liabilities and partly because if war broke out the Bank would stand in need of such additional foreign resources as could conveniently be accumulated. A great number of countries (as may be seen from the table on next page) reported exactly the same gold reserves at the end of 1939 as at the end of 1938. In some instances gold was no doubt held outside the reported reserves and changes in these undisclosed holdings may have occurred in the course of the year, probably leading on balance to a loss of gold.

Reported Gold Reserves		End of 1937	End of 1938 (1)	Loss (−) or gain (+) during 1938	End of 1939 (1)	Loss (−) or gain (+) during 1939
		in millions of dollars (at $35 per fine ounce)				
Group 1:	U. S. A. (2)	12,760	14,512	+ 1,752	17,644	+ 3,132
	France (3)	2,564	2,435	− 129	2,714	+ 279
	Argentina	469	431	− 38	466	+ 35
	South Africa	189	220	+ 31	249	+ 29
	Canada	184	192	+ 8	214	+ 22
	Roumania	120	133	+ 13	152	+ 19
	Java	79	80	+ 1	90	+ 10
	Brazil	32	32	0	38	+ 6
	Mexico	24	29	+ 5	32	+ 3
	Yugoslavia	51	57	+ 6	59	+ 2
	Finland	27	25	− 2	27	+ 2
	Greece	24	27	+ 3	28	+ 1
	Total	16,523	18,173	+ 1,650	21,713	+ 3,540
Group 2:	British India	274	274	0	274	0
	Bulgaria	24	24	0	24	0
	Chile	30	30	0	30	0
	Denmark	53	53	0	53	0
	Egypt	55	55	0	55	0
	Estonia	15	15	0	15	0
	Japan	261	164	− 97	164	0
	Lithuania	13	11	− 2	11	0
	New Zealand	23	23	0	23	0
	Norway	82	94	+ 12	94	0
	Poland	83	85	+ 2	85 (4)	0
	Portugal	69	69	0	69	0
	Turkey	29	29	0	29	0
	Total	1,011	926	− 85	926	0
Group 3:	Peru	20	20	0	19	− 1
	Uruguay	74	69	− 5	68	− 1
	Germany	48	45	− 3	43	− 2
	Colombia	16	24	+ 8	21	− 3
	Latvia	15	17	+ 2	13	− 4
	Hungary	25	37	+ 12	24	− 13
	Sweden	244	321	+ 77	308	− 13
	Belgium (5)	758	728	− 30	714	− 14
	Czecho-Slovakia	92	83	− 9	56 (6)	− 27
	Italy	210	193	− 17	144	− 49
	Switzerland	648	699	+ 51	547	− 152
	Netherlands	930	995	+ 65	690	− 305
	United Kingdom (7)	2,689	2,690	+ 1	1	− 2,689
	Total	5,769	5,921	+ 152	2,648	− 3,273
Grand total (8)		23,450	25,200	+ 1,750	25,500	+ 300

(1) Partly estimated.

(2) Not including gold held in Stabilization Fund: $ 80 million in December 1938 and $ 164 million in September 1939.

(3) Not including gold held in Exchange Stabilisation Fund i.e. $ 331 million in December 1938 and $ 477 million in May 1939 (latest data reported). (4) Last data reported.

(5) Not including gold held by the Treasury: $ 81 million in December 1937, $ 44 million in December 1938 and $ 17 million in December 1939. (6) For 1939 Bohemia and Moravia.

(7) Not including Exchange Equalisation Account: September 1937, $ 1,395 million and September 1938, $ 759 million. In September 1939, $ 1,162 million were transferred from the Bank of England to the Account.

(8) Partly estimated and including also other countries (but not U. S. S. R. or Spain).

The greatest reduction in central-bank gold reserves — apart from the United Kingdom — is found in the Netherlands, where the reserves of the Nederlandsche Bank fell by nearly one-third from $995 million at the end of 1938 to $690 million at the end of 1939. It is probable that the Equalisation Fund also parted with gold in the course of the year although the amount is not reported. The gold loss was in the main due to export of capital, both foreign and Dutch; the import surplus on merchandise account rose by Fl. 175 million (= $93 million) from 1938 to 1939, while losses in income from transit trade were to some extent counterbalanced by greater profits from the Netherlands Indies. Switzerland also lost gold in 1939: the reduction in the reserves of the National Bank was $152 million, but at the same time the Bank increased its foreign exchange reserves to the extent of $18 million, while the Exchange Equalisation Fund disposed of part of its gold holdings. In the spring of 1939 large amounts of mainly foreign capital were withdrawn from the Swiss market and another important cause of the loss of gold was the increase during the autumn in the import surplus by Sw. fcs 290 million (= $65 million) as compared with the previous year, together with a marked decline in the income from tourist traffic. The gold holdings in Sweden, after having risen since 1933, fell, on balance, by $13 million in 1939 and, in addition, the Riksbank used its exchange reserves to the extent of $122 million for foreign payments. The net loss of gold and foreign exchange was S. Kr. 565 million, due partly to an increase in the import surplus from S. Kr. 238 million in 1938 to S. Kr. 610 million in 1939, partly to an export of capital (net purchases of securities from abroad and withdrawal of funds from Swedish banks) and, finally, to an increase in cash payments for imports for which credits had regularly been granted in the past. The current account of the Swedish balance of payments, which produced a surplus of S. Kr. 48 million in 1938, is estimated to have closed with a deficit of S. Kr. 250 to 350 million in 1939.

The Netherlands, Switzerland and Sweden, all three creditor countries, had record monetary reserves at the beginning of 1939, which enabled them to meet substantial withdrawals of capital and to pay for higher excess imports especially during the last quarter of the year. In the Netherlands and Switzerland no restrictions had been imposed on exchange movements, while in Sweden restrictions first on trading in securities and later on the exchanges were introduced in the winter of 1939–40. Foreign holders of Swedish balances may dispose of them freely, but the remaining balances of this character are not considerable.

In Italy the gold holdings of the Banca d'Italia fell by $49 million to the countervalue of $144 million at the end of 1939. Although the import surplus was reduced from Lit. 2.9 milliard in 1938 to Lit. 1.5 milliard in 1939, other items in the balance of payments, and especially the income from tourist traffic, declined considerably. The National Bank of Bohemia and Moravia also shows a loss of gold in 1939 amounting to the countervalue of $27 million. In spite of considerable fluctuations, particularly in the early part of the year, the gold reserves of the National Bank of Belgium were reduced by only $14 million while the gold holding of the Belgian Treasury was down by a net amount of $27 million.

Altogether the "other countries" in the table on page 72 had a net loss of $143 million from their reported gold holdings. If account be taken of reductions in gold held by exchange funds and other undisclosed reserves, the total gold loss of the "other countries" would be well above the figure given.

But the main movements of gold in 1939 occurred in relation to the London market. The last figures available for the total gold reserves of the United Kingdom refer to the position at the end of March 1939, which makes it possible to indicate the changes that occurred in the six months from the end of September 1938.

United Kingdom total gold reserves	Bank of England	Exchange Equalisation Account	Total
	In millions of fine ounces		
1938 30th September .	76.8	21.7	98.5
1939 31st March . . .	30.4	49.5	79.9
Change . .	—46.4	+27.8	—18.6
	£ million (at 148s. an ounce*)		
1938 30th September .	568	160	729
1939 31st March . . .	225	366	591
Change . .	—343	+206	—138
	$ million (at $35 an ounce)		
1938 30th September .	2,690	759	3,449
1939 31st March . . .	1,066	1,732	2,796
Change . .	—1,624	+ 973	— 653

* i.e. at the average gold price in London from October 1938 to March 1939.

The decline of 46.4 million fine ounces in the gold reserves of the Bank of England was due to the transfer of 47.1 million fine ounces of gold from the Bank to the Account on 6th January 1939 and a repurchase of 0.7 million fine ounces on 1st March 1939. The reduction in the combined holdings of the Bank and the Account shows a net loss of gold amounting to 18.6 million fine ounces, or £138 million at the average price of gold over the period, equivalent to $653 million. Judging by the trade statistics of gold imports and exports, this loss of gold would seem to have been about equally divided between the last quarter of 1938 and the first quarter of 1939. After the outbreak of hostilities the Chancellor of the Exchequer announced on 6th September that, with a view to concentrating all the government's financial resources in one reserve, the Treasury and the Bank of England had agreed that, except for a nominal amount, the whole of the gold held in the Issue Department should be transferred to the Exchange Equalisation Account. As no statement of the Account was published at the end of September 1939 the latest figures available for the combined reserves of the Bank and the Account are those for the end of March 1939 when these reserves amounted to £591 million at the price of 148s. an ounce or $2,796 million.

For the movements in the nine months April–December 1939 an indication may be obtained from the United States trade statistics, which show net imports of gold from the United Kingdom amounting to $1,359 million. This figure includes, however, gold from other sources than the British monetary reserves: it comprises inter alia about $200 million which arrived from South Africa and also gold passing through London from other countries. Shipments from South Africa had been suspended in September 1938, when the British authorities began to earmark gold with the Reserve Bank of South Africa, but were resumed in the spring of 1939 at about the normal rate.

United States import figures also include gold which was previously transferred to London for safe custody or bought in the London market and held there for account of overseas banks and individuals but which was either directly shipped to the United States in 1939 or sold in the London market for conversion of the proceeds into other currencies, thus involving the shipment of a corresponding amount of gold. On the basis of the considerable excess of net imports of gold into Great Britain over and above the stocks held by the Exchange Equalisation Account and the addition to the holdings of the Bank of England in recent years, it may be estimated that by March 1939 gold held under earmark for central banks or as private hoards in London amounted to about £300 million. No information is available as to movements in the amount of gold earmarked in London. With regard to private hoards the Annual Bullion Review of Samuel Montagu & Co. for 1939 mentions that nervousness spread among the holders of gold especially towards the end of March; there was a large-scale movement to convert gold into dollars and the market had to deal with heavy resales on continental account. The same tendency continued in April; and again in the last week of August 1939 a reselling movement set in. On 24th August the sterling price of gold at 148s. 5d. was at a discount (½d.) against the dollar exchange parity for the first time since the previous May and official quarters secured a good proportion of the gold available in the market. On some occasions during the year gold was bought for hoarding purposes (e. g. at the end of June when certain holders of dollars were anxious to exchange into gold, fearing that the power to devalue might be exercised by the President of the United States before 1st July); even so there can be little doubt that on balance a substantial portion of the gold held in private hoards on the London market was sold and made available for export.

Moreover, part of the gold shipped from London out of the reserves of the Exchange Equalisation Account was replaced by the building-up of earmarked gold in Canada and India. It is estimated that at the beginning of September 1939 gold earmarked in the vaults of the Bank of Canada — not all, however, for British account — amounted to about $700 million. Although before the end of the year the British authorities shipped a considerable portion of this gold from Canada to New York for conversion into dollars, British reserves held abroad probably increased over the year.

Variations in the amount of gold held under earmark and in private hoards make it difficult to estimate from the customs figures the net changes in the reserves, but it would seem probable that the total British reserves were drawn upon to an amount of perhaps $1,000 million in 1939. This loss of gold can only to a small extent have been due to a higher deficit on the current account of the balance of payments (the import surplus rose by only £14 million from 1938 to 1939) and must be largely attributable to various movements on capital account. Although some advance payments were made to United States manufacturers of aeroplanes and other war commodities for plant development and the American "cash and carry" legislation necessitated increased cash payments for imports, these changes affected only the last quarter of the year. Gold exports up to September 1939 were mainly a counterpart to the persistent outflow of funds from the London market. Since the introduction of exchange restrictions in September 1939 non-residents have still been able to dispose of their balances in sterling, although only on the free market.

In April 1940 arrangements were completed for the direct purchase of the whole South African gold production during the war by the Bank of England, acting for the British Treasury. The mines, as hitherto, continue to sell their output to the Reserve Bank for account of the South African Government. The Bank of England now takes delivery in South Africa and pays the full official price of 168 s. an ounce, thus saving the South African authorities the costs of shipment.

Turning now to the United States, the following table shows the main movements in 1939:

Analysis of Changes in U. S. Gold Stock in millions of dollars			
Net imports	3,574	Increase in monetary gold stocks	3,132
Domestic production	160	Net increase in earmarking for foreign account	534
Total	3,734	Total	3,666

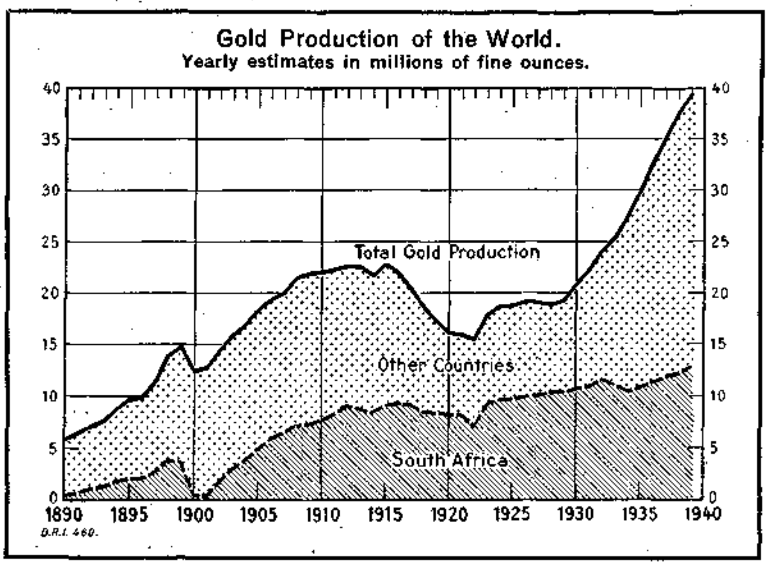
Full correspondence between the totals cannot be expected since newly-produced gold may have been employed for industrial purposes. At the end of 1939 gold held under earmark with the Federal Reserve Banks for foreign account amounted to $1,163 million. At the same time central banks possessed dollar balances to the extent of perhaps $500 million, so that the total resources of foreign monetary authorities with the Federal Reserve Banks reached the high figure of about $1,660 million.

The round $3,000 million of imported gold sold in 1939 to the U. S. Treasury corresponds to the extent of $727 million to a surplus in the current account of the balance of payments; as to the remainder, capital movements reported to the U. S. Treasury show an inflow of $1,114 million, while the balance-of-payments estimates leave $1,151 million as a "residual", the nature of which is not specifically stated. There are, however, strong reasons to believe that this residue in the main represents the result of various capital transactions and it may thus be assumed that the total inflow of capital into the United States was in the neighbourhood of $2,000 million.

In the six years from the beginning of 1934 to the end of 1939 the monetary gold stock of the United States rose from $4 milliard, the level around which it had fluctuated since the end of 1924, to $17.6 milliard at the end of 1939. Of the increase, $2.8 milliard represent the result of revaluation and $0.2 milliard an addition from the gold-buying programme before the revaluation, while $10.6 milliard were derived from imports and domestic sources. Imports account for the bulk of the new gold — not less than $9.7 milliard — and, in addition, $1 milliard of silver was bought from abroad.

Less than one-quarter of the total imports of gold and silver is accounted for by a surplus in the current account of the balance of payments, i. e. by payments for goods and services sold to foreign countries in excess of goods and services bought from them. Of the remainder, over $5 milliard are identified as being the result of the recorded capital flow to the United States, while over $3 milliard are the result of unidentified transactions, mainly capital movements.

The persistent flow to the United States has gradually led to a lopsided distribution of the world's monetary gold. In 1934 the United States had 30 per cent. of the total gold reserves and at the end of 1939 about 60 per cent. Still it must be borne in mind that other countries than the United States own about $10 milliard in gold, the equivalent of 280 million ounces, compared with total central gold reserves owned in 1913 by the same countries amounting to about 140 million ounces, or somewhat less than $3 milliard at the value of the dollar at that time. The considerably increased gold reserves of many countries as compared with the period before 1914 have proved useful as a means of meeting great and often erratic movements of funds in a world in which, for a variety of reasons (not least the higher public debts), the liquid portion of the national wealth has tremendously increased, so that capital can more easily be turned into money balances and be moved from one country to another. Barring the introduction of exchange restrictions, substantial gold backing would seem to have been the only effective method of coping with this international liquidity problem. In this respect the more abundant supply of gold from current production has been distinctly helpful to monetary management.



It is interesting to note the slowing-down of the world output of gold from 1915 onwards, under the influence of the rise in costs and commodity prices brought about by the war of 1914–18. Conversely, the increase in the gold output after 1929 was connected at first with the decline in prices and then, from 1931, with the depreciation of currencies and the consequent rise in the price of gold, which made production more profitable and in particular enabled producers to extend the margin of production to less rich deposits. Whether the present war will tend to increase costs and thus put a brake on production is still, of course, an open question.

In 1929 the value of the world's total gold production (at $20.67 an ounce) was $397 million and in 1939 (at $35 an ounce) it was $1,382 million. Still commodity prices in the United States in 1939 were about 20 per cent. below the 1929 level, indeed hardly higher than in 1934, when the inflow of gold to the United States set in. Why is it that the tremendous increase in the quantity and still more in the value of the new gold supply has failed to bring about an increase in commoditly prices? As the newly-produced gold since 1934 has gone mainly to the United States the problem is essentially one of American conditions.

Current gold production obviously affects prices only in so far as it leads directly or indirectly to an increase in the effective demand for commodities. It may do so directly through the addition to purchasing power, which is obtained when gold-producing areas sell their current output to monetary authorities at home or abroad. South African merchandise imports rose from £53 million in 1931 to £91 million in 1939 and these imports were paid for mainly by gold from the mines. One would normally expect that such gold as pays for the imports of gold-producing countries would reappear in the balances of payments of other countries as an offset against a surplus on the current account (the gold being used to pay for deliveries of goods and services). Considering that in the period 1934–39 the United States was by far the greatest recipient of newly-produced gold, it is somewhat surprising to find that the surplus on the current balance of payments was equivalent to only about one-third of the $6.1 milliard of newly-produced gold which came directly or indirectly to the United States, the other two-thirds covering part of the inflow of capital. An interesting question arises as to how it happened that so much of the newly-produced gold was turned into a vehicle for capital movements. In part at least an explanation may be found in the working of the following "triangular" relations: in the years 1934–39 many debtor countries had substantial surpluses in their current balances of payments which would have enabled them to acquire gold; as a matter of fact many preferred or were bound to repay foreign liabilities or they acquired foreign balances, and in that way the gold stream was diverted to the creditor countries, which received the gold as a counterpart to an item in their capital account. Even if liabilities were repaid in the first place to, say, the London market, the gold might still be heading for the United States, in so far as British individuals or firms, who found no outlet for new investments in developing areas overseas, invested in American stocks or accumulated dollar balances in amounts equivalent to those repaid to London. Thus Finland, out of current surpluses in its balances of payments, reduced its net foreign liabilities of FM 9 milliard in 1931 to under FM 1 milliard in 1938. The movements are directly traceable in the case of Canada, which provides an example of a gold-producing country able extensively to redeem foreign liabilities. In the four years 1936–39 Canada reduced the outstanding amount of its bonds payable optionally in New York by $493 million: in the same years the net surplus on the current account of its balance of payments was above $600 million, while net exports of newly-produced gold were $623 million.

Other examples could be quoted (as e.g. the Argentine) and in the aggregate these repayments no doubt amount to a substantial figure.

The fact that debtor countries redeemed a large part of their foreign liabilities, and that, for this and other reasons, the United States has received so large a portion of the newly-produced gold as a counterpart to capital movements, would seem to be of importance in explaining the absence of a sustained rise in prices. Unlike earlier foreign investments, e.g. in American railways before 1900, the capital funds transferred to the United States were not sent to finance new industrial or commercial ventures for which the resources of the domestic capital market were insufficient. Foreign funds were, under the prevailing conditions, not used for this or similar purposes. In the years 1934–39, it is generally held, there was only partial employment of the country's capacity for capital accumulation, as is shown by the low level of new investments in plant and equipment. But, if the United States failed to utilise in full its own supply of potentially available savings, either at home or through foreign investment, it follows that it would be even less able to employ additional funds received from abroad. Amounts transmitted by means of gold shipments would thus on the whole remain idle, i.e. fail to be translated into active purchasing power. If that is true with regard to the major part of the gold derived from current production, it must also be true with regard to the $3.1 milliard which came to the United States from the central bank reserves of other countries, for such gold was shipped largely as the result of a flight of capital and is mostly held as bank balances. Gold in itself has no mystical influence on prices; it is only when the supply brings about an increase in active purchasing power that an effect on the price level can be expected. When account is taken of the nature of the gold flow to the United States, it seems clear that it is the obstacles to a recovery in private investment for housing and other purposes which have, in the main, prevented the inflow of gold from affecting the level of prices.

This brief and somewhat simplified analysis may be contrasted with the experience of previous periods. Before 1914 it was taken for granted that there would normally be an active demand for credit accommodation and that credit institutions would lend to the extent which their resources permitted. Whether gold arrived on account of current or of capital transactions was then of little moment, since it would as a rule all be used to expand the active credit volume. With a certain time-lag, changes in the supply of gold, the recognised basis of credit, could then be expected to influence prices. The disappearance of active demand for credit, which in recent years has been so characteristic a feature of developments in the United States and many other countries, has temporarily eliminated a link in the chain through which gold influenced prices.

American conditions have been primarily considered in this analysis but, in so far as other countries have gained gold, similar tendencies are noticeable. For some years England has had a deficit in the current account of its balance of payments, such gold as has been acquired being the result of capital movements largely of a short-term character. The funds obtained were liable to withdrawal at short notice and for that reason the gold received was largely "sterilised" through the action of the Exchange Equalisation Account. In Switzerland the Exchange Fund established in 1936 was endowed out of the profits arising from the revaluation of the gold holdings of the National Bank and did not serve the purpose of sterilising incoming gold. As a result of the inflow of funds, mainly foreign, and thus also of gold, the commercial banks obtained large cash balances with the National Bank from the autumn of 1936. The existence of these cash balances played, however, only a small part in influencing the Swiss credit structure since the banks pursued a very cautious policy, amounting in fact to a kind of "voluntary sterilisation". In these circumstances it is not surprising that the mounting supplies of new gold have been ineffective in producing a rise in commodity prices.

It may be, however, that a certain change in the forces at work has set in since September 1939. The gold now being sent to the United States is mostly used to purchase commodities for export, while capital movements are held back by exchange restrictions. It may thus be expected that to an increasing extent the incoming gold will cause an expansion in active purchasing power. Considering the magnitude of the American market this expansion, while no doubt acting as a stimulus, is hardly in itself sufficient to affect the general trend of commodity prices in the United States. Attention must still be directed to the volume of private investments and account must also be taken of the vast possibilities of increasing the supply of goods through a fuller utilisation of capacity as regards both raw materials and industrial products. Nevertheless, the question of the probable effects of gold movements on commodity prices has assumed a somewhat different aspect through the actual spending of the funds procured by the incoming gold.

In a measure the gold reserves of the various countries may be regarded as an accumulation of assets available for emergency payments abroad; and it is therefore natural that governments have turned increasingly to their central banks, in order to meet their foreign exchange requirements. In several countries the central banks have directly supplied the governments with the foreign currencies needed to pay for extraordinary imports, e. g., of armaments, considering that the extension of such credits would not augment the volume of purchasing power on the domestic market. Even when no such direct relationship has been established between foreign payments and the amount of funds with which central banks have supplied their governments, it is likely that these funds will largely be offset de facto by deliveries of foreign exchange for official purposes. That may, for instance, be the case also when "revaluation profits" have been allotted to the government, as in Switzerland. The gold holdings of the National Bank were revalued in 1936 at a price equivalent to a 25 per cent. depreciation of the currency, which gave a book "profit" of Sw.fcs 538.6 million, reduced by minor adjustments to Sw.fcs 533.4 million at the end of 1939. Out of this account — the Exchange Equalisation Fund — Sw.fcs 325 million have been allotted to the Federation (Sw.fcs 75 million in 1939 and Sw.fcs 250 million in 1940) and Sw.fcs 150 million to the Cantons (half in 1939 and half in 1940). The amounts received by the government from its "revaluation profits" are available for current expenditure without any distinction between domestic and foreign payments. As a matter of fact, considerable amounts of foreign exchange from the reserves of the National Bank have been employed for payment of excess imports, which must be taken into account in judging the effects of the additional spending power obtained from the central bank.

In the past, great wars have invariably been periods of important movements in prices under the influence of intensive government demand for war supplies, growing scarcity of commodities, the use of accumulated specie and bullion reserves and a more or less direct resort to inflationary financing. A strain has been put on the monetary systems and the countries affected have generally found it difficult to avoid depreciation of their currencies in terms of gold (or silver). Some notable differences have, however, occurred in the last century and a half. During the Napoleonic wars, the French currency, once some order had been re-established in 1796 after the débâcle of the "assignat", remained steadily at its metallic parity notwithstanding nearly twenty years of hostilities. In England, on the other hand, gold payments were suspended in 1797 and in 1814 the average premium on gold amounted to about 35 per cent., while commodity prices had risen about 75 per cent. above the level in 1790. After the wars were over a policy of adjustment was put into effect with the result that gold payments could be resumed in 1821. The restoration of the gold standard at the old par was successfully accomplished, but commodity prices continued to decline and by 1826 were back to the level of 1790.

During the war of 1914–18 commodity prices rose again, while this time the U. S. dollar remained at its gold parity all through the war and post-war period — the American market determining, so to say, the value of gold. Inflation was carried to varying degrees in different countries; some fifteen currencies were, however, subsequently able to link on to gold at the old parities. Commodity prices seemed to have become stabilised at about 50 per cent. above the 1914 level until the sharp decline from 1929 set in. Under the impact of falling prices and violent movements of funds it became too difficult to retain the old parities and in 1936 the last of the "free" currencies submitted to depreciation. Thus the restoration of the gold standard at the old par had proved unsuccessful. The double effect of falling price levels and currency depreciation had a most remarkable influence on prices in terms of gold, which in 1939 had fallen to about one-half of what they were ten years earlier. Indeed, they reached a point at least 10 per cent. below the lowest level recorded for fully two hundred years. According to old criteria it would be natural to expect that war, together with an abundant gold supply, would cause a pronounced advance in prices; but, as has been indicated in the previous pages, the situation is far from simple, the trend of gold prices being more than ever determined by the capacity of production and the volume of investments in countries outside Europe and especially in the United States.

IV. INTERNATIONAL CAPITAL MOVEMENTS.

The movement of capital to the United States reached its climax in 1939 when some $2,000 million was transferred from abroad, a movement generally as unwelcome to the recipient as to the countries losing the funds. The only other national economy experiencing an appreciable afflux of capital in 1939 was France, but this movement, essentially a repatriation of French funds, did much to strengthen the country's financial position, weakened in the past by capital flight.

The war has led to a further dislocation of foreign trade financing, although pre-payment for imports has benefited the raw-material-producing countries, as is shown in a striking way by the growth of the sterling reserves of the raw-material-producing members of the British Empire. Quotations of foreign bonds fell heavily in the first three quarters of the year but the securities of overseas primary-producing countries in particular staged a sharp recovery. In present conditions foreign lending has practically ceased but it is evident from statements made in authoritative quarters that the question of possible foreign credits in the reconstruction period after the war is already being considered.

In the six years 1934–39 the increase in the United States gold stock from imports amounted to some $10,000 million, of which at least four-fifths represented a capital movement of a nature and volume such as has never before been experienced. True, the liquidation of earlier short-term foreign credits plays some rôle in this movement, but to an insignificant extent compared with the "international liquidity crisis" of 1931–32. Estimates made at the Bank for International Settlements at that time indicated a reduction of the total outstanding international short-term credit volume from around $14,000 million in 1930 to $8,000 million at the end of 1932. This vast liquidation fell primarily on the reserves of central banks and was one of the immediate causes of the currency depreciations and the introduction of exchange restrictions in those years. But of the $10,000 million gold shipped to the United States $6,000 million has come from new production and a further $1,000 million from the hoards of the East. The remaining $3,000 million came largely from those central banks which, at any rate in recent years, held such substantial reserves that the loss produced little deflationary effect in the countries from which the capital flowed.

The preponderance of capital movements in the balance of payments of the United States is brought out in the following summary table based on data published by the U. S. Department of Commerce and the U. S. Treasury:

United States Balance of Payments 1934-39.

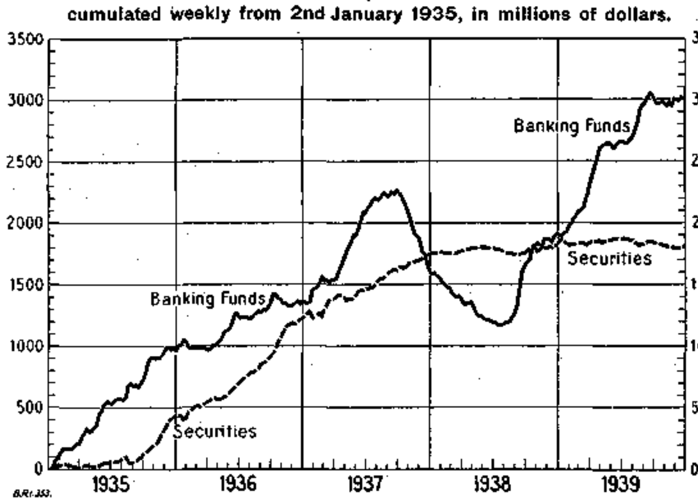
In millions of dollars	Capital influx					Trade and service items (2)	Gold imports (net)
	"reported"			"residual" etc. (1)	grand total		
	long-term	short-term	total				
1934	194	192	386	456	842	375	1,132
1935	442	971	1,412	480	1,892	— 153	1,739
1936	792	404	1,196	161	1,357	— 327	1,117
1937	512	290	802	680	1,482	— 96	1,386
1938	76	293	369	469	838	802	1,640
1939	(— 2)	1,116	1,114	1,276	2,390	657	3,040
Total of six years	2,014	3,266	5,279	3,522	8,801	1,258	10,054

(1) Including paper currency imports and exports, and miscellaneous capital movements.
(2) Including silver.

The "residual", i. e. the item included to "balance" the accounts, doubtless covers certain errors and omissions relating to the current items of the balance of payments, unreported operations of the Stabilisation Fund, differences due to time lags, etc., but these are probably minor matters, the main part of the residual being due to capital movements which escape recording; in fact, when placed on a monthly basis the balancing item shows large fluctuations positively correlated with the size of the capital influx. For these reasons the residual has been incorporated as part of the capital movements in the table in order to give a broader picture than that derived from the reported movements alone.

But to explain the underlying motivation of these vast capital movements reliance must be placed on an analysis of that part which is "reported": of the total capital movement of, say, $8,800 million about sixty per cent. has been reported on the average over the six years — but in 1938 and 1939 over one-half appears to have escaped the statistics. It is important when discussing the recorded movement to realise that this is a sample only, although a large one.

Net Movement of Capital to United States
cumulated weekly from 2nd January 1935, in millions of dollars.



The total reported influx of capital in 1939 is given as $1,114 million in the above table but, as the graph shows, there was actually some decline in the last three or four months of the year. In the twelve months to August 1939 the reported influx amounted to $1,800 million, a larger sum than for any other similar period. About half of the total came in during twelve weeks of severe political crisis: four weeks in September 1938, five in March and April 1939 and three in August, immediately preceding the outbreak of war.

The following table gives the main classes into which the reported sample of the total movement may be divided since the U. S. Treasury figures were first published at the beginning of 1935:

Reported movement of capital to United States.

In millions of dollars	Decrease of U. S. banking funds abroad	Foreign securities purchased by foreigners	Influx of foreign funds into			Total recorded inflow
			American securities	dollar balances	total	
1935	361	125	317	609	926	1,412
1936	70	191	601	334	935	1,196
1937	18	267	245	272	519	802
1938	29	27	49	264	313	369
1939	135	110	— 112	981	869	1,114
Total of five years	613	720	1,100	2,460	3,562	4,893

These statistics may be divided into four main classes:

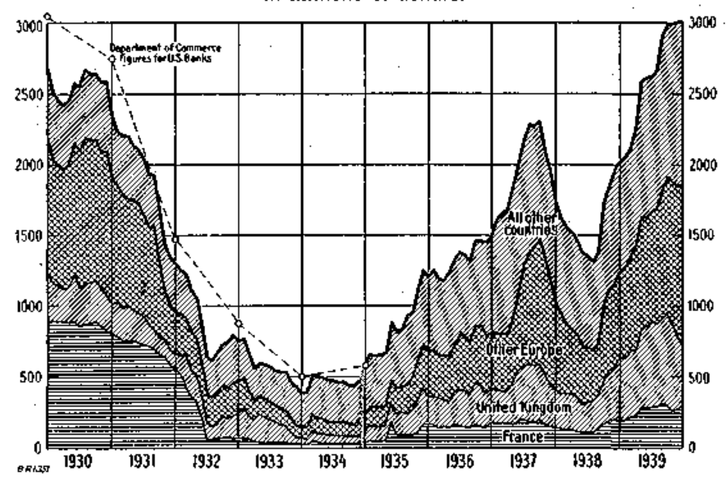
(i) The decrease of United States banking funds employed in foreign countries has continued over the whole period. Over two-thirds of the total is accounted for by two countries: a reduction of $180 million in Germany reflecting the liquidation of blocked funds over the five years and of $250 million from England (of which $200 million in 1935, a consequence of the large volume of American swap money in London at the end of 1934).

(ii) The purchase of foreign securities by foreigners has depended upon the liquid dollar funds available for this purpose and, in some cases, the incentive given by the low level to which the securities had fallen. The United Kingdom has repurchased $130 million (particularly from 1935 to mid-1937 when sterling was generally firm against the dollar) and Latin America $180 million (of which $160 million in 1937, the best recent year for primary commodity prices). While United Kingdom and Argentine government bonds were redeemed at par, the average price of foreign security purchases by foreigners was around 50 per cent. of the parity price.

(iii) The purchase of foreign securities by foreigners naturally involves an influx of foreign funds but it is evidently of a different nature from the purchase of American domestic securities and the building-up of dollar balances. Foreign purchases of American securities have generally taken place when the New York stock exchange was rising, while sales have not been made on balance during the declines. Until the mobilisation of securities in England *in September 1939 and the subsequent sale of some $100 million in the last* four months of the year there were hardly any foreign purchases or sales on balance after the top of the bull market in Wall Street in the spring of 1937.

(iv) One-half of the reported influx of capital into the United States in the five years was due to the accumulation of dollar balances by foreigners. In 1939 this proportion rose to 90 per cent. when a record volume of funds, nearly $1,000 million, was received on this account, raising the total recorded influx for the year to three times that of 1938. Foreign banking funds in the United States at the end of 1939 reached a total of $3,000 million — roughly equal to the highest attained ten years ago when the "gold exchange" standard was in full swing and many central banks held dollars in their reserves. The distribution of short-term dollar assets at the end of 1929 compared with 1939 was as follows.

Foreign Short-term Banking Funds in United States
In millions of dollars.



From 1930 to 1934 the graph is based on figures collected by the Federal Reserve Bank of New York, with an indication of the total for the country from the annual statistics of the U.S. Department of Commerce. For 1935 and onwards the weekly figures published by the U.S. Treasury relating to the entire country are taken.

Foreign dollar balances[1].

In millions of dollars	1929[2]	1939	Change
United Kingdom	302	468	+ 166
France	924	264	— 660
Netherlands	99	203	+ 104
Switzerland	105	366	+ 261
Germany	205	8	— 197
Italy	157	36	— 121
Other European countries	371	520	+ 149
Canada	242	285	+ 43
Latin America	188	365	+ 177
Far Eastern countries	49	405	+ 356
All other countries	31	90	+ 59
Total	2,673	3,010	+ 337

(1) Including a small amount payable in other currencies (1939, $40 million).
(2) 1929 data apply to New York banks only, but cover about 90 per cent. of the total.

Dollar working balances have been built up for many reasons. Some part is doubtless the much advertised "refugee" money belonging to foreigners. In many cases, however, funds came only temporarily into this category; refugees from Europe have often transferred funds before they themselves were able to cross to the United States. A recent enquiry has shown that considerable sums have been transferred from non-resident to resident American names, a fact which throws some further light on the composition of the "residual" in the balance of payments.

Balances have also been accumulated for the purchase and redemption of long-term loans, for example by the Latin American countries in 1936–37. Further, for those countries such as Holland and Switzerland, whose currencies were pegged on the dollar in 1939, central bank dollar balances were necessary particularly when gold shipments were difficult: Dutch balances increased by $100 million and Swiss by $150 million during the year. But very great importance has been assumed by the accumulation of dollars for the payment of American exports. The only considerable decline of foreign dollar balances in recent years was that of nearly $1,000 million in the ten months to July 1938 — during which period the United States had a merchandise export surplus of $1,020 million. In so far as there was an outflow of capital from the United States at this time it was offset by foreign purchases of dollars to pay for American exports, while dollar balances previously accumulated were drawn down directly for this purpose. Balances of this nature have become of greater necessity to importers from the United States as foreign trade is financed more and more on a cash basis. In the last four months of 1939 the dollar balances of England, France and Canada were drawn down by about $300 million.

Except for Belgium, Holland and Switzerland, all European and most non-European countries had introduced foreign exchange restrictions by the end of March 1940, and in several cases foreign holdings of American securities had been mobilised and concentrated in the hands of the controls. The possible movements of refugee funds, indeed of any privately-owned capital, have thus become more restricted. Already after May 1939 capital movements to the United States seem to have been dominated by the flow of foreign government and central bank funds. European central bank dollar balances are fed from releases of gold previously earmarked in New York, from new shipments and from official sales of mobilised foreign securities (or private sales in anticipation of mobilisation) and dollar purchasing power may thus be built up to provide the counterpart to the higher value of American exports since the beginning of the war. On the other hand, the dollar balances of Latin American and certain overseas countries increase with the improvement in their balances of payments.

The withdrawal of American capital from abroad during recent years reduced total foreign investments (excluding war debts) to $11,580 million by September 1939. At that time foreign capital in the United States amounted to $8,830 million, so that the net creditor position of the United States was reduced to $2,750 million, less than one-third of the figure for the end of 1934.

Although the records of the movement of capital to the United States probably covered little more than half of the total influx in 1939, these statistics are the most perfected that are published. For other countries the fragmentary data that exist must be arranged as a mosaic to form a more or less imperfect pattern. The influx of capital from abroad to France was very dissimilar in composition and motivation from that to the United States. The French recovery dating from November 1938 was accompanied and sustained by a repatriation of French capital exported in previous years. As there is reason to believe that the current balance of payments was approximately in equilibrium (until the special imports made since the beginning of the war), the monthly additions to the gold stock in this period give some indication of the volume of incoming capital.

The following table gives the monthly increases in the aggregate gold holdings of the Bank of France and of the Exchange Stabilisation Fund until May 1939; and for later months average figures of the capital influx are based on supplementary information provided by the Minister of Finance (notably in a speech on 13th December 1939).

French repatriation of capital.

Monthly estimates	In millions of Fr.fcs
1938 November .	1,175
December .	7,560
1939 January . .	1,820
February . .	3,100
March . . .	3,415
April . . .	1,320
May	835
June . . .	2,260
July	2,260
August . .	2,260
September .	3,000
October . .	3,000
November .	3,000

In the ten months up to the outbreak of war the gold holdings increased by Fr.fcs 26,000 million, while a further Fr.fcs 10,000 million came in in the three and a half months to mid-December. Except for the unusually high influx in December 1938, probably due to a large extent to the closing of exchange and gold positions, the repatriation of capital tended to be heaviest when the international position deteriorated. In addition to the increase of the gold holding due to incoming liquid capital, some Fr.fcs 24,000 million of securities previously held abroad have been registered in France or physically repatriated following the introduction of exchange restrictions and of the obligation to declare assets held abroad.

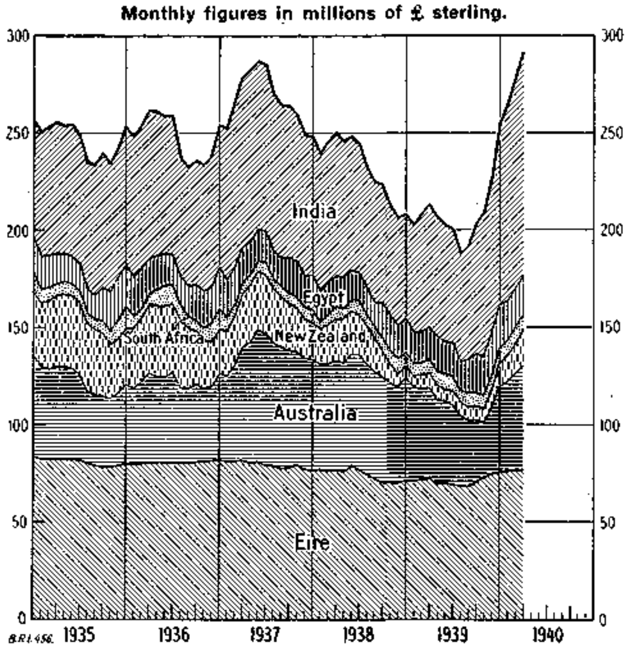
A net increase of about $100 million of French dollar assets reported in the United States during 1939 doubtless represented a concentration of funds in official hands as private holdings were sold (partly over London). But a great part of the repatriated French funds came from England, where private gold holdings and balances on French account had been very large. The Exchange Equalisation Account came under fire from several points during the first eight months of 1939: there was an outflow of capital particularly towards France and the United States, certain central banks converted sterling resources into gold, the English balance of current payments was passive while the London funds of the Empire were drawn down to meet the needs of international payments.

It is not possible to give precise figures from which a complete picture could be obtained. In the twelve months to March 1939 the total gold reserve of the Bank of England and the Exchange Equalisation Account was reduced on an average by about £24 million a month and an outflow continued until 24th August, when the exchange control temporarily withdrew from the market.

The merchandise import surplus for the first eight months of 1939 was £253 million against £264 million in the same period of 1938 and the current balance of payments in 1939 was probably not very different from 1938, i. e. passive at the rate of about £1 million a week. It is difficult to disentangle the capital movements to the United States and to France as a large part of the repatriation to France from the United States passed through London: the capital flow to the United States from England, reported at $200 million (according to the U. S. Treasury Statistics), say £43 million, from the beginning of January up to 23rd August 1939, is thus a net amount. Moreover, a large proportion of the £150 million repatriated to France in the ten months to August 1939 came directly from England. But in so far as this French capital was previously held in private gold hoards in London it did not, of course, reduce the English reserves. In addition, certain central banks which had held sterling balances and bills as part of their reserves converted them partially or wholly into gold to the extent of perhaps £35 million. Further, the London funds of the Empire were drawn down by at least £20 million to meet payments largely outside England. As mentioned previously in these Annual Reports, London is the reserve centre for a group of countries mainly producers of primary commodities whose holdings of sterling balances and bills fluctuate widely with the good and bad seasons.

The graph shows how the normal rhythms of exporting and importing seasons in 1935 and 1936 were followed by exceptionally good conditions for primary producers in the first half of 1937. But the United States, the chief importer of raw materials, suffered a sharp setback in the autumn and export prices for these countries fell, while the stimulus given their internal economies in 1937 led to heavy imports in 1938 and 1939. In the case of New Zealand these conditions were aggravated by the expansionist policy of the government and by a flight of capital. The sterling reserves of the six countries shown in the graph fell by £100 million in little over two years. In addition, sterling funds were used to support the Shanghai dollar; and the various Currency Boards of the Empire also drew on their London funds: sterling reserves of the

London Funds of the British Empire.
Monthly figures in millions of £ sterling.



West African Currency Board, for example, fell from £20 to 12 million in the two years to June 1939. Altogether there resulted a drain of over £1 million a week on the English gold reserves throughout the two years — one reason for the undertone of weakness in the sterling-dollar rate during the period, obscured until the middle of 1938 by the considerable reduction of foreign dollar balances in the United States, already mentioned. For England, the strain resulting from the drawing-down of the Empire's sterling reserves is, of course, offset to some extent by the fact that imports of primary commodities are cheaper at these times.

The downward trend of London funds was sharply reversed from August 1939 — in the eight months to March 1940 the whole of the ground lost by the Empire countries in the previous two years was recovered and the sterling reserves of the six countries shown in the graph are now above the highest point of 1937. Large-scale purchases of primary products by the British Government throughout the Empire have brought this dramatic change in the picture. Cotton has been bought from Egypt, bulk purchases of jute for sandbags from India, dairy produce and wool from New Zealand. In many cases whole crops have been purchased — from Australia the whole of the wool clip and the exportable surplus of butter, cheese, eggs, beef, mutton, lamb, pork, zinc, lead, copper, sugar, and substantial quantities of dried and canned fruits; in all over £A 100 million has been spent. And while prices have been satisfactory for the exporters payment has been made in cash for wool on appraisement and for many other commodities on shipment, so that the seasonal increase in London funds began earlier than usual. These conditions apply not only to the countries shown in the graph but over the extent of the Empire — tin and rubber have been bought from Malaya, raw cocoa from West Africa, etc.

A safety valve against the accumulation of too bulky sterling reserves is provided by the past indebtedness of these countries to London. In 1938 England had £1,000 million invested in the bonds of Empire governments (in addition to local government bonds and commercial and industrial securities) and lending continued in the first part of 1939: South Africa borrowed £5 million for defence purposes at 3½ per cent. in May, Australia raised £6 million for defence at 4 per cent. in June, and in July 1939 New Zealand issued £16 million 3½ per cent. short-term bonds to convert an earlier loan maturing in January 1940 (obtaining, in addition, £9 million of credits for defence and import purposes).

The afflux of reserves in 1939–40 has led the Indian Government to take steps towards the repatriation of part of its sterling debt against the issue of rupee securities, and at the end of February 1940 nearly £9 million sterling securities had already been purchased. In March 1940 the South African Government gave notice to repay the £8 million London issue of the 5 per cent. Inscribed Stock 1940–60. In some cases gifts to the British Government have been made out of sterling funds such, for example, as the £1 million from the Straits Settlements in April 1940. In the case of countries outside the British Empire other arrangements have been made, e. g. the sterling received by the Argentine for its exports is placed in a special account at the Bank of England, any surplus on which above £1 million may be converted into gold (and reconverted into sterling whenever required).

After England the countries most concerned on account of capital outflows in 1939 were Belgium, Holland, Switzerland and Sweden: in general these countries were little affected by the repatriation of French capital and more by the widespread movement towards New York, but each case had its individual features. The efflux from Belgium was temporary but rather violent. Some B.fcs 4,400 million of gold was lost in the two months March-April 1939, but energetic measures by the National Bank soon halted and reversed the movement. In Holland the Nederlandsche Bank lost gold intermittently throughout the year, the balance sheet showing a fall of Fl. 450 to 1,100 million, of which Fl. 65 million in the two weeks 6th–20th November, when the international tension was great. Fl. 450 million in gold with the florin depreciated by 22 per cent. is equal to 575 million current florins. In addition the item "advances" declined Fl. 80 million on the year, this being partly a reflection of the redemption of loans by the Exchange Equalisation Fund, commensurate with its gold deliveries. The gold losses are paralleled by the fall of sight balances at the Nederlandsche Bank from Fl. 425 to 230 million, largely in consequence of a loss of deposits and cash by the commercial banks. In the first quarter of the new year these losses of deposits and gold were checked. The relation of Java to Amsterdam was somewhat similar, from a monetary point of view, to that of the primary producing Dominions to London. The Javasche Bank had a reserve of around Fl. 125–130 million in the first seven months of 1939, from which point it had risen above Fl. 150 million by the end of March 1940.

During the first four months of 1939 there was some flight of capital, particularly of foreign funds, from Switzerland and the National Bank lost over Sw. fcs 400 million in gold and foreign exchange. The rest of the year was comparatively calm: the National Bank parted with a further Sw. fcs 30 million when sterling was unpegged in August, but the demand subsided in a few days; a further demand for foreign exchange beginning towards the end of October was largely to cover requirements for imports. In view of the change in conditions during the year the gentlemen's agreement between the National Bank and the commercial banks, concluded in November 1937 with the object of reducing the excessive volume of foreign deposits in the banks, was allowed to lapse.

At the time of the Munich crisis there was an afflux of foreign capital to Sweden mostly from neighbouring countries, deposits of foreign banks and bankers with Swedish commercial banks increasing in the month of September 1938 by nearly S. Kr. 100 million to a total of S. Kr. 250 million. As since early 1937 it had been the policy of Swedish banks to carry liabilities to foreigners in excess of their foreign assets, this movement was accompanied by an increase in the reserves of the Riksbank. During the following twelve months up to the outbreak of war there was a reflux of foreign bank deposits and a mild decline of the Riksbank's reserves. An abrupt change took place on the outbreak of war in Europe, accentuated by the Russian-Finnish war. In the seven months to the end of March 1940 the Riksbank lost some S. Kr. 700 million in gold and foreign exchange, i. e. over one-third of its reserves, the losses being particularly high in October and December 1939. There were a number of reasons for this efflux. Swedish assistance to Finland in the form of gifts and credits opened has been estimated to have been not less than S. Kr. 400 million, a considerable part of which led to increased Swedish imports or direct losses of foreign exchange to cover Finnish imports from other countries. Further, there was some efflux of foreign funds, impeded, however, by the restrictions imposed on foreign selling of Swedish securities. But foreign banks and other foreign customers of Swedish banks withdrew S. Kr. 170 million deposits, of which the banks met some S. Kr. 70 million from their own foreign resources and passed on the demand for S. Kr. 100 million foreign currency to the Riksbank (from the end of 1939 the banks had a surplus of foreign assets over total liabilities to foreigners for the first time in over two years). Further, the current balance of payments was estimated to be passive to the extent of S. Kr. 250–350 million in 1939 (against an active balance of S. Kr. 48 million in 1938), owing in part to the formation of reserve stocks: the merchandise import surplus was particularly high in the three months November 1939 to January 1940. As imports had generally to be paid cash or even in advance instead of on the usual credit terms, a further extraordinary but temporary demand for foreign exchange, estimated at some S. Kr. 50–150 million, arose on this account.

Indeed, foreign credits granted for trade financing throughout the world have become shorter during the year, or, more usually, have been replaced by cash terms and even payment in advance. The United States Neutrality Law laid down that transfer of ownership of merchandise exported to belligerent countries must take place before shipment — in other words cash terms were stipulated before the merchandise might leave the territory of the United States. As shipment might be delayed or slow the result often amounted to payment in advance. Moreover, such goods might not be carried in United States ships and, further, United States ships were prohibited from navigating at all in a defined area which included most of European waters north of Spain. "Cash and carry" terms were thus applied by law to belligerents and "carry" terms to a large number of non-belligerents.

In any case "cash" terms were gradually being applied to most European countries by American exporters before the war began. But the effect of the Neutrality Law was further to tighten up conditions and to impede normal trade financing. Not only Sweden, mentioned above, but European neutrals generally were called upon to repay former trade credits, thus imposing a strain on their external resources. As no adjustments have been made in the merchandise trade statistics for the movement of trade credits in the preliminary estimates of the United States balance of payments, some part of the high "residual" in 1939 is doubtless related to this cause.

The introduction of foreign exchange restrictions in England and France and the calling of foreign trade credits had similar effects. Being forced to pay cash or even in advance for imports from the United States, these countries in turn tended to export also for cash only, especially to Europe. Some countries, such as Norway and Denmark which imported generally on a three or four-months' credit basis, found themselves obliged to pay for four or five months' imports, including the laying-in of reserve stocks, in a comparatively short space of time. The calling of English credits is reflected in the fall of the clearing banks' "acceptances, endorsements, etc." from £132 million in October to £108 million in November (the subsequent increase being explained by the expansion of English import financing). Further, stipulations that trade invoices should be made out in certain "specified" currencies in many cases run directly contrary to the usual commercial practice. Foreign trade contracts are generally made out in the currency of the importer or exporter (the importer being desirous of paying in a "weak" and the exporter of receiving a "strong" currency) or in some international currency such as the dollar. But under the British regulations, for example, imports to England from countries other than the United States may not be paid for in dollars. However necessary these measures may be from the point of view of strict exchange control, they often run against the traditional methods of trade contracts and financing, as similar measures introduced earlier on in other countries have shown long ago. In the case of England the disturbance was probably less than in some other instances as it had long been the practice of certain areas, the Empire, Scandinavia and South America, for example, to conduct their trade with England in sterling. But measures were necessary to prevent leakages: exchange control in the Dominions and colonies, "special" sterling accounts for Sweden and Norway, the agreement with the Argentine, etc.

With the lapsing of such a large proportion of the world's foreign credits on trade account the banking systems in many countries have been called upon to finance their own foreign trade, particularly their imports, and this is one of many reasons for the increase of the internal credit volume in most countries on the outbreak of war. To some extent the inability or reluctance of exporters to give the usual credit terms has been made good by official or semi-official bodies, such as the Export-Import Bank of the United States formed in 1934 specifically to aid in financing and to facilitate exports and imports between the United States and foreign countries, particularly through intermediate and longer-term credits (up to five years). In the middle of December 1939 the $100 million resources of the bank were fully utilised or allocated in the form of credits granted chiefly for exports to China and to Latin American countries.

In March 1940 the resources of the bank were augmented by a further $100 million and the Export-Import Bank itself or in conjunction with the Reconstruction Finance Corporation opened several credits to the northern European countries, $30 million to Finland, $15 million to Sweden, $10 million to Norway, $10 million to Denmark and $1 million to Iceland. On the spread of the European war to northern Europe in April 1940 the credits in favour of Norway and Denmark, which had hardly been drawn upon, were suspended.

U. S. Export-Import Bank — position on 15th December 1939 of credits granted. (1)

Credit receiver	For export to	Outstanding credits	Credit lines not yet used
		In thousands of dollars	
American Locomotive	Brazil	—	7,000
Universal Trading Corporation	China	12,659	10,510
Baldwin Locomotive	Chile	—	1,600
American Locomotive	Portugal	246	4,754
U. S. Steel and Bethlehem Steel	Brazil	—	1,100
J. G. White Engineers	Haiti	1,905	3,095
International Tel. & Tel.	Various countries (2)	10,000	—
Bank of Nicaragua	Nicaragua	50	1,450
Bank of Paraguay	Paraguay	—	3,000
Banca Commerciale Italiana	Italy	2,752	3,248
Bank of Uruguay	Uruguay	—	4,000
Banco Hispano America	Spain	2,955	9,545
Fomento Corporation	Chile	—	5,000
Panamanian Credits	Panama	—	2,500
Moore-McCormack Lines	Brazil	—	2,275
Totals		30,567	59,077

(1) In addition to these transactions the Export-Import Bank had an outstanding credit of $ 3.3 million to the National Economic Bank of Poland and, of the $ 19.2 million guaranteed to the Bank of Brazil, $ 3.4 million was still outstanding.
(2) For other purposes.

Foreign trade credits granted in Europe directly by the governments or by governmental bodies have generally been of a political nature and often to cover supplies of war materials. The British and French credits to Poland, to Greece, Roumania and Turkey, and German credits to Russia are of this nature. More normal assistance has been given to exporters in some cases by the guaranteeing of exchange rates, as in Italy, or by forward dealing in exchange rates for longer than the usual periods, as has been undertaken by the Sveriges Riksbank and the Reserve Bank of India, while some form of insurance against war risks has usually been made available.

But, in spite of the trade credits of the U. S. Export-Import Bank and political credits in Europe, the general trend towards the steady withdrawal of past short-term loans remains predominant. A two-year credit of Sw.fcs 50 million to the Czecho-Slovakian Post Office Savings Bank, granted in 1937, was repaid to the Swiss banks early in 1939. The German Standstill Agreements, first concluded in the autumn of 1931 as emergency measures and since renewed periodically, covered in February 1938 credits amounting to only RM 780 million against RM 5,000 million in February 1932. On the outbreak of war in September 1939 the agreement in force was denounced by the British and American creditors. After a brief interruption a new agreement was made with Belgian, Dutch and Swiss creditors covering RM 220 million. In November agreement was also reached with the American creditors, who withdrew their counter-claims on German assets in the United States: interest rates were reduced by about ½ per cent. and certain credit lines were cut down. Further, to the extent of indebtedness paid off, new bills might be drawn for financing shipments from the United States which do not violate the Neutrality Act. The various agreements run until the end of May 1940 and contain certain new provisions as to the utilisation of registered and travel marks and regarding the fund created from the transfer fees. Including RM 120 million in respect of American credits the agreements with the four neutral countries covered RM 340 million, while a further RM 360 million was due to creditors in belligerent countries, chiefly British banks.

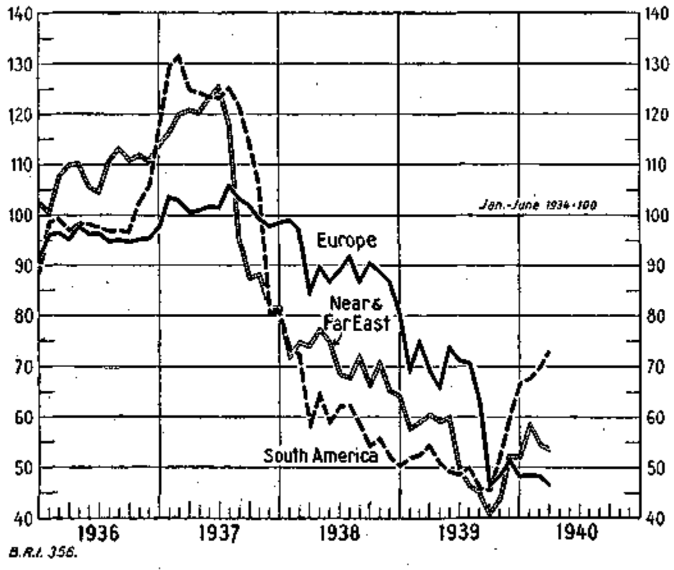
An *exception to the general reduction of foreign short-term credits* was the renewal for a further two years of the Swiss banks' credit of Sw. fcs 40 million to the Argentine Government early in May 1940 on the same terms as before, i. e. at 3½ per cent. on bills with a nominal maturity of six months. The credit of Fl. 12½ million from Dutch banks was repaid while $5 million was taken up from American banks for two years.

On clearing accounts also the general tendency appears to have been towards a repayment of the outstanding balances or "Spitzen". The excess of German exports in the last months of 1939 towards Holland, Italy, Switzerland, Yugoslavia and other contiguous countries brought a considerable repayment of Germany's clearing debts to exporters in these countries. Hungary appears to have played a leading part in various arrangements for settling clearing balances by triangular arrangements. For example, Hungary, by ceding lira claims equivalent to about Din. 25 million, was able to reduce its debt to Yugoslavia, which country was indebted to Italy in respect of industrial deliveries. Arrears owing to Great Britain on its clearings with Spain and Turkey were loosened by credits granted by the British Government. The fall of sterling brought some disturbance into the working of clearings between foreign countries denominated in that currency but, whereas the clearing between Norway and Spain, for example, was changed from sterling to Norwegian crowns, it was decided to retain sterling settlements as the basis for the Lithuanian clearings with Hungary and Greece.

At long term new foreign lending has dried up except for a few favoured borrowers. From England the chief overseas borrowers were the Dominion Governments mentioned earlier in this chapter: there were no foreign issues. Public offerings in the United States were virtually confined to three Canadian issues, made in the first eight months of the year, of which only $35 million out of $85 million was for new money. In May 1939 the French Government placed Fl. 155 million 4 per cent. 6-year bonds with a group of Dutch banks and Fl. 100 million 3½ per cent. 6-year bonds (later issued to the public at 97½) with a Dutch-Swiss group. These operations permitted the consolidation of a number of short-term loans made by the French Treasury and French railways. A substantial part of the total Fl. 255 million was placed outside Holland and Switzerland, the latter country, in fact, receiving some Sw. fcs 75 million in October 1939 in connection with the repayment of earlier loans.

The first nine months of 1939 saw a further considerable decline in foreign-bond quotations. The graph, which is based on data published by the Municipal and General Securities Company, although suffering some inevitable lack of continuity in the indexes, nevertheless gives a reasonably correct picture of developments. The outbreak of war in China was responsible for the sharp decline of Far Eastern securities from the middle of 1937. South American bonds, which benefited from the favourable price and crop conditions in 1937, declined with the fall of primary commodity prices later in that year and subsequently reflected the continued weakness of these prices. Since the outbreak of war in Europe, the index of South American bonds has improved, as a result of the favourable possibilities for the foreign trade of these countries and the renewed service of Brazilian securities with which this index is rather heavily weighted. The bonds of India, Australia and New Zealand showed similar advances from the low point in September, but, not being classed as "foreign bonds", are not represented in the index. European bonds have been weak since the "Anschluss" in March 1938, falling precipitately from the autumn of 1938 and again immediately prior to the outbreak of war. Although Danzig suspended the service of its foreign bonds in July, not all developments in 1939 were unfavourable. Hungary and Roumania continued to make transfers of an agreed portion of the contractual debt service, while an offer by the Greek Government to increase the percentage of the contractual interest paid on its external bonds from 40 to 43 per cent. for the duration of the war was recommended for acceptance by the bondholders' committees. A feature of 1939 was the improvement in the prices of defaulted bonds in comparison with undefaulted bonds. The extension of the war in the spring of 1940 again brought severe falls of European foreign bonds.

Foreign Bonds quoted in London.
On base January-June 1934 = 100.
(Indexes of Municipal and General Securities Co. Ltd.)



In April 1940 the Portuguese Government announced the voluntary conversion of existing 3 per cent. external bonds (with interest payable in sterling or other foreign currencies) into 4 per cent. bonds payable in escudos: this form of repatriation was made in order to stabilise the position of Portuguese holders of the external debt.

A further development has been the extensive declarations and mobilisations of foreign securities undertaken by certain governments. Many such operations have taken place in recent years but have been confined in general to the so-called debtor countries and were directly due to a shortage of international purchasing power. The new development is that they have now been undertaken by important creditor countries, such as England and France. As regards France the obligation to declare assets held abroad has already been mentioned. In England the registration of certain securities held by residents and payable in foreign currencies was called for in September 1939, while restrictions were placed upon their transfer. In so far as sales to non-residents were permitted the foreign exchange proceeds had to be surrendered against sterling under the foreign exchange regulations. After registration two batches of specified dollar securities were requisitioned, the first of 60 stocks in February and the second of 117 stocks in April 1940. These securities were purchased by the U. K. Treasury through the Exchange Equalisation Account, which at the outbreak of war was empowered to hold foreign securities as well as gold and foreign balances, and paid for in cash in sterling (which the Account raised by issues of Treasury bills). The amounts obtained by these mobilisations of securities have not been published but the total of the two requisitionings has been estimated at £75–100 million, giving an equivalent of dollar purchasing power to the British Government while new investment funds were released in the British market. Of a somewhat different nature was the requisitioning in October 1939 of the 3½ per cent. Canadian 1930–50 stock denominated in sterling, of which £28 million was outstanding. English holders were repaid in sterling for the securities which were transferred by the British Government to the Canadian Government for Canadian dollars (obtained from part of an internal Canadian issue). In this way Canadian exchange was placed at the disposal of the British Government, whose purchases in Canada during the first year of war will amount, it is estimated, to the equivalent of £89 million. Towards the end of 1939 registrations or mobilisations of foreign securities were also made in Spain and in the early part of 1940 in Sweden, Denmark and Australia.

Although for the time being conditions are likely to remain unfavourable for foreign issues, it is not too early to consider under what circumstances and conditions foreign loans for reconstruction after the war may be floated. In this connection should be mentioned the report of the League of Nations Committee for the Study of International Loan Contracts published last year. The Committee, which was set up in 1935, had as its object the examination of the means for improving contracts relating to international loans which might be issued in the future. At the time when the Report was published in May 1939 it was estimated that, of the total amount of outstanding external issues made on the London market, the amount in default did not exceed 30 per cent. and that a corresponding figure for dollar issues on the New York market was 40 per cent. There were times in the past when the percentage of default on loans issued was at least as high, although the absolute amount at that time was doubtless not so large. Amongst its general conclusions the Committee mentions that the number of defaults which can be attributed to faulty legal provisions is exceedingly small. In the vast majority of cases the reason for the default is to be found in economic conditions and defaults have increased concurrently with attempts made to restrict the movements of men and the flow of goods, the very basis of the exchange of capital. Defaults have resulted in many cases from unilateral action by the debtor countries without consultation with the creditors, contrary to the practice of normal times when debtors in difficulties more usually approach their creditors to obtain by negotiation an alleviation of their contract.

With regard to the future, the Committee suggested that some part at least of the defaults could be traced to excessive and uncoordinated lending to countries whose possibilities of repayment were not commensurate with the burdens they had assumed; that to prevent a recurrence of these unfortunate results steps should be taken to secure a more coordinated examination of the economic possibilities of borrowing countries before new loans are granted, and that such coordination might be achieved through the cooperation of some recognised international financial authority working through small standing committees of financial experts.

V. THE TREND OF INTEREST RATES.

The diverse movements of market rates in 1939 are both interesting and significant. In Europe long-term yields and with them short-term rates generally rose in the first eight months of the year, the movement becoming accentuated in the summer concurrently with the increase of international tension and reaching its climax at the outbreak of war. From this point extremely divergent trends are apparent. In the principal belligerent countries, Germany, France and the United Kingdom, the shock to the markets soon passed and by the spring of 1940 the long-term yields on government securities were as low as or lower than they had been a year before.

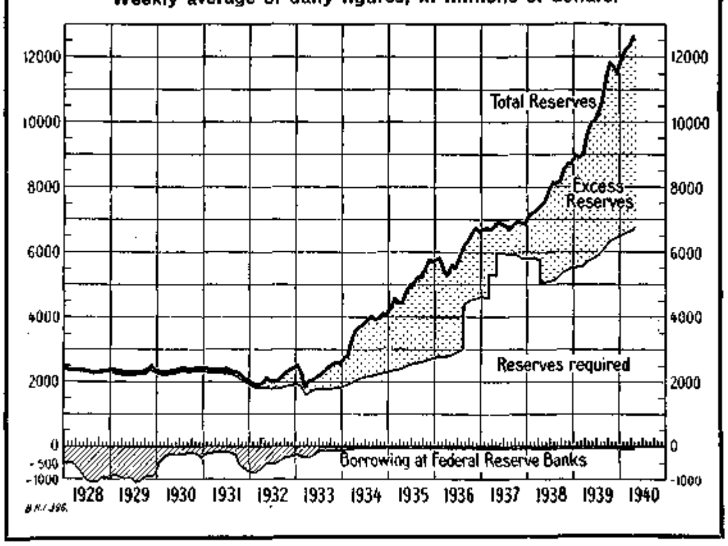
In Italy rates remained comparatively stable all through 1939, while in Switzerland, Belgium, Holland and Scandinavia the rise of long-term rates in the summer continued in general until the end of the year and even beyond, so that the yields on government securities, for example, were some one to two per cent. higher on the year.

Outside Europe the United States markets, under the influence of incoming gold movements, present a picture of liquidity such as has rarely or never been seen before.

For the past six years the money and capital markets in the United States have been dominated by the huge influx of gold into the country, the continuous government deficit financing and the relative lack of demand for short or long-term business credit. The influence of these three factors was intensified in 1939: gold imports, at $3,000 million, reached record proportions, the budget deficit was the highest ever attained (with the exception of 1936, when the soldiers' bonus was paid), while the business demand for credit at short term was slight and at long term so low as to be almost negligible.

The gold movement has been the mechanism for, and the outward and visible sign of, a vast influx from abroad of American and foreign capital, resulting in simultaneous increases of bank deposits and cash reserves. In the six years from 1934 to 1939 some $10,000 million in gold came in from abroad and led to an increase of $9,300 million in the deposits of the member banks and in their cash reserves. On the basis of the increased cash ratios the deposits of the banks were further expanded on balance by the granting of $1,000 million in loans and the purchase of $7,000 million government securities. Cash reserves in the six years have risen from $3,100 to 12,400 million, while deposits are up from $24,000 to 40,000 million (against $34,000 million in 1929) — the overall proportion of cash increasing from slightly under 13 to over 30 per cent. For individual banks, especially in New York, the cash percentage has been much higher, in some cases even exceeding 60 per cent. of total deposits.

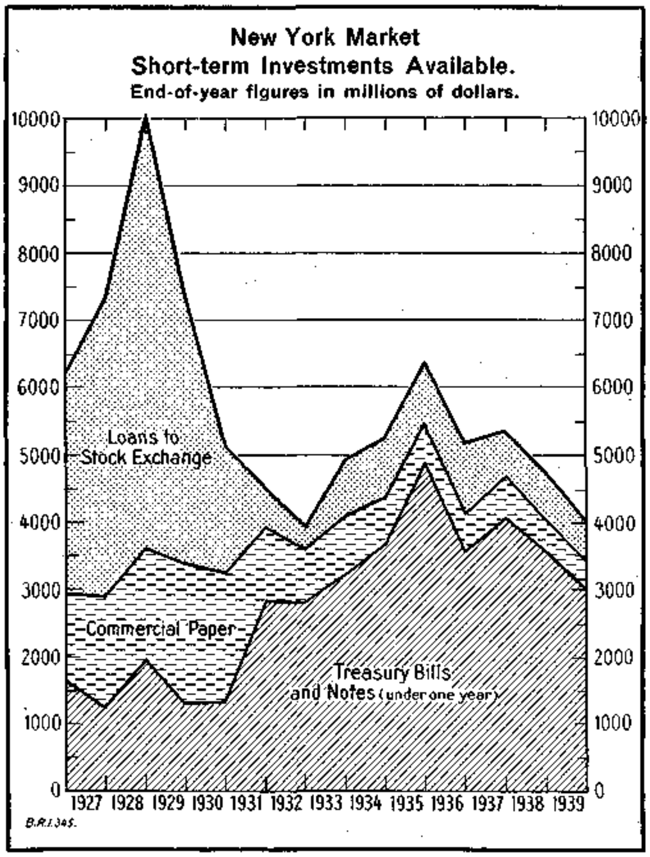
Total loans of member banks were $25,000 million and more in the late 'twenties, but this total included a considerable volume of loans for carrying securities. At the end of 1933, when stock exchange loans were very low, the total of all loans was down to $12,800 million, half the earlier figure, and continued to fall until 1935, when it reached $12,000 million. An expansion to $14,300 million in the middle of 1937 was followed by a fall to slightly below $13,000 in the summer and autumn of 1938 and by an increase to nearly $14,000 at the end of 1939. In spite of every effort of the banks to explore new fields for lending, with the active encouragement of the Federal Reserve authorities, the expansion of commercial loans is negligible over the past six years compared with the rise of business activity and industrial production from the bottom of the great depression to about the 1929 level. The average rate charged to customers on commercial loans in the principal cities is now only 2½ per cent. against 5 and 6 per cent. in the late 'twenties: the average rate in New York is below 2 and little over 3 per cent. in the South and West. These averages cover fairly wide ranges: in New York 60 per cent. of the money lent to commercial borrowers is at rates between 1 and 2 per cent. and less than 15 per cent. at rates above 3 per cent; in the South and West 20 per cent. of the funds is lent at 1 to 2 per cent. and the remainder spread over rates from 2 up to 6 per cent. The lending of working capital to business concerns has generally been the most profitable form of banking business as well as the most appropriate use of a bank's resources, and it might be taken for granted that the banks would further this branch of their activities to the utmost — indeed, in the 'twenties the banks' loans (including loans against securities) were fully expanded and the banks even borrowed from the Federal Reserve Banks to make up their legal minima of cash resources (as the graph shows).



U. S. Member Bank Reserves.
Weekly average of daily figures, in millions of dollars.

Complaints from concerns unable to obtain credit from the usual sources led to the Federal Reserve Banks' being authorised in 1934 to make direct industrial loans. Some confirmation that sound borrowers were already satisfied by the commercial banks was given by the Federal Reserve Bank of New York in its Annual Report for 1938: "As a banking operation, the lending of working capital by this bank has not been profitable ... net earnings (on these loans) were not sufficient to provide fully for the reserves set up against estimated losses."

Thus for a large part of the member banks' resources no commercial outlet can at present be found and the money market is glutted with funds. The next graph shows that the usual material for the short-term employment of banking funds is very reduced; the total of paper circulating on the market with under one-year maturity is little over $4,000 million. Besides the funds already employed in this way there remains a further $5,000 to 6,000 million excess reserves of the member banks which would seek this form of employment if material existed.



Money market rates had already fallen so low that the further addition of idle funds in 1939 could hardly force rates any lower — and the outbreak of war in Europe in September caused the barest flicker of disturbance. Dealers' quotations for three-months' Treasury bills, 0.03 per cent. in the first half of 1939, rose to 0.20 per cent. in September and finished the year at 0.04 per cent. — the yield on new issues of Treasury bills was generally negligible or nil, a "high peak" of 0.16 per cent. being reached in September. Other short-term market rates were higher, but not much so — 4 to 6-month commercial paper at $\frac{1}{2}$–$\frac{5}{8}$ per cent., bank acceptances at $\frac{7}{16}$ per cent. and stock exchange call money at one per cent. are all about as low as can easily be imagined. The flood of surplus cash is so great that market rates, and even fluctuations of several hundred million dollars in excess bank reserves, have ceased to have any significance as indications of market and banking conditions. Fine measures of "liquidity" are not appropriate when the whole system is swamped.

"Cheap money" posed problems for the banks in other countries besides the United States, but never in the same degree. The huge increase of deposits has raised expenses with little or no corresponding income, while it decreases the ratio of capital funds to total liabilities and thus increases the banks' vulnerability to capital losses (although, on the other hand, the risk of loss is reduced by reason of the proportionately large holdings of cash). Cash reserves earn nothing and money employed in the market next to nothing —

with little demand for business loans even at present low interest rates, the banks have been virtually forced into the government bond market and questions of budget finance become of first importance to them.

United States Budget position.

Year to 30th June in thousand millions of dollars	Revenue	Expenditure*	Balance
1927	4.1	3.0	+ 1.1
1928	4.0	3.1	+ 0.9
1929	4.0	3.3	+ 0.7
1930	4.2	3.4	+ 0.8
1931	3.2	3.7	— 0.5
1932	2.0	4.5	— 2.5
1933	2.1	3.9	— 1.8
1934	3.1	6.0	— 2.9
1935	3.8	7.0	— 3.2
1936	4.1	8.7	— 4.6
1937	5.3	8.4	— 3.1
1938	6.2	7.6	— 1.4
1939	5.7	9.2	— 3.5

* Excluding debt retirement through sinking fund.

In the prosperous years 1927–29, with budget revenue at $4,000 million, the annual surplus available for repayment of debt (including the ordinary appropriations for redemption in the budget) amounted to $1,000 million. In 1939, with national income still short of the level of the late 'twenties, receipts from taxation (including social security contributions) were about 50 per cent. higher. But as budget expenditure in 1939 was three times as high as in 1927–29 there was a deficit for 1939 of $3,500 million. By the end of 1939 the direct public debt had risen to nearly $42,000 million and the government guaranteed debt to $5,700 million, so that the total United States direct and fully-guaranteed obligations stood at $47,700 million against $16,000 million in 1930.

Not the whole of the annual increase in the public debt has been publicly offered, as substantial amounts have been absorbed in recent years by the investment requirements of social security funds and other Treasury trust accounts. In future this investment demand, especially on account of the old age benefit fund, will be reduced as a result of changes in social legislation during 1939.

The enormous increase of the public debt has given the banks an outlet for their resources provided neither by the money market nor by a demand for business credit. In fact, the bond market has to an increasing extent been utilised by the banks not only for investment but as a means of adjusting their cash position, thus usurping the functions of the money market. This question first became of importance in the spring of 1937 when increases of the member banks' "required" reserves brought a flood of bond sales and provoked the intervention of the Federal Reserve Banks which, between 4th and 28th April, bought $96 million Treasury bonds to stabilise the market. In its Annual Report for 1937 the Federal Reserve Board remarked that "in recent years the bond market has become a much more important segment of the open money market, and banks ... to an increasing extent use their bond portfolios as a means of adjusting their cash position to meet demands made upon them". Such considerations have led the Reserve Banks in recent years to make a shift in their holdings of government securities: while the total has remained virtually unchanged at $2,500 million the relative importance of the bond holding has grown (particularly bonds of over five years' maturity).

Federal Reserve Banks' government security holdings.

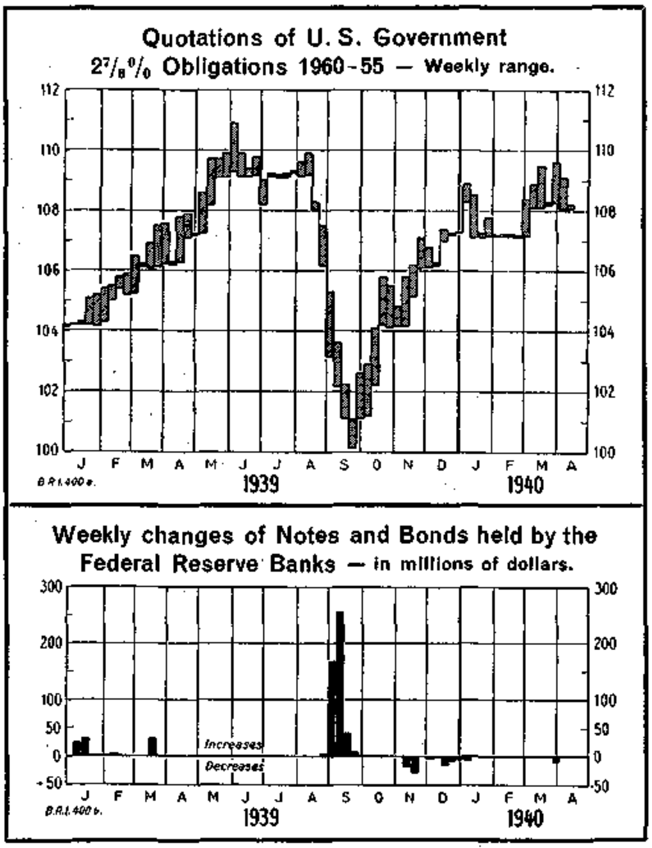
At end of month In millions of dollars	Bonds	Notes	Bills	Total
1936 December . . .	491	1,341	599	2,430
1937 ,, . . .	752	1,155	657	2,564
1938 ,, . . .	841	1,157	566	2,564
1939 June	911	1,176	463	2,550
July	911	1,176	401	2,488
August	912	1,179	335	2,426
September . . .	1,316	1,245	242	2,803
October	1,316	1,245	174	2,736
November . . .	1,283	1,233	35	2,552
December . . .	1,351	1,133	—	2,484
1940 January	1,344	1,133	—	2,477
February	1,344	1,133	—	2,477

In June 1939 it was decided to allow the Reserve Banks' Treasury bill holding to run off as for some time money market conditions had been such that bills could be replaced only with difficulty even on or near a no-yield basis.

Things were different on the government bond market where quotations began to decline early in June 1939, as war in Europe became imminent, and a slump set in towards the end of August. In the period between 25th August and 16th September several changes were made in the Federal Reserve Banks' lending rates — six of the Reserve Banks reduced their rates for rediscounts and advances to member banks against government obligations from 1½ to 1 per cent. (the rate in force in New York since August 1937) while all twelve Reserve Banks lowered their rates for similar advances to non-member banks to the same level (involving reductions up to 3 per cent.). Thus all commercial banks in need of cash could obtain advances at par against government securities — in seven Reserve districts at 1 per cent. and in the other five at 1½ per cent. only. There should therefore have been no selling by the banks for purely liquidity purposes, but there was, in fact, a widespread feeling that the low point in interest rates had been reached. The New York banks had already recognised the impossibility of selling their large holdings without disorganising the market and they informed their correspondents in the country of their intention not to do so, but many smaller banks and other holders of government securities started to sell and ordinary buying orders were virtually absent. (Member banks' holdings of direct government obligations rose by $300 million on the year to over $11,000 million; but, whereas New York banks bought over $500 million, country banks sold $200 million.)

In the five weeks to 27th September the Reserve Banks bought $474 million United States bonds and notes at declining prices as the graphs on next page show.

The weekly high and low quotations of a representative government security are here compared with the weekly increases and decreases of the



Reserve Banks' combined holding of government bonds and notes (thus eliminating changes in the separate holdings due to conversions etc.).

The Federal Reserve Bank of New York, in its Annual Report, explains: "These purchases were made, not in an attempt to fix or peg the prices of government securities, but rather for the purpose of facilitating an orderly readjustment of the market to levels at which buying orders from other sources would come into the market in sufficient volume to maintain the conditions of orderly trading. By the last week of September this objective had been achieved". The recovery of the market during the latter part of 1939 enabled the Reserve Banks to resell some $72 million of their longer-term holdings.

An article on "The Banks and Idle Money"*, in the March 1940 issue of the Federal Reserve Bulletin, in a discussion of these developments states: "It is a fact ... that many banks do not view long-term bonds in their portfolios as permanent investments in the same way that life insurance companies do and are anxious to take paper profits or avoid paper losses by selling bonds before a price-decline occurs. This attitude of banks, in view of the large increase in their bond holdings, has placed new responsibilities on Federal Reserve authorities and has necessitated some change in the focus of Federal Reserve policy. Whereas formerly banks adjusted their reserve positions by shifting holdings of short-term paper, now they are inclined first to sell long-term Treasury bonds and keep their short-term assets. ... Thus the Government bond market has become the country's central money market, which is the medium in which Reserve policies may first find expression."

The fact that the demand for business credit is no more lively at long term than at short term is shown in the following table of capital issues made by United States domestic corporations:

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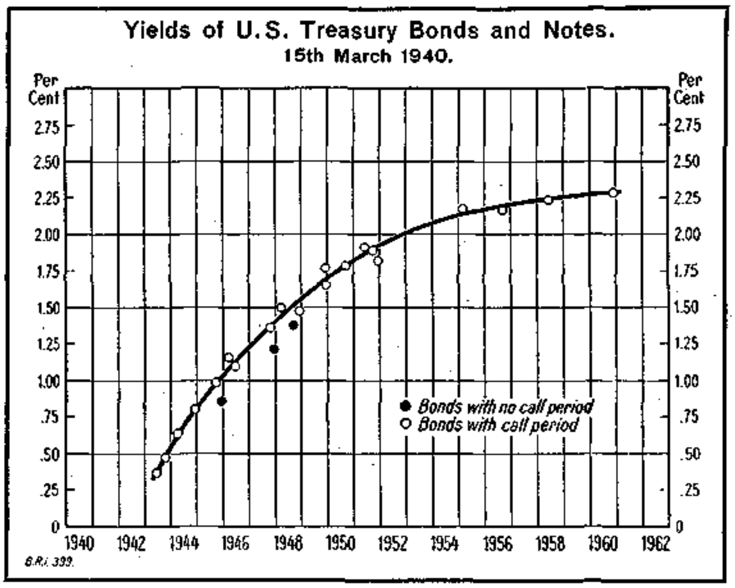
* By Mr Woodlief Thomas.

U. S. Capital Issues for new money.

Quarterly in millions of dollars	1929	1937	1938	1939
January—March .	1,532	390	111	82
April—June . . .	1,688	439	252	128
July—September .	1,518	246	342	91
October—December	1,050	150	167	69
Total	5,788	1,225	872	371

These figures relate to issues on the market for public subscription. Other securities placed privately with insurance companies and other investing institutions, of which no regular statistics exist, probably raised total issues to $2,100 million, i.e. about the same figure as the previous year, but including a larger proportion of refunding issues than in 1938.

The yields of United States Government securities, although not quite at the extremely reduced level of the first week of June 1939, are very low indeed. Treasury-bill issues give no yield and 2 to 5-year notes practically none. The following chart from the U. S. Treasury Bulletin shows that even the longest (twenty-year) bonds gave yields of only 2.29 per cent. in March 1940.



In these circumstances any further expression of cheap money must be found in the penetration of low rates through the country and through all lending activities. The further lowering of mortgage rates, for example, which has made some progress in recent years, may give a stimulus to residential and other building.

Apart from the United States, France was the country where internal credit conditions in 1939 were most influenced by incoming capital movements. The financial and economic recovery dating from November 1938 and the repatriation of capital which continued without serious interruption throughout 1939 were reflected in the condition of the money and capital markets, particularly in the first half of the year. The discount rate of the Bank of France was reduced from 2½ to 2 per cent. in January 1939, at which level it has since remained unchanged. The average rate for fortnightly loans against first-class securities on the stock exchange (the "reports au parquet" or "contango" rate) was only one per cent. in the first half of the year, while in the same period the yield on the 4 per cent.

rente of 1918 remained under 5 per cent. The market was liquid, deposits in the commercial banks increased and some Fr. fcs 4 milliard of discounts and advances were repaid to the Bank of France. Government expenditure was covered by taxation and market borrowing: an issue of 5 per cent. 40-year rentes at 98 brought in Fr. fcs 10 milliard (cash and conversion) in May, June and July (with no gold or exchange guarantee) and no recourse was had to advances from the Bank of France.

This picture was abruptly changed in the middle of August, when the growth of political tension and the outbreak of war led to heavy demands on the Bank of France, as the following table shows:

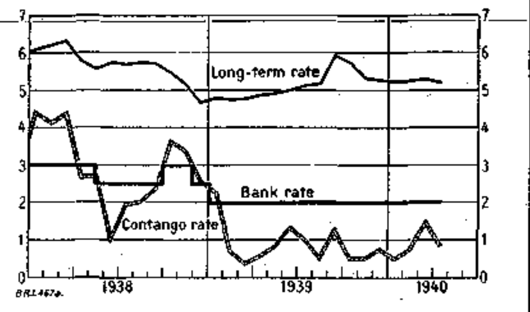
Bank of France — total credit granted.

In milliards of Fr. fcs	1938	1939			1940
	29th Dec.	17th Aug.	7th Sept.	28th Dec.	28th March
Private credit:					
discounts	9.7	6.0	20.1	7.5	6.9
advances	4.1	3.8	6.2	3.7	3.7
Total . . .	13.8	9.8	26.3	11.2	10.6
Public credit:					
advances to govt.	30.6	30.6	30.6	44.7	47.8 *
Total . . .	44.4	40.4	56.8	55.9	58.4
Open market purchases . .	1.9	2.9	4.3	5.8	7.2
Total of above items . . .	46.3	43.3	61.2	61.7	65.6
Note circulation	110.9	123.1	146.1	151.3	156.0

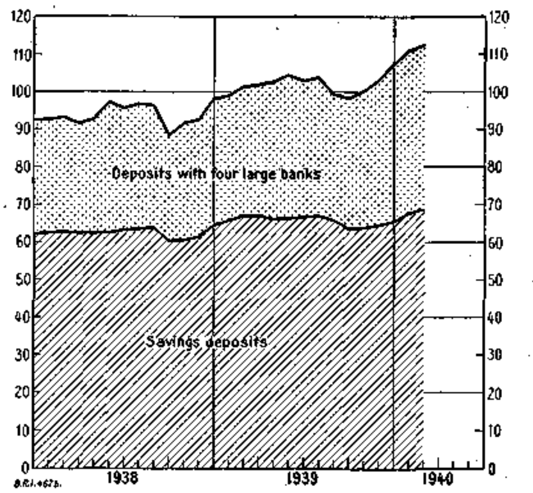
* Including Fr. fcs 17.3 milliard from the gold revaluation profit in March 1940.

From the middle of August the commercial banks, in order to meet the demand for notes, were obliged to apply for discounts and advances at the Bank of France; but from 7th September already some reflux occurred, the banks were in a position to begin repayment of the accommodation thus obtained and at the end of the year the total volume of private credit outstanding was less than at the end of 1938. On the other hand the government, from the middle of September, drew on its advance account at the Bank of France in roughly the same rhythm as that assumed by the repayment of private credit. In 1939 the note circulation rose by about Fr. fcs 40 milliard, of which Fr. fcs 15 milliard corresponded to an extension of the credit volume (public and private) of the Bank of France while the remainder was generally a counterpart to the return of capital funds from abroad acquired by the French monetary authorities. Deposits in the four large Paris banks, which hold some half to two-thirds of the deposits of all the commercial banks, increased by some Fr. fcs 9 milliard on the year, notably from August, and continued to rise in the new year, from Fr. fcs 42.4 milliard in December, to the record figure of Fr. fcs 46.6 milliard at the end of March 1940. The turnover of accounts is, however, sluggish judging by the volume of bank

France – Interest Rates – in percentages.



Bank Deposits – in thousand millions of francs.



clearings in Paris, which from September to the end of the year was barely half that of the previous year.

The pressure of August–September was thus temporary — the money market soon became easier and bank deposits increased; the contango rate on the stock exchange again fell below one per cent. War financing, as in other countries, was met in the first place by short-term borrowing. Besides the advances from the Bank of France, the Finance Minister announced in February 1940 that Fr. fcs 2.2 milliard of rediscountable Armament bills at six and twelve months had been issued in September, 5.3 milliard in October and an average of 8.0 milliard in December 1939 and January 1940.

The rente market recovered in September without help from the Rente Fund (originally formed to support the prices of government securities) and early in 1940 the yield of the 4 per cent. rente of 1918 again fell to around 5 per cent., but no long-term government issue has yet been made on the market. The volume of borrowing envisaged is considerable: besides the Fr. fcs 80 milliard ordinary budget for 1940, to be covered by taxation, Fr. fcs 55 milliard for military expenditure, to be covered by borrowing, has been approved for each of the first two quarters of the year. This would give an annual rate of borrowing of some Fr. fcs 220 milliard, compared with a total public debt before the present war of about Fr. fcs 450 milliard. Owing to the depreciation of the franc, however, the gold value of the public debt in 1939 was not higher than it was in 1914.

Contrary, and to some extent complementary, to the situation in France, there was a further outflow of funds from England in the first eight months of 1939. Although the operations of the Exchange Equalisation Account tended to protect the short-term market, the scarcity of "outside money" (i. e. money lent to the discount market by other than clearing banks) made itself felt. The liquid funds of foreign banks, already reduced in volume, when not simply transferred abroad were more profitably employed in dollar swaps and gold arbitrage than on the money market. The Treasury-bill rate, however, remained at little over ½ per cent. until the middle of March, from which time, under the influence of the international situation (and with the possibility that the 2 per cent. bank rate would become effective or even be increased), the rate rose to 1½ per cent. in the middle of April, falling again to ¾ per cent. early in May.

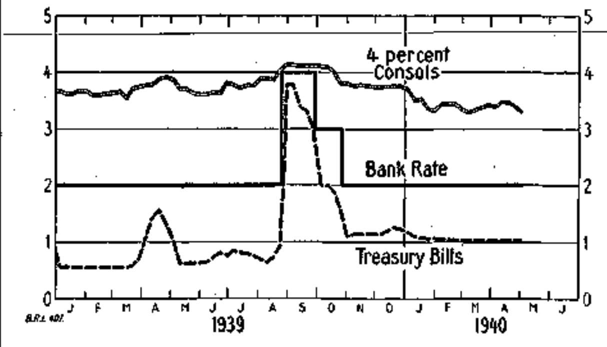
The alert of March–April 1939 was also reflected in a sharp decline on the stock exchange, 3½ per cent. War Loan, for example, falling from 98 early in March to 91 at the end of April. There was, however, a relatively greater decline of short-dated government stocks, which are held both inside and outside the market as an employment for liquid resources and are thus more subject to sudden realisation in emergency than the longer-term securities bought for investment purposes. By and large, long-term interest rates in these first eight months of 1939 continued the upward trend which was taking government bond yields from under 3 per cent. in 1935–36 towards 4 per cent. An indication of this trend was the increase, by two steps of $^1/_8$ per cent. in April and May, of the rates charged for housing and other loans to local authorities borrowing from the Local Loans Fund, the new rates ranging from 4 to 4¾ per cent.

Although these conditions were not very propitious for the new capital market, almost all issues during the year were made in the first eight months: new domestic industrial issues according to the Bank of England's compilation totalled only £39 million, about one-half of the figure for 1938 and less than a quarter of that for 1936.

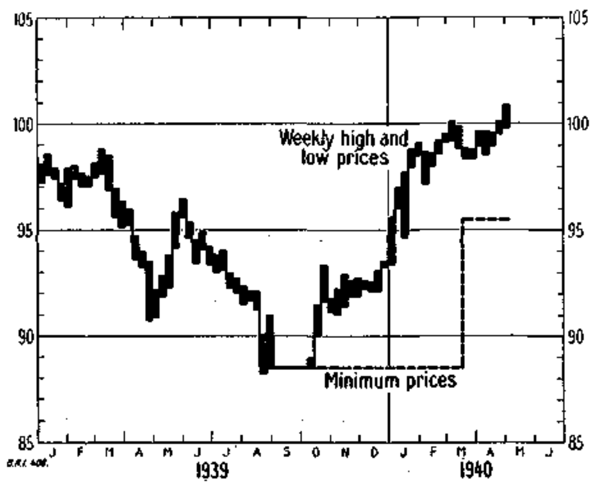
In August 1939, as the international situation became more threatening, the efflux of capital increased in intensity. On the 24th, the day before sterling fell on the exchanges, bank rate was raised from 2 to 4 per cent., thus abruptly terminating the unbroken period of seven years during which 2 per cent. had been in force. The new rate was immediately effective, the clearing banks' lending and deposit rates, Treasury-bill and other market rates all falling into line. The slump in prices of gilt-edged securities was checked by the introduction of minimum prices (corresponding approximately to the lowest prices on 23rd August), below which it was prohibited to deal — the price of 88½ was fixed for 3½ per cent. War Loan, as shown in the graph. Fortnightly settlements on the stock exchange were abolished, and all dealing was made strictly for cash.

On the outbreak of war in September a number of emergency measures were taken: foreign exchange regulations, capital market and other controls were imposed. Exceptional discount facilities at the Bank of England (at 2 per cent. above bank rate) were made available for market acceptors whose clients, on account of war conditions, failed to remit amounts due. Although the problem presented to acceptors by the war was slight compared with that in August 1914, it was complicated by the existence of about £37 million German standstill credits still outstanding (some 60 per cent. of which had, however, been taken off the market well before the outbreak of war).

London Market Rates — In percentages.



Quotation of 3½% War Loan.



With the market protected against an outflow of domestic capital, the strained conditions of early September soon passed. Bank rate was reduced to 3 per cent. on 28th September and again to 2 per cent. on 26th October. Market rates tended to anticipate and precede bank rate on the downward tack. A notable exception was the clearing banks' rate for loans to the market, which maintained its traditional relationship of one per cent. below bank rate and thus reached its low level of one per cent. in October (compared with ½ per cent., i. e. 1½ per cent. below bank rate, which had ruled in the exceptional period from the end of 1934 to August 1939). As short loans at this rate from the clearing banks constitute the principal resources of the discount market, the Treasury-bill rate returned to a level slightly over one per cent. With the growth of the Empire countries' sterling reserves, "outside money" became more plentiful. Aided by the reduction of bank rate and the increasing liquidity of the market, gilt-edged stocks floated clear of the minimum prices early in October (the short-dated in the first place) and dealing, which had been very difficult, became more normal.

Increased government expenditure, due to the war, was financed, as in other countries, by short-term issues in the first place and the Treasury bills offered for tender mounted from the usual £30–40 million to £55–65 million weekly. In November an attempt was made to attract small savings with the issue of 5 to 10-year savings certificates and 7-year savings bonds, each giving a yield of about $3^{1}/_{8}$ per cent. and carrying facilities for earlier redemption, the amounts of individual holdings being limited. (Up to the end of March 1940, £120 million of these savings issues had been subscribed, an average of about £1 million per working day.)

The market remained liquid over the end of the year, no recourse being had to the Bank of England. A new technique of open-market operations was developed during the year, first in April 1939 and on a larger scale in

December. The Bank of England made an important departure from precedent in buying considerable amounts of shortly-maturing Treasury bills direct from the clearing banks, which replenished their portfolios by purchasing longer bills from the market. The liquidity of the original ten clearing banks at the end of 1939 is shown by the fact that the increase of aggregate deposits by £163 million to £2,350 million during the year was covered as to over 80 per cent. by an increase of liquid assets (cash, call money and bills discounted). Almost the whole of the increase of deposits and liquid assets took place during the last four months of the year and reflects the rise of government expenditure covered by Treasury bills; the volume of "tender" bills outstanding rose from £500 million in the middle of September to over £800 million in January 1940. The increase of deposits at the ten clearing banks was greater in 1939 than in any year since 1932, when the gold standard had been suspended and the great War Loan conversion was made.

The growing volume of money accumulating in savings banks, insurance companies and certain extra-budgetary funds exerted its influence on the stock exchange in the almost total absence of new capital issues, and gilt-edged prices rose in a lively market. In the second half of January 1940 the conversion of 4½ per cent. Conversion Loan 1940–44 (of which a large part was held by banks and market houses) into a 2 per cent. 3 to 5-year loan was announced and £250 million of the £350 million outstanding was converted. But no "new money" was called for. On the contrary, towards the end of January a temporary ban was placed on municipal conversion offers "involving cash borrowing". Further, a series of U. S. dollar securities were mobilised, payment being made to holders in sterling early in March. By this time the weight of money had pushed long-term 3½ per cent. stocks nearly to par and middle-term issues were yielding around 3 per cent.

On 5th March 1940 a £300 million 3 per cent. 15 to 19-year War Loan was announced — to be issued at par on 12th March. The £300 million new long-term money received corresponded approximately to the increase in the issue of "tender" Treasury bills since the outbreak of war and was sufficient to cover requirements for three or four months at the current rate of spending.

Total government expenditure in England increased from an average of £250 million a quarter in 1938 to £625 million in the first quarter of 1940, that is from £2¾ million to nearly £7 million a day.

U. K. Government expenditure.

In millions of £ sterling	Total *			Portion covered by issues under Defence Loan Acts		
	1938	1939	1940	1938	1939	1940
January–March	247	298	625	65	111	166
April–June	235	296	.	—	15	.
July–September	238	347	.	—	65	.
October–December	284	543	.	17	246	.

* Omitting self-balancing items.

After the issue of the 3 per cent. War Loan, the Chancellor of the Exchequer stated that "the policy of the Government is to aim at stability of interest rates and to secure that the yields offered on future loans, whatever their type, shall ... be in agreement with the level of interest rates established by the terms of the recent 2 per cent. Conversion Loan and of the 3 per cent. Loan just issued". On 18th March 1940 a new list of minimum prices for gilt-edged stocks was published — that for 3½ per cent. War Loan was raised from 88½ to 95, some 3 points below the then current market price (excluding accrued interest). The minimum for the new 3 per cent. loan was fixed at 98, giving a maximum yield of 3.14 per cent. (or under 2 per cent. to the investor when income tax at the standard rate has been deducted).

Being protected by stringent exchange regulations, the German money and capital markets are unaffected by international movements of funds but reflect the changing conditions of the domestic situation, especially changes in the volume and methods of government financing and in the business demand for capital.

Until March 1938 German Government expenditure was met partly by the issue of "special" bills which did not bear the name of the Reich and were excluded from the official statistics. As no further "special" bills were issued after 1st April 1938, the monthly statements of the public debt, summarised on the following page, may be taken to give a picture of the current receipts from government borrowing (certain issues which produced no cash receipts, such as those made to compensate German holders of Austrian and Czecho-Slovakian government securities being omitted.)

The Finance Plan of March 1938 aimed at covering Reich expenditure in excess of current tax revenue by means of long-term loans; but some elasticity was given to the system by the issue of six-months' "delivery" bills in so far as they might be repaid on maturity. Long-term loans comprise the market issues of Treasury bonds and the so-called "liquidity" loans, 27-year bonds on tap directly to savings banks, insurance companies and social funds for the employment of their liquid resources. The monthly increase of these loans reflects the growth of savings accumulating in savings deposits, payments of life assurance premiums, etc.

"Delivery" bills were issued from April 1938 at an average of RM 500 million a month and by October the total outstanding amounted to about RM 3,000 million (of which some two-thirds had been taken over by the banks). The first bills matured and were repaid in November 1938 but further bills were issued until April 1939. After this date no more issues were made and the circulation of "delivery" bills was reduced month by month on maturity until in October 1939 the issue had been entirely repaid. Treasury-bill issues, later to become one of the main forms of raising funds, began to be of importance from the end of 1938.

In the fiscal year ending March 1939 long-term market loans were issued to a total of RM 5,400 million, while a further RM 1,900 million was obtained

Reich Internal Debt — monthly increases or decreases (—)*.

In millions of Reichsmarks	Short-term: Reichsbank (1)	Treasury bills etc. (2)	Sundry short-term loans (3)	Total (4)	Long-term: Rentenbank (5)	Market issues (6)	"Liquidity" loans (7)	Net total (8)	Tax certificates (9)	Grand total (10)
1938										
April . . .	— 60	246	—	186	—	1,337	210	1,528	—	1,714
May . . .	5	483	—	488	—	262	148	376	—	864
June . . .	— 19	502	—	483	—	367	37	289	—	772
July . . .	18	468	—	486	—	—	10	— 4	—	482
August . .	18	506	—	524	—	—	299	299	—	823
September	—	240	—	240	—	—	96	— 173	—	67
October. .	— 49	186	—	137	—	1,840	55	1,784	—	1,921
November.	37	— 213	—	— 176	—	7	157	164	—	— 12
December.	53	236	10	299	—	1,171	153	1,223	—	1,522
1939										
January .	—	242	20	262	—	330	362	687	—	949
February .	—	650	— 10	640	—	2	328	330	—	970
March . .	— 73	714	— 20	621	—	100	58	2	—	623
April . . .	73	994	240	1,307	—	—	10	— 25	—	1,282
May. . . .	—	189	365	554	—	—	144	136	669	1,359
June . . .	—	— 92	— 325	— 417	—	—	811	676	829	1,088
July . . .	454	— 215	— 281	— 42	—	—	11	11	781	750
August . .	126	1,023	—	1,149	—	—	13	13	845	2,007
September	— 461	1,320	—	859	400	—	229	528	905	2,292
October. .	324	784	—	1,108	161	—	320	481	803	2,392
November.	— 243	1,791	—	1,548	58	—	404	462	—	2,010
December.	486	1,053	—	1,539	55	—	358	312	— 161	1,690

* Only the "new" internal debt is taken into account, i. e. that contracted since 1924.

(1) Working credit, the RM 100 million limit of which was removed in June 1939.

(2) Including certain other short-term financing, in particular the six-months "delivery" bills issued from April 1938 to April 1939 and completely repaid by October 1939.

(3) In April and May 1939 a special "over-bridging" credit from the banks.

(5) Loan to Reich corresponding to issue of Rentenmark notes to supplement the coin circulation.

(6) No market issues were made in 1939, the amounts shown in the first quarter being delayed subscriptions to the loan of December 1938.

(7) Issues made directly to employ the liquid resources of savings banks, insurance companies, social funds, etc. — given net, i. e. with current amortisations deducted.

(8) Total of long-term loans less sundry amortisations.

(9) Utilised for payments in accordance with the New Finance Plan of March 1939 — not, therefore, wholly cash receipts but supplementing general revenue.

from the "liquidity" loans, so that long-term borrowing (less amortisations of RM 800 million) gave a net amount of RM 6,500 million, being about 60 per cent. of the RM 10,700 million new money raised by government borrowing in the period.

The Finance Plan of March 1939 provided that up to 40 per cent. of the amount of official contracts might be paid in equal proportions of 7 and 37-months' "tax certificates" which to a limited extent had the status of legal tender and, on maturity, could, with varying advantages for individual firms, be utilised for the payment of taxes or could be held for longer periods as an investment. Expenditure was to be met in this manner and not by long-term market loans. The capital market, which for years had been reserved for Reich loans, was opened particularly for industrial bond issues.

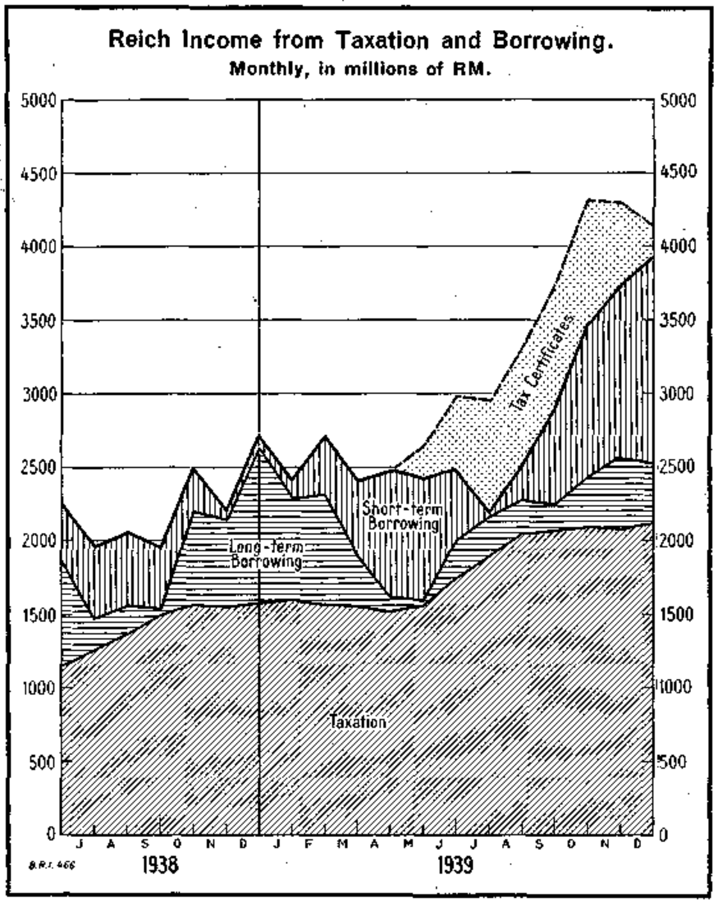
"Tax certificates" were issued from May 1939 at an average of RM 800 million a month and by the end of October the total outstanding amounted to RM 4,800 million. But the certificates proved difficult to digest in large amounts, for, although quoted on the bourse, they were not rediscountable and might not serve as cover for bank loans. Their issue was discontinued in November and about half of the 7-months' issue of May was presented for payment of taxes in December 1939. From 1st April 1940 "tax certificates" were deprived of their qualities as means of payment.

In the nine months April to December 1939 the total borrowing of the Reich was RM 14,900 million (including a net issue of RM 4,700 million tax certificates) compared with RM 8,200 million in the same period of 1938: no long-term market issues were made, but the long-term "liquidity" loans produced RM 2,300 million against RM 1,200 million in the last nine months of 1938. Net long and medium-term borrowing, including RM 670 million from the Rentenbank to supplement the coinage and RM 2,400 million three-year tax certificates, amounted to RM 5,000 million in the last nine months of 1939, i. e. slightly over one-third of the new money raised by Reich borrowing. The higher proportion of short-term borrowing in the period is mainly due to the expansion of the Treasury-bill issue between August and November 1939 when total borrowing exceeded RM 2,000 million a month. Mention should also be made of an "over-bridging" credit of RM 600 million obtained from the banks and utilised in April and May 1939. This credit was repaid in June and July, when the removal of the previous limit of RM 100 million on direct advances from the Reichsbank enabled fuller recourse to be had to ways and means advances. By December 1939 the total of these advances was RM 785 million.

It is probable that the rise in monthly expenditure was roughly parallel to the total receipts from borrowing and from taxation. To give a broader picture the graph on the next page has been drawn up, based on a three-months' moving average of the monthly data (the quarterly figures for taxation published in the last half of 1939 being first placed on a monthly basis in the light of experience of the movement of the monthly statistics in recent years).

From an average of RM 2,700 million a month in the first half of 1939 the actual monthly figures of total receipts rose to RM 3,750 million in August and RM 5,000 million in September, declining in the following months. In the five months of heavy borrowing from August to December 1939 total expenditure would appear to have been covered as to 50 per cent. from taxation.

In addition to the regular influence of the quarterly payment of direct taxation, the phases through which the markets passed were largely reflections of the changing methods of budget financing and, in the last part of the year, of the increased volume of government borrowing. The issue of non-rediscountable "delivery" bills in 1938 had somewhat tightened up the



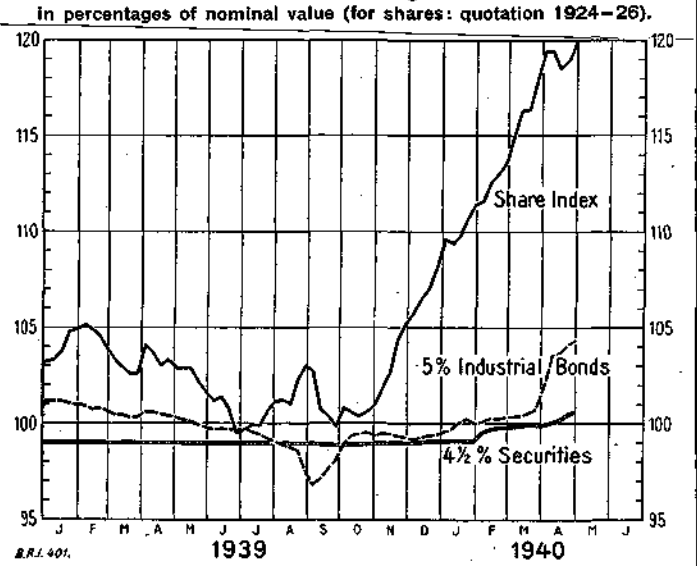
Reich Income from Taxation and Borrowing.
Monthly, in millions of RM.

banks (which experienced a demand for new advances for the first time for some years), but the issue of rediscountable Treasury bills in the early months of 1939 again loosened up the market and on 2nd May the private discount rate was reduced by $^1/_8$ to $2^3/_4$ per cent. The new financing by tax certificates from May onwards, however, had the effect of shifting the provision of funds for government orders on to industrial concerns, thus inciting a further demand for bank advances while checking an increase of deposits. Further, the demand for bank-notes on the outbreak of war, which provoked an increase in the Reichsbank circulation from RM 8,710 to 10,970 million in the two weeks to 7th September, added to the stringency. These conditions, which continued into October, also affected the bond and share markets.

Prices of industrial bonds fell to their lowest point early in September, while to maintain quotations of government securities the Reichsbank bought RM 100 million in August, RM 400 million in September and a further RM 100 million in October. Reich $4\frac{1}{2}$ per cent. Treasury bonds were rigidly held slightly below par, but the three-year tax certificates fell to a point where the effective yield rose above 6 per cent.

Conditions changed rapidly in November, when a policy of credit expansion was adopted. Tax certificates were no longer utilised but an increased issue of rediscountable Treasury bills was made, while the private discount rate was again reduced by $^1/_8$ to $2^5/_8$ per cent. and on the bond market the Reichsbank, to meet the growing demand, sold RM 440 million of the securities it had previously bought. The Prussian State Bank (Seehandlung) performed a somewhat similar function on the share market by selling from its trustee holding of shares taken by the Reich in payment for the tax on Jews in November 1938.

German Stock Exchange Indexes
in percentages of nominal value (for shares: quotation 1924–26).



B.R.J. 401.
Source: German Institute for Business Research.

The issue of Treasury bills became the principal method of government financing and increasingly liquid conditions have characterised the market up to date. Deposits in the banks rose rapidly and two further reductions of the private discount rate to $2^3/_8$ per cent. were made. By January the Reichsbank had sold in all over RM 1000 million securities since the last week of October, in February the market quotations of Reich bonds advanced to par and in March 1940 a new series of 4 per cent. Reich Treasury certificates of about 5 years' maturity were put on the market at 99 to meet the intense demand for investment material. In April 1940 the issue price was raised to 99¼ and in May quotations reached par.

Although it was the declared policy to open the capital market for industrial bonds in 1939, conditions in the first ten months of the year were not propitious for new loans. But from November industrial issues became possible in favourable conditions. The first loan of importance was the issue of RM 500 million 4½ per cent. certificates (1945–49) by the German Railway Company, of which RM 300 million were offered to the public at 98¾ early in November 1939. Following the success of this loan, numerous flotations of industrial bonds were made. In the last quarter of 1939 these issues totalled RM 130 million (in addition to the railway loan), while a further RM 182, 83 and 133 million were issued in the months of January, February and March 1940 respectively, making a total of over RM 900 million in the twelve months since April 1939. To appreciate the importance of these amounts it may be recalled that the total industrial bond issues in 1938 barely exceeded RM 100 million. In May 1940 RM 500 million 4 per cent. bonds were issued by the Prussian State, of which RM 250 million were placed on the market at 99¾ (the balance being for consolidation of short and middle-term paper).

The liquidity of the money market continued in the spring of 1940 and on 9th April the Reichsbank lowered its official discount rate from 4 to 3½ per cent. — the first change for eight years. Commenting on this reduction of rate, the President of the Reichsbank at the Annual General Meeting said that it was to be looked upon as only the first step towards a systematic cheap-money policy to lighten the burden of war financing, in the first place for the Reich and in due course for the general economy of the country. Later in the month the Central Credit Committee representing the Reich groups of credit institutions announced general reductions of interest rates as from 1st May 1940. On the one hand the rate for advances was lowered from 5 to 4½ per cent. while on the other hand interest on ordinary savings deposits was reduced by ½ to 2½ per cent. and on longer-term savings deposits by ¾ to 3¼ per cent.

Interest rates on the Italian money and capital markets showed great stability throughout the year. Bank rate remained at 4½ per cent. (unchanged since May 1936), while the long-term rate, which tended to rise slightly in the early part of 1939, fell back at the end of the year. Thus the percentage yield of the 5 per cent. rendita (1935), which averaged 5.4 in 1937 and 5.5 in 1938, rose to 5.6 in April and May to fall, particularly after August, to 5.3 in December 1939 — the lowest yield for some years. The firmer bond market reflected in these yields was accompanied by a lively share market with rising quotations, particularly in the last quarter of the year, so that the general index of share prices in December 1939 was 40 per cent. higher on the year and the average yield about 4 per cent. (with certain leading shares down to 2 per cent.). Deposits in the savings banks and with credit institutions increased considerably in the latter part of the year.

Italian savings deposits.

End of year in millions of lire	Total credit institutions	Postal savings banks	Total
1938	59,672	29,236	88,908
1939*	66,518	30,647	97,165

* Provisional.

There was also a further increase in the capital of Italian companies, although to a lesser extent than in 1938, when exceptional issues of bonus shares were made in connection with the 10 per cent. tax levied on joint stock capital.

Italian joint stock companies' capital.

In millions of lire	New companies formed	Increases of capital	Capital reductions	Liquidations of companies	Net capital increase (+) or reduction (—)	Total capital outstanding at end of year
1934	414	3,134	3,664	3,347	— 3,463	44,320
1935	311	2,787	1,811	1,512	— 225	44,095
1936	354	3,608	1,327	925	+ 710	44,805
1937	2,283	3,282	621	2,054	+ 2,890	47,695
1938	341	6,568	545	929	+ 5,434	53,129
1939*	500	4,300	1,000	700	+ 3,100	56,300

* In round figures.

The rising bond and share markets mentioned above were favourable to the flotation of important capital issues; in particular the Finsider (a financial concern controlling four large iron and steel, engineering and electrical companies) issued Lit. 900 million shares, thus doubling its capital at Lit. 1,800 million. But the most important operation was for account of the government: in the middle of February 1940 an issue of 5 per cent. 9-year Treasury bonds was made at 97½, to cover the estimated deficit of Lit. 6,000 million on the 1939-40 budget and to redeem maturing Treasury bonds. Subscriptions attained some Lit. 16,000 million, including Lit. 10,500 million new money, which enabled the Treasury to repay part of the advances it had previously obtained from the Banca d'Italia for defence purposes.

After the devaluation of the franc in the autumn of 1936, interest rates declined in Switzerland and the cheap-money régime reached its climax in 1938 when the average yield of twelve Confederation and Railway bonds fell below 3 per cent. At this time the item "other sight liabilities" at the National Bank, representing largely the cash reserves of the commercial banks, rose to nearly Sw.fcs 2,000 million; to appreciate how extraordinarily high these resources were, they may be compared with the note circulation, at that time around Sw.fcs 1,500 million.

In 1939 there was in fact very little movement in short-term rates: bank rate, at 1½ per cent. since November 1936, remained unchanged throughout the year, while the private discount rate was adjusted only from 1 to 1¼ per cent. in September. In 1938 the Confederation had begun to borrow against "rescriptions", i. e. Treasury bills, from the National Bank, and in May 1939 this credit was repaid from the proceeds of Treasury certificates with a currency of 2-3 years, which the government was able to place with commercial banks to an amount of Sw.fcs 120 million at rates varying between 2¾ and 3 per cent. As a reflection of this transaction and of the efflux of funds from Switzerland during the first half of the year, the "other sight liabilities" at the National Bank fell from Sw.fcs 1,700 million at the beginning of 1939 to Sw.fcs 1,100 million at the end of June. The tension of the market at the outbreak of war in September was, as already mentioned, very slight, an expansion of some Sw.fcs 300 million in the note issue being wholly covered by the banks drawing on their liquid resources at the National Bank, which were thus reduced to Sw.fcs 800 million (a figure less than half that of 1938 but still high compared with earlier standards).

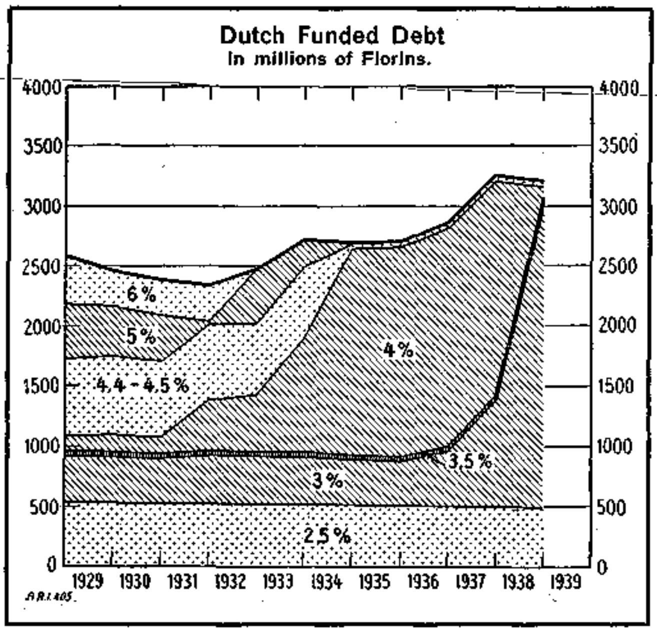
Although there was little discounting at the National Bank in September, the President, in his speech to the General Meeting in March 1940, said that the assistance given by the Bank to the market could not be judged merely by the figures in the Bank return since indirect support had been given by promises to discount or advance against security in certain cases if this should be necessary, lenders thus being assured of liquidity in case of need (as had been done also in the past).

In October 1939 the Confederation accepted an offer of the banks to take up Sw.fcs 200 million Treasury bonds, Sw.fcs 60 million repayable in one year at 2¾ per cent., 80 million in two years at 3¼ per cent. and 60 million in three years at 3½ per cent. The money market, indeed, remained fairly liquid, especially after the turn of the year when a considerable reflux of notes took place. At the end of March 1940 the "other sight liabilities" at the National Bank stood at Sw.fcs 700 million (compared with a note issue of Sw.fcs 2,000 million).

The change of conditions in 1939 was reflected more in the long than in the short-term market. The average yield of the twelve Confederation and Railway bonds rose from 3 to 3½ per cent. in the spring of 1939 and, after touching 4½ per cent. in the autumn, finished the year at 4¼. The Confederation, whose borrowing from the National Bank had been completely repaid before the beginning of the war, again borrowed against rescriptions from the National Bank to the extent of some Sw.fcs 200 million (including the Federal Railways) by the beginning of March 1940. Early in that month a ten-year National Defence loan for Sw.fcs 200 million (bearing interest at 3½ per cent. for the first four years and thereafter 4 per cent.) was issued at 99.4 in order to cover part of the mobilisation expenses. Following the issue of this loan the rescriptions of the Confederation placed with the National Bank were repaid. The costs of mobilisation and other extraordinary military outlay have been estimated at about Sw.fcs 2,500 million from the outbreak of war to June 1940, partly covered by the imposition of new taxes and an increase in the rate of some old extraordinary taxes.

The increase in the long-term rate is of particular importance in Switzerland. In the first place an appreciable part of the banks' resources are obtained by the issue of 3 to 5-year bonds in the nature of fixed time deposits. Any change in the interest rate on these bonds must be submitted for approval to the National Bank, which has not, however, the right of veto. During 1939 numerous requests for increases were received and it was necessary, after attempts to postpone rises in the rates by offering other advantages to the creditors (by way of shorter term, etc.), to agree to increases up to 4 per cent., that is about one per cent. higher on the year. Secondly, the high volume of mortgage indebtedness in the country makes the interest rate on this form of borrowing an important factor in the Swiss economy. During the year this rate also rose from about 3 to around 3¾ per cent.

Long and short-term interest rates in Holland fell with few interruptions from 1932, the cheap money movement being intensified after the devaluation of the florin in 1936 and reaching, as in Switzerland, its climax in 1938, when the total deposits at the Nederlandsche Bank, a good indication of the liquidity of the market, reached Fl. 1,000 million and exceeded the volume of the note issue. Bank rate at 2 per cent. was applied from the end of 1936, but the private discount rate continued to fall to an average of only 0.2 per cent. in 1938, at which time the "prolongatie" rate (for one-month loans on the stock exchange) was 0.5 per cent. and the yield of the irredeemable government rente was just 3 per cent. The next graph shows how this period of extremely cheap money was utilised by the government to reduce the interest paid on the funded debt. While in 1929 sixty per cent. of the funded debt bore interest at 4.4 per cent. or more, nearly the whole of this debt had been converted to a 3 per cent. basis by the end of 1938.



The money market was quiet in the first seven months of 1939, except for some mild tension in March and April, which momentarily brought the private discount rate at 1¾ per cent. within range of bank rate. But there was some efflux of capital, which had its clearest expression in the gradual fall of the "other" deposits at the Nederlandsche Bank (comprising principally the cash reserves of the commercial banks) from over Fl. 600 million early in the year to around Fl. 350 million in July, while the yield of the irredeemable rente rose quietly to 3½ per cent.

On 11th August the failure of the Mendelssohn Bank with wide connections in Holland and other countries came as a shock to the markets. In response to a tightening of money the Nederlandsche Bank raised its rate from 2 to 3 per cent. on 29th August. The Mendelssohn failure and the outbreak of war put a certain pressure on the central bank, the note issue reaching its highest point at Fl. 1,200 million on 4th September, an increase of nearly Fl. 200 million in two weeks — "other" deposits were drawn down by Fl. 80 million to Fl. 300 million, while credit granted by way of discounts and advances expanded by Fl. 100 million. The following weeks brought some relaxation of the strain; while bank rate remained at 3 per cent. the private discount rate fell back from 3 to little over 2 per cent.

The importance of "prolongatie" loans has declined considerably in recent years, although they still remain a characteristic feature of the Amsterdam market. At the end of August and in early September the rate for these loans jumped to over 4 per cent. (compared with ½ per cent. in the first quarter of the year). But no difficulties arose; in fact the total amount of such loans was estimated at only Fl. 50 million, compared with Fl. 325 million in 1914, while September 1939 witnessed a sharp bull market in Amsterdam as in New York, so that market loans were well covered.

Meanwhile the position of the Treasury had been growing tighter. In the first seven months of the year the banks had allowed their holdings of Treasury bonds to run off, so that the total outstanding fell from Fl. 220 million at the end of December 1938 to Fl. 155 million at the end of July 1939. The Treasury started to issue Treasury bills on the market in May, but by August had fully utilised its deposit and was forced to borrow from the Nederlandsche Bank.

Dutch Treasury position.

End of month in millions of florins	Liquid Asset: deposit at Nederlandsche Bank	Short-term borrowing: from Nederlandsche Bank			Short-term borrowing: from market				Total short-term borrowing from market and Nederlandsche Bank
		advance and overdraft	against Treasury bills	total	Treasury bonds	Treasury bills	call money	total	
1939 July . . .	46	—	—	—	155	64	—	219	219
August. .	—	13	23	46	135	75	5	215	261
September	—	11	51	62	123	135	5	263	325
October .	—	19	9	28	109	223	5	337	365
November	—	18	68	86	100	275	10	385	471
December	—	7	76	83	99	327	10	436	519
1940 January .	—	17	16	33	79	383	10	472	505
February .	—	7	36	43	79	388	70	537	580
March* . .	18	—	—	—	79	368	—	447	447

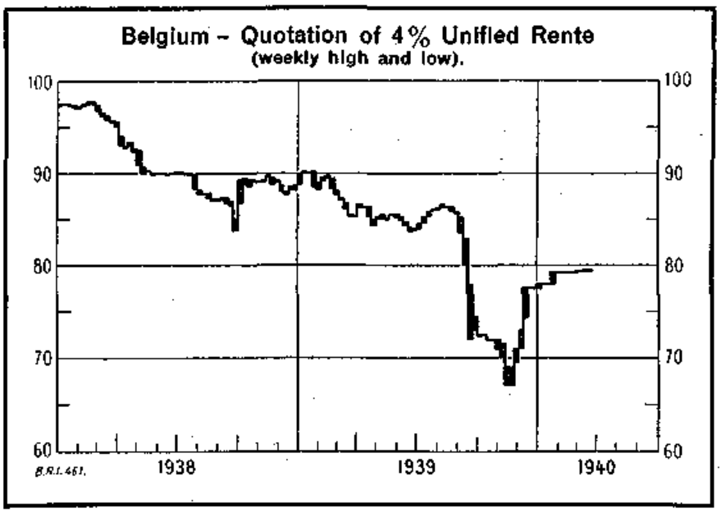
* 21st March.

Costs of mobilisation, estimated at Fl. 1.7 million a day, and other exceptional charges abruptly raised total government expenditure — which would appear to have been covered to the extent of about 50 per cent. by the proceeds of taxation. The deficit was met largely by Treasury-bill issues which found a ready market with the banks, particularly after September, owing partly to the liquidation of sterling balances. In December a 4 per cent. 40-year loan for Fl. 300 million was issued in order to consolidate part of the floating debt. But, although short-term market rates had fallen after September, long-term interest rates had continued to rise from 3½ per cent. in July to about 4¼ per cent. in December. The government 4 per cent. loan was thus somewhat below the market, but the fact that the bonds could be used at par to pay certain direct taxes would probably have greatly shortened the maturity of the loan; nevertheless, the amount subscribed by the public was less than Fl. 100 million.

In February 1940 a further 4 per cent. 40-year loan for Fl. 300 million was issued. These bonds could not be utilised at par for tax payments, but, in conformity with the methods used during the war of 1914–18 for the raising of government loans, the Bill authorising the issue provided for a compulsory loan at 3 per cent. if the voluntary loan were not subscribed. This loan was fully successful, being entirely taken up by the public. The first quotation of the new loan was at 96¼ and by the end of March 1940 it had fallen to 93½, giving a yield of 4½ per cent. (while the December loan remained at 99¼). The money market was, however, easier by this time, the "prolongatie" rate being 2½ per cent. and the private discount rate down to one per cent.

The revaluation of the Nederlandsche Bank's gold holding at the end of March 1940 gave the government a profit of Fl. 132 million to be credited to the Loan Fund, from which part of the costs of mobilisation were defrayed.

The Belgian money and capital markets experienced somewhat disturbed conditions in 1939 — the efflux of capital in the spring, the continued losses of deposits by the commercial banks and the failures in the autumn, the emergency government financing and the heavy decline of the government rente.



The exchange crisis of May 1938, when the National Bank of Belgium lost B.fcs 4000 million gold in one month and bank rate was raised from 2 to 4 per cent., was repeated in March and April 1939 but on a less intense scale. B.fcs 4,400 million gold was lost over the two months; the banks drew down their cash reserves at the National Bank by B.fcs 2,000 million and borrowed B.fcs 2,650 million on discounts and advances (covering also an expansion of B.fcs 250 million in the note circulation). Bank rate, which in October 1938 had been reduced to 2½ per cent., was raised to 4 per cent. on 17th April. The reflux of capital in the following months (which raised the National Bank's reserve in August to the highest level since February 1938) permitted the reduction of bank rate to 3 per cent. on 11th May and to 2½ per cent. on 6th July. At this time the National Bank introduced two new credit facilities — the discounting of export bills, at one per cent. below bank rate (1½ per cent.), and "advances in current account" (overdrafts) on government securities having less than 120 days to run (thus including Treasury certificates), at bank rate (2½ per cent.).

However, the banks did not wholly regain their liquidity, their cash reserves at the National Bank in July and August being around B.fcs 1,200 million, against 2,500 million in January and February 1939 and 4,000 million early in 1938.

Belgian bank deposits.

At end of month in millions of B.fcs	Deposits: commercial banks	Deposits: savings banks*	Note circulation
1936 December	23,570	11,456	22,702
1937 "	21,971	12,489	21,542
1938 "	18,085	12,671	21,989
1939 March	17,228	12,567	21,619
June	16,811	12,338	22,212
September	15,772	11,795	27,006
December	14,494	11,958	27,994

* December figures include interest added.

There appear to be three main reasons for the decline of commercial banks' deposits in recent years — transfer to the savings banks which allow higher rates of interest, some hoarding of notes and the withdrawal of foreign (and a comparatively small amount of Belgian) capital from the country. In 1939 a further depressing factor was the fall until November of the 4 per cent. "unified" rente.

The failure of the Mendelssohn Bank in Amsterdam precipitated the closing of the Caisse Générale de Reports et des Dépôts of Brussels in November and of the Crédit Anversois early in December. The former was reorganised without loss to the depositors by a banking consortium, but the latter had to liquidate: depositors received 75 per cent. of claims up to B.fcs 10,000 and 25 per cent. above that amount. The Institut de Réescompte et de Garantie, formed in 1935 to grant credits to the banks upon assets which by their nature could not be given as collateral to the National Bank, was called upon to open emergency credits which, at the end of 1939, amounted to B.fcs 568 million. The total deposits held with the banks in difficulties, however, amounted to only 3½ per cent. of all bank deposits.

In August 1939 the "open-market" powers of the National Bank were extended beyond the limits imposed in 1937: the maximum was raised from B. fcs 1,500 million to B.fcs 5,000 million, augmented by B.fcs 686 million at the end of 1939 through the amortisation of securities held under previous laws. The costs of mobilisation and other extraordinary military outlay estimated at some B.fcs 6,000 million a year were met principally by the issue of short-term Treasury certificates, taken in a large measure by the National Bank, whose holding of government securities rose as is shown in the table. At the end of December 1939 the National Bank held B.fcs 3,740 million out of the total short-term domestic debt of B.fcs 4,430 million.

National Bank of Belgium — holding of government securities.

At end of month in millions of B.fcs	Short-term	Long-term	Total
1938 December. .	25	603	628
1939 March . . .	211	622	833
June	225	660	885
September .	414	1,132	1,546
December. .	3,740	862	4,602

As the graph on the previous page shows, the 4 per cent. rente fell heavily, especially in September 1939, passing under 70 in November, but rising again to 77½ at the end of the year and to nearly 80 in the first quarter of 1940. The National Bank acquired long-term securities in August and September, but by the end of December had reduced its holding by some B.fcs 270 million. In September 1939 the Minister of Finance was authorised to proceed to the liquidation of the Rente Fund established in 1935: by the middle of 1938 its original gold holding of B.fcs 1,000 million, formed from the revalued assets of the National Bank, had been sold to the Bank and the francs obtained entirely invested in rentes.

A return of confidence after November 1939 and the exceptionally active foreign trade balance, leading to a reinforcement of the National Bank's reserve, had favourable effects on the money and capital markets, and bank rate was reduced to 2 per cent. on 25th January 1940. From 31st January 1940 the Belgian Government issued an "Independence Loan" in the form of bearer Treasury bills at 4, 8 and 12 months at discounts corresponding to interest rates of 2.4, 2.7 and 3 per cent. respectively: in the three months to the end of April 1940 over B.fcs 2,000 million had been subscribed.

For the Northern countries the transition from peace to war conditions in Europe led to more abrupt changes on the money and capital markets than almost anywhere else. The central bank in Sweden came under pressure from three directions, from the banks as a consequence of demands for liquidity by the public, from the Treasury to meet extraordinary expenditure, and on foreign account reflecting an efflux of capital, an increased import surplus and changed conditions of foreign trade involving higher cash payments in foreign currencies.

These conditions constituted a decisive change from those of recent years. In the 'twenties the Swedish banking system had maintained its resources fully utilised. Total credits granted to the public exceeded deposits up to the aggregate of the banks' capital funds (some S.Kr. 800 million), while cash reserves were very small and dependent on rediscount facilities at the Sveriges Riksbank, which thus had a firm control of the market. In the great depression the credit volume of the banks declined and deposits remained roughly unchanged, while the business revival of the 'thirties was characterised by a more rapid increase of deposits than of credits, under the influence of an inward movement of gold and foreign exchange. As a consequence the banks accumulated large cash reserves, recourse to the Riksbank was no longer necessary, and in 1937 the traditional excess of credits over deposits was replaced by a surplus of deposits over credits for the first time in Swedish banking history. In 1938 and the first three quarters of 1939 the banks' deposits roughly equalled their credits, and cash resources remained high, although somewhat below the record levels of 1937.

The outbreak of hostilities on the continent and later in Finland brought a rapid change. In consequence of the laying-in of stocks, the increased volume of internal trade, the intensification of imports and the shortening of trade credits, all coupled with the general desire for individual liquidity and a flight of foreign capital, the banks were constrained to increase their loans to the public while their deposits were heavily drawn upon. The change which has taken place in the position of the Swedish commercial banks since August 1939 is summarised below.

Swedish commercial banks.

End of month in millions of S.Kr.	August 1939	March 1940	Seven months' changes
Deposits	4,717	4,391	— 326
Credits	4,618	4,966	+ 348

The increase in credits plus the decline of deposits amounted to S.Kr. 674 million, which gives an indication of the pressure to which the banks were exposed. The result was an excess of credits over deposits amounting to S.Kr. 575 million in March 1940, the almost complete utilisation of the banks' cash reserves and the rediscounting of nearly S.Kr. 200 million of bills with the Riksbank.

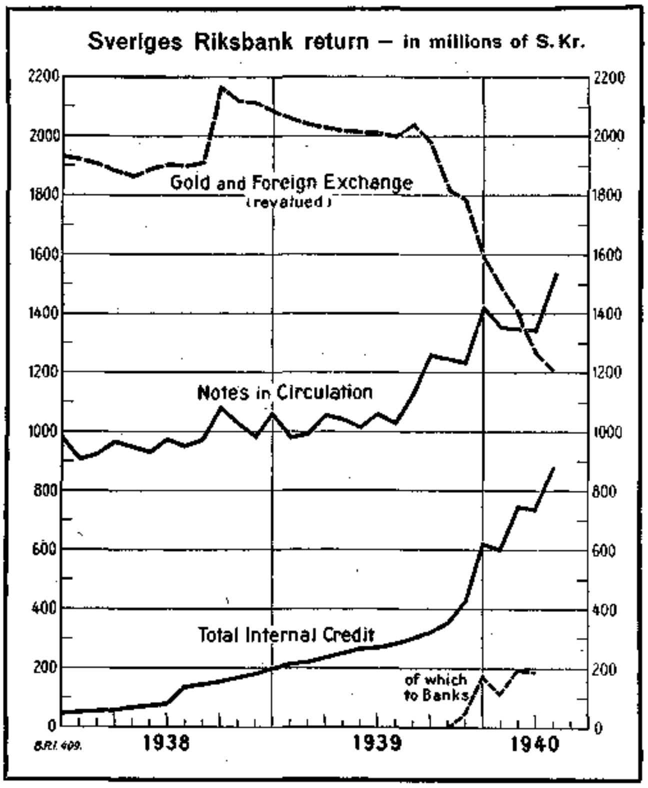
The Riksbank's own position was also affected by the granting of credits other than through rediscounting:

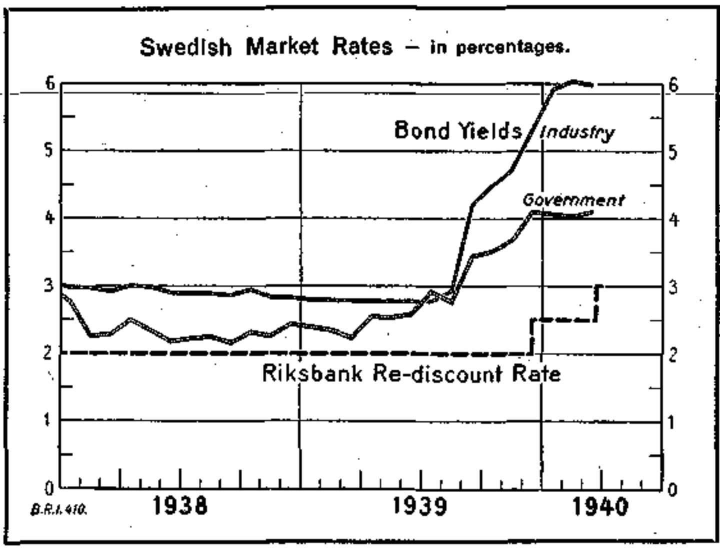
Sveriges Riksbank return.

End of month in millions of S. Kr.	August 1939	March 1940	Seven months' changes
Public deposits . . .	388	138	— 250
Other deposits . . .	437	95	— 342
Total deposits	825	233	— 592
Rediscounting	nil	188	+ 188
Other credits	257	550	+ 293
Total credits	257	738	+ 481
Gold and foreign exchange	2,037	1,332	— 705
Note circulation . . .	1,126	1,342	+ 216

The pressure on the Riksbank may be measured by the loss of external resources plus the expansion of the note circulation. The chart shows graphically the abruptness in the change of the Riksbank's position from the summer of 1939.

On 15th December the official discount rate was raised by $^1/_2$ to 3 per cent. and the rediscount rate for banks to 2½ per cent. (the first changes since December 1933), followed by parallel adjustments of the lending rates of the commercial banks. In general it was held that the increased requirements of the government and the private demand for accommodation would naturally lead to a stiffening of interest rates, and the savings banks, which had to meet withdrawals of deposits, were among the first to increase their rates. On 20th March the rediscount rate was raised and made equal to bank rate at 3 per cent. and on 17th May 1940 both rates were further increased to 3½ per cent. (the latter change not being shown in the graph on the next page).





The trend of long-term rates is shown by an increase from 2½ per cent. in the yield of outstanding Swedish government bonds in the second quarter of 1939 to an average rate of 3 per cent. in the third quarter and to 4 per cent. In December — the highest for six years. Industrial bond yields rose more abruptly, finishing the year 1939 well above 5 per cent. Similar conditions prevailed in the mortgage market, the interest rate on 10-year first mortgage loans, which had been stabilised from the end of 1937 at about 3 per cent., rising rapidly while lending dried up.

Minimum prices were introduced on the stock exchange at the outbreak of war for both shares and bonds and had the effect, as in England (where, however, minima were established only for gilt-edged), of causing a certain stagnation of the turnover. In Sweden prices were adjusted downwards from time to time in accordance with the prevailing situation and in the new year the minimum price system was abandoned, so that the market was set free to find its own level. In these conditions bond issues which had been active in the second and third quarters of 1939 fell very low in the fourth quarter, being, in fact, less than half of the volume of the quarter's amortisations.

In December 1939 the government commenced the issue of savings bonds for small denominations and with a limitation of individual holdings to S.Kr. 500, bearing interest at nearly 4 per cent. A premium bond loan of S.Kr. 150 million was issued in January 1940 with prizes equivalent to an interest rate of 3¾ per cent. In February a 4½ per cent. 5 to 35-year government loan (convertible after 10 years) for S.Kr. 100 million was issued at 99 per cent. in conformity with the prevailing conditions on the market and was readily subscribed. This was the highest interest paid on a government issue since 1932 — and the suddenness of the change may be appreciated from the fact that as late as July 1939 a government conversion loan bore 2¾ per cent. interest, giving the holder the lowest yield of any long-term government issue outstanding. The rate on savings bank deposits was raised from 3 to 3½ per cent. from 1st April 1940 and in May the commercial banks followed with increases of both their lending and their deposit rates.

The market situation in Denmark was closely bound up with the country's foreign trade position; the gradual improvement of the foreign balance through 1937–38 permitted the reduction of bank rate by ½ per cent. to

3½ per cent. in February 1939. From April export prices tended to fall and some mild deterioration set in, insufficient to have much effect on interest rates or the rather liberal lending policy of the banks, while the bond market, of considerable importance in Denmark, remained firm. In the autumn the fixing of maximum prices for agricultural products in England held down Danish export prices while the prices of imports soared and the terms of trade turned distinctly adverse.

The effect on internal monetary and banking conditions was immediate: the Nationalbank's net foreign exchange reserve of D.Kr. 69 million at the end of August had been fully utilised by the middle of October and a deficit of D.Kr. 49 million, due to drawing on foreign credits, appeared by the end of the year. Bank rate was raised by two steps of one per cent. each to 4½ per cent. on 20th September and 5½ per cent. on 10th October. The bond index fell from 100 in August to 92 in December. A government conversion offer of D.Kr. 60 million 4½ per cent. Treasury certificates of only eighteen months' term was made at slightly under par in November, but over half of the issue had to be taken up by the bank consortium. Of the Nationalbank's expansion of credit by D.Kr. 270 million (about 60 per cent.) in the four months to the end of December, one-third was due to the increased overdraft on the account of the Ministry of Finance. The bond index fell slightly to 91 in January 1940 but the Nationalbank's loss of exchange was stemmed, import permits having been cut down severely. (In May 1940 bank rate was reduced to 4½ per cent.)

Developments in Norway were somewhat similar to, but rather less violent than, those in Denmark, although the bond market gave earlier signs of weakness, the index falling gradually from 100 in December 1938 to 96 in June 1939 (a fact which somewhat impaired the liquidity of the commercial banks' bond holdings). Increased needs of internal credit combined with losses of foreign resources put a strain on the Norges Bank, which raised its official rate by one per cent. to 4½ per cent. on 22nd September, a measure which, the Governor of the Bank observed, "ought really to have been put into operation somewhat earlier". Besides the usual credits granted to the commercial banks, the Norges Bank made special arrangements to assist the banks in the financing of imports for which the ordinary foreign credits were not available and temporarily took over from the banks certain commitments resulting from the purchase of commodities for storage in the country. The strain on the Norges Bank continued until early in the new year, by which time the bond index had fallen to 80. (Bank rate in Oslo was reduced to 3 per cent. in May 1940.)

In the first eight months of 1939 conditions on the money and capital markets in Finland were comparatively quiet. As in most other countries, the central bank came under some pressure in September, the note issue rising by FM 285 to 2,550 million while its foreign exchange holding decreased by FM 250 million; the stringency was comparatively moderate although it led the commercial banks to rediscount a small amount of bills for the first time in six years. In October, as the foreign situation turned threatening for Finland, the pressure on the Bank of Finland became tremendous — the note circulation jumped by FM 830 million, of which FM 750 million was issued in the second week of the month, when reservists were called up and Helsinki evacuated.

Over the two months September and October the note circulation had increased by FM 1,120 million, i. e. nearly 50 per cent., while FM 400 million of foreign exchange reserves had been utilised. The Treasury withdrew FM 240 million, the total of its account, the banks drew FM 350 million of their balances and borrowed FM 560 million (120 million by rediscounts and 440 million on a special credit opened for them) while other borrowing raised the central bank's credit expansion in the two months to FM 950 million. Throughout this period the Bank of Finland maintained its official discount rate unchanged at 4 per cent. and the commercial banks made no change in their rates for deposits and loans.

In November the note circulation began to decline and the pressure appeared to have passed. On 15th November the government issued a 5 per cent. 5-year Defence Loan for FM 500 million, which was raised to FM 700 million in order to accept all subscriptions. But the bank return of 23rd November 1939 was the last to be published. After the outbreak of hostilities at the end of the month the publication of most statistics was suspended. The returns of the three big banks, however, show the greatest strain in November and December, while their deposits and cash holdings increased in the new year as the government drew on the FM 1,000 million "Konjunktur" fund of the budget which was utilised to cover war expenditure. The peace treaty was signed in the middle of March 1940, but the publication of statistics has not yet been resumed and it is not yet possible to comment on developments during the three and a half months of hostilities. When the stock exchange was reopened at the beginning of April 1940 there was a rise in the prices of industrial shares of 30–50 per cent. above those quoted on 29th November 1939.

Bank Polski note circulation.

In millions of zloty	End of month 1938	End of month 1939	Increase in 1939 over corresponding month of 1938
January	1,014	1,348	+ 334
February	1,016	1,354	+ 338
March	1,107	1,669	+ 562
April	1,141	1,808	+ 667
May	1,123	1,841	+ 718
June	1,137	1,848	+ 711
July	1,123	1,883	+ 760
August	1,149	1,929 (1)	+ 848 (2)
September	1,548	2,500 (3)	+ 950 (4)
October	1,476	.	.
November	1,373	.	.
December	1,406	.	.

(1) 20th August 1939. (2) Compared with 20th August 1938.
(3) Estimated. (4) Approximate.

Bank rate was held unchanged at 4½ per cent. in Poland in spite of the pressure exerted on the Bank Polski, some measure of which is given by a comparison of the volume of notes outstanding with the previous year (only a small part of the increase being due to the Polish occupation of Western Teschen, Silesia, in October 1938).

The last return published on 20th August 1939 showed an increase of Zl. 848 million in the note circulation compared with the previous year, some Zl. 700 million thereof being due to an expansion of credits granted chiefly to the banks and to the government. It has been estimated that the circulation reached Zl. 2 ,500 million by the end of the campaign in September — more than double the normal level of early 1938. In the western part of Poland which has been incorporated into the Reich the credit conditions of Germany now apply, while in the part of Poland which has been formed into a Governor-Generalship, Reichskreditkassen were at first established and from 8th April 1940 a new bank of issue with head office in Cracow began operations.

Lithuania suffered two waves of withdrawals from the banks in 1939, the first and most violent in March and April after the separation of the Memel district and the second in the autumn. Bank rate was raised from 5 to 7 per cent. in the middle of May (except for export and agricultural bills) and this was followed by an increase in the rates of the private banks to 10 per cent. for credit operations and to 7 per cent. for deposits; it was possible to reduce bank rate to 6 per cent. in July and the autumn pressure was met without a change of current rates. After the return of Vilna in October some reflux of notes occurred and deposits with the banks increased.

On the conclusion of the civil war in Spain a period of reconstruction was inaugurated. The 5 per cent. bank rate, in force without change since 1899, had been lowered to 4 per cent. in Burgos on 27th November 1938 and a similar reduction was made in Madrid on 14th October 1939. Two 3 per cent. three-year reconstruction loans have been issued, for Pesetas 2,000 million in October 1939 and for Pesetas 2,500 million in April 1940.

The outbreak of war and the credit strain produced everywhere in Europe coincided in Hungary with the seasonal financing of an abundant harvest. No change was made in bank rate, however, which has remained at 4 per cent. since August 1935. In October 1939 a considerable proportion of the credits were repaid to the National Bank and the market tension shortly disappeared. The government's milliard pengö "investment" programme, which had been launched in 1938, was the chief influence on the capital market. Finance for this plan of expenditure on armaments, communications and agricultural improvements was to come, as to 600 million pengö, from a capital levy spread over five years and, as to 400 million, from credit operations. The first issue for 125 million pengö was made in the autumn of 1938. In March 1939 150 million pengö 5 per cent. 30-year bonds were issued at 96 and in July 50 million Treasury bills (renewable every three months for four years) were sold to financial institutions: receipts from the capital levy in 1939 were estimated at 120 million. The return of the Sub-Carpathian Territory in March 1939 and the stimulation given by the government's investment programme carried Hungarian industrial production to a record high level during the year.

The Hungarian Government's internal debt has grown since 1931 as follows:

Hungarian Public Debt.

End of June in millions of pengö	Long-term	Short-term	Total
1931	136	—	136
1932	127	135	262
1933	123	226	349
1934	116	255	371
1935	113	294	407
1936	110	362	472
1937	106	328	434
1938	103	339	442
1939	764	316	1,080

The increase in 1939 reflects the issues under the investment programme as well as 95 million due to the exchange of Czech notes in the ceded territories and other debts. In January 1940 a further 140 million pengö was issued for the investment programme on the same terms as in March 1939, while an extra 130 million will be needed to cover the budget deficit.

Exceptional military expenditure in the autumn of 1939 was met in Yugoslavia primarily by borrowing directly or indirectly from the National Bank. By decrees of 24th August and 16th September 1939 the government was permitted to borrow up to Din. 839 million in anticipation of a revaluation of the National Bank's gold holding. A further decree of 18th November 1939 authorised the issue of National Defence bills which might be rediscounted at the National Bank (later to be redeemed from special taxation). The evolution of the National Bank's return has been as follows:

National Bank of Yugoslavia.

End of month in millions of dinars	August 1939	March 1940	Seven months' change
Treasury borrowing .	nil	2,755	+ 2,755
Other internal credit .	2,396	2,219	— 177
Private accounts . . .	1,330	1,836	+ 506
Note circulation . . .	7,986	10,400	+ 2,414
Gold and foreign exchange . .	2,432	2,919	+ 487

The government has borrowed Din. 2,755 million from the National Bank in seven months (with its earlier debts of Din. 2,230 million the total government debt to the Bank approaches Din. 5,000 million, nearly 50 per cent. of the note issue). This increase of central bank credit since the outbreak of war has its counterpart largely in the note circulation, which has risen by over Din. 2,400 million. Government spending gave back some liquidity to the banks, which ceased to borrow from the National Bank after October and repaid part of the earlier credit granted while they reconstituted their cash reserves. The National Bank retained its official discount rate of 5 per cent. unchanged throughout the year. The rates of the commercial banks were at their lowest point in July with an average of 8.5 per cent. and rose to 8.7 per cent. in December (9.2 per cent. at Belgrade, 8.8 at Skoplje, 8.6 at Zagreb and 7.4 per cent. at Ljubljana).

In the British Empire the common factor has been the necessity for increased government borrowing to meet war expenditure, generally facilitated, since the introduction of foreign exchange restrictions in September 1939, by some decline of long-term interest rates. In Eire, which remained neutral in the European conflict, an issue of 4 per cent. Exchequer Bonds 1950–60 for £7 million was made at par in December 1939 to provide money for defence, for refunding and other purposes.

The South African budget has given surpluses in recent years but the outbreak of war caused an expansion of expenditure. Although no war loan has yet been issued advantage was taken of the low level of ruling interest rates to convert on 1st February 1940, the first option date, the £14 million 5 per cent. 1940–50 loan to a ten-year loan on a 3¾ per cent. basis. The Finance Minister requested the co-operation of financial institutions in maintaining a cheap-money policy. Since the outbreak of war the cash balance of the Treasury has been high and no recourse has been had to the Reserve Bank for advances or loans.

In October 1939 the Canadian Government issued $200 million 2 per cent. 2-year notes to the chartered banks, of which $90 million was for the purpose of taking up and retiring Canadian issues in the United Kingdom. The first public war loan of $200 million 3¼ per cent. 12-year bonds was issued in February 1940 and oversubscribed by fifty per cent. The fall of bond prices on the outbreak of war had only partially been recovered by December and yields on long-term government bonds were about ¼ per cent. higher on the year.

For a year and more before the war the liquidity of the trading banks in Australia declined as primary producers made additional calls on bank credit, and interest rates had been rising in spite of intervention by the Commonwealth Bank, which, amongst other measures, directly subscribed £A 6 million to the 3⅞ per cent. £A 72 million cash and conversion loan of December 1938. In February and May 1939 two long-term 3⅞ per cent. government loans for public works were floated, for £A 8½ million at par and for £A 4¾ million at 99 respectively. Further, the Commonwealth Bank took £A 3 million 3½ per cent. four-year bonds to fund earlier issues of Treasury bills covering deficiencies of revenue. Yields on both long and short-term government securities reached 4 per cent. by the end of September 1939 and from that point started to fall. In December the Commonwealth Bank and the trading banks together took up £A 12 million 3½ per cent. bonds at par repayable from 1942 to 1944. By February 1940 it was possible to make a market issue at par for £A 18 million of five-year bonds at 3⅜ per cent. and 10–16 year bonds at 3⅝ per cent. Capital-market regulations have been in force since the outbreak of war and in its Directors' Report in December 1939 the Board of the Commonwealth Bank expressed the belief that "it is desirable to keep rates of interest as low as possible", adding "The maintenance of low rates of interest, however, depends on a number of factors of which central bank action is only one. An excessive rise in prices, for example, might make it impossible to keep interest rates low". So far no such rise had taken place in Australia.

The heavy borrowing by the New Zealand Government direct from the Reserve Bank in the second half of 1938 was accompanied by a rapid fall of the Reserve Bank's sterling reserves and of the trading banks' cash balances at the Reserve Bank, so that the market became tight and there was some stiffening of interest rates — the yields on government bonds rising from 3½–3¾ per cent. in the middle of the year to 4¼–4½ per cent. in December 1938. The Reserve Bank raised its discount rate from 2 to 4 per cent. in November and exchange restrictions were introduced.

The direct advances of the Reserve Bank to the government which had risen to £N.Z. 17.5 million at the end of 1938 (against £N.Z. 7.1 million at the end of 1937) continued to rise in 1939 to £N.Z. 20.0 million in March. But, with the export of capital prohibited, the market became easier and long-term rates declined partly under the influence of purchases of government securities by the trading banks. In May 1939 the government successfully issued £N.Z. 4½ million 4 per cent. bonds in two forms, at 99 repayable in 1948 and at 96 repayable 1954–58 with a sinking fund for the long-term issue. After this public issue in May the government's total advances from the Reserve Bank fell to £N.Z. 16.5 million in the middle of June but rose again to £N.Z. 19.6 million at the end of August. This expansion of credit to the government accompanied by a fall of the trading banks' advances and discounts somewhat eased the position of the market. On 6th September the Reserve Bank reduced its discount rate from 4 to 3 per cent. The outbreak of war was followed by a rather rapid expansion of the Reserve Bank's advances to the government to £N.Z. 23.6 million at the end of the year and £N.Z. 25 million in February 1940. The advances and discounts of the trading banks continued to fall and they again purchased government securities, raising their holdings in the last four months of the year by £N.Z. 5 to 15 million. The yield on government securities which had risen somewhat in the summer of 1939 declined again to the spring level.

Japanese Government bond issues.

Monthly in millions of Yen	1937	1938	1939
January	—	300	400
February	—	300	300
March	185	330	430
April	—	200	300
May	—	300	400
June	—	400	400
July	—	300	400
August	200	400	500
September	—	400	500
October	300	700	600
November	200	—	400
December	600	700	660
Total issues for year	1,485	4,330	5,290

Persistent monthly issues of government bonds for rising amounts have, after two and a half years, produced some fatigue on the market in Japan, and recently assimilation of the bonds has proved more difficult. In round figures the monthly issues since the beginning of hostilities in China in the middle of 1937 have been as shown on the table.

While the external debt has remained practically unchanged — falling slightly with the regular amortisation to its booked amount of Yen 1,267 million at the end of 1939 — the internal bonded debt has more than doubled from Yen 9,270 million in July 1937 to Yen 20,250 at the end of 1939 in spite of increases of taxation in each fiscal year.

Government issues are made through the Bank of Japan, which has been able to place the greater part of the issues with other banks and institutional investors, as the figures relating to the chief holders of government bonds show:

Principal holders of Japanese Government bonds.

In millions of Yen	Bank of Japan	Other special banks	Ordinary commercial banks	Treasury Deposit Bureau	Savings banks	Trust companies	Insurance companies	Total
Dec. 1936	829	323	2,561	1,910	1,016	360	167	7,166
„ 1937	1,387	342	2,500	2,248	1,145	410	230	8,262
„ 1938	1,841	708	3,634	3,177	1,424	510	350	11,644
„ 1939	2,417	1,082	4,618	4,674	1,873	590	540*	15,794
3 years' increase	1,588	759	2,057	2,764	857	230	373	8,628

* Estimated (Yen 497 million at end of September 1939).

At the end of 1939 these banks, savings banks, trust and insurance companies held over three-quarters of the total internal bonded debt. The Bank of Japan has, however, had to take up increasing amounts of the bonds issued; the three-years' increase in its government bond holding, Yen 1,588 million, is paralleled by the increase of the note issue in the same period by Yen 1,813 million to Yen 3,679 million. The sharply increasing price level is doubtless one of the causes of the rising cost of the war. The total budget expenditure has more than doubled and is now over Yen 10,000 million a year, i. e. greater than the total internal debt in the summer of 1937.

Notwithstanding the increase in the government debt, the yield of government bonds has fallen over the past three years from 4.0 to 3.8 per cent. and at the same time the market has been open to other issues. In fact one reason for the recent difficulty in the assimilation of government bonds has been the large issues of private corporate bonds: over Yen 1,000 million were issued in 1939, bringing the total outstanding up to Yen 4,700 million, against issues of Yen 470 million in 1938 and only Yen 130 million in 1937.

Perhaps the most striking feature of the experience of the past year on the world's credit and capital markets as a whole has been the extraordinarily efficient working of the internal liquidity mechanism in the face of most difficult conditions. In August 1914 the mechanism temporarily broke down when the first shock came: bank rates rose up to 6–10 per cent., general moratoria were proclaimed, stock exchanges closed for months and some of the most liquid assets were frozen up. The contrast with 1939 is remarkable as far as domestic markets are concerned — few movements of bank rate, a few unimportant restrictions on the withdrawal of bank deposits and modifications of conditions of payment for mobilised men, stock exchanges open almost without interruption and few claims to liquidity which could not readily be met.

The following table gives a review of bank rate changes in 1914–15 and 1939–40 for nine central banks:

Official discount rates of certain central banks
1914–15 and 1939–40.

1914–15	Belgium	England	France	Germany	Holland	Italy	Sweden	Switzerland	U. S. A.
Rates prevailing 1914 July 28	4	3	3½	4	3½	5	4½	3½	—
Changes made 1914 July 29	.	.	.	.	4½	.	.	.	.
,, 30	5	4	4½	.	.	.	.	4½	.
,, 31	6	8	.	5	.	.	5½	5½	.
Aug. 1	.	10	6	6	6	6	.	.	.
,, 3	7	.	.	.	.	.	6½	6	.
,, 6	.	6	.	.	.	.	.	.	.
,, 8	.	5	.	.	.	.	.	.	.
,, 12	.	.	.	.	.	.	.	.	.
,, 17	6	.	.	.	.	.	.	.	.
,, 19	.	.	.	.	.	.	.	.	.
,, 20	.	.	5	.	5	.	.	.	.
,, 27	5	.	.	.	.	.	.	.	.
,, 28	.	.	.	.	.	.	6	.	.
Sept. 10	.	.	.	.	.	.	.	5	.
,, 28	.	.	.	.	.	.	.	.	.
Nov. 9	.	.	.	.	.	5½	.	.	.
,, 16	.	.	.	.	.	.	.	.	6*
Dec. 23	.	.	.	5	.	.	.	.	5
1915 Jan. 1	.	.	.	.	.	.	.	4½	.
,, 7	.	.	.	.	.	.	5½	.	.
Feb. 3	.	.	.	.	.	.	.	.	4½
,, 18	.	.	.	.	.	.	.	.	4
Rates in effect 1915 March 31	5	5	5	5	5	5½	5½	4½	4
1939–40	**Belgium**	**England**	**France**	**Germany**	**Holland**	**Italy**	**Sweden**	**Switzerland**	**U. S. A.**
Rates prevailing 1939 Aug. 23	2½	2	2	4	2	4½	2½	1½	1
Changes made 1939 Aug. 24	.	4	.	.	.	.	.	.	.
,, 29	.	.	.	.	3	.	.	.	.
Sept. 28	.	3	.	.	.	.	.	.	.
Oct. 26	.	2	.	.	.	.	.	.	.
Dec. 15	.	.	.	.	.	.	3	.	.
1940 Jan. 25	2	.	.	.	.	.	.	.	.
April 9	.	.	.	3½	.	.	.	.	.
Rates in effect 1940 April 30	2	2	2	3½	3	4½	3	1½	1

* Rate quoted on opening of Federal Reserve Bank of New York for 60 to 90-day paper.

In some measure the movement of interest rates in 1914 was no doubt dependent on the long-term upward trend since the beginning of the century. Immediately upon the outbreak of war central bank rates were raised from 3–5 per cent. in July to 6–10 per cent. early in August. After eight months of war the general level of 5 per cent. had been reached in Europe, which by and large remained in force as a minimum during the next four or five years. None of the eight European rates was reduced below 4½ per cent. during the war and this rate was quoted only in Holland and Switzerland.

In August 1939 six of the European rates were between 1½ and 2½ per cent. inclusive, one was at 4 and one at 4½ per cent. Only the Bank of England and the Nederlandsche Bank raised their rates when war was imminent, followed by the Sveriges Riksbank in December. (If, besides the countries shown in the table, the whole of Europe be considered, the increases in Norway and Denmark in September should be added.) The Bank of England soon returned to its earlier rate while rates in Belgium and Germany were reduced in 1940. After eight months of war two of the eight European rates were higher and two lower on balance, while the range of rates 1½—4½ per cent. was the same as before the war.

Two things are striking about the table — the relative lack of disturbance in 1939–40 compared with 1914–15 (seven changes for eight European banks in eight months against thirty changes) and the relatively low rates in force after eight months of war (a range of 1½–4½ per cent. against 4½–5½ per cent.). The low rates are the resultant of a number of forces reflecting the recent trend towards a reduced level of interest payments and the modern tendency towards markets closed against outside influences by foreign exchange restrictions.

The outbreak of war caused less disturbance on the money and capital markets in 1939 than in 1914, partly because the banks and other credit institutions were more prepared for it, particularly after the rehearsal in September 1938, but also because the old conception of liquidity has changed. Up to the time when the Federal Reserve System was founded in 1914 it was considered that central bank credit should be based essentially upon the rediscount of commercial bills which were "self-liquidating" (by the sale of the goods they represented at or before maturity) — a system most advantageous from a monetary and other points of view, as long as sufficient material of the kind demanded was available in the markets. But changes in the financing of trade have led to the virtual disappearance of the commercial bill in many countries and the classic conception of liquidity has been found inadequate in modern conditions. In the United States the theory of "shiftability" was developed — any assets for which there was a high degree of marketability were considered liquid — while the evolution of the American banking law and Federal Reserve policy has been towards increased emphasis on "sound" business rather than "liquidity" as expressed by the form of the contract or instrument or by maturity date. There is, in fact, a parallel evolution in many European countries although often more or less disguised by the erection of some special institution between the central bank and the primary borrower. Thus almost everywhere the basis of central-bank credit has been widened, at any rate as regards short-term transactions.

As regards the long-term markets, represented particularly by stock exchange business in government bonds, no uniform technique has been evolved, although stock exchanges, with few exceptions, have been kept open throughout the worst crises. Generally central banks have assumed some responsibility for the orderly conduct of the bond markets, but in view of the volume of transactions and the possibilities of severe capital losses have rightly shown themselves anxious not to become the "shifter of last resort". The Federal Reserve Banks have openly accepted some responsibility for "maintaining orderly market conditions" and by co-ordinated purchases steadied the government bond market at a time of severe pressure. The Reichsbank and the National Bank of Belgium have also supported the government bond market, while the Banco Central in the Argentine did the same for account of the Ministry of Finance. In some other cases it has been possible to utilise extra-budgetary funds for this purpose. Experience of official intervention of this nature in the past points to the conclusion that, so long as the operations are conceived as temporary measures to bridge over some passing slump of prices due to a "liquidity crisis", they may prove effective in maintaining orderly conditions and beneficial as a rallying-point to steady the market. But if official intervention be made to peg particular prices, especially if this be against the long-term trend, such operations may be very costly and also lead to a distortion of the whole credit structure.

As a contrast to direct or indirect use of central-bank credit to support the government bond market, mention may be made of the technique of "minimum prices" for stock exchange dealings introduced in England and Sweden. Under this system dealings tend to dry up when the minimum is reached, but persons requiring cash against their bonds can generally borrow against them from the commercial banks, if their need be urgent enough. In Sweden several adjustments were made in the minimum prices by the Stock Exchange Committee: in England the market floated off the minimum prices after a few weeks at the beginning of the war and the minima were readjusted upwards to a little below the new quotations. Other measures such as legal authority to carry government bonds at par for balance-sheet purposes are used in the United States to check indiscriminate selling. Some of these interventions are probably temporary expedients, but others seem to be in line with a more permanent development and deserve close study.

The first shock of the outbreak of hostilities was thus generally overcome with relatively little disturbance. So far government borrowing to defray the immense costs of a modern war or to meet heavy mobilisation expenses in neutral countries has mostly had the character of emergency financing. There has not, as a rule, been time to frame long-term programmes, just as it cannot yet be told what may be the eventual effects on currency and credit conditions of heavy government borrowing over a protracted period.

VI. CENTRAL BANKING DEVELOPMENTS.

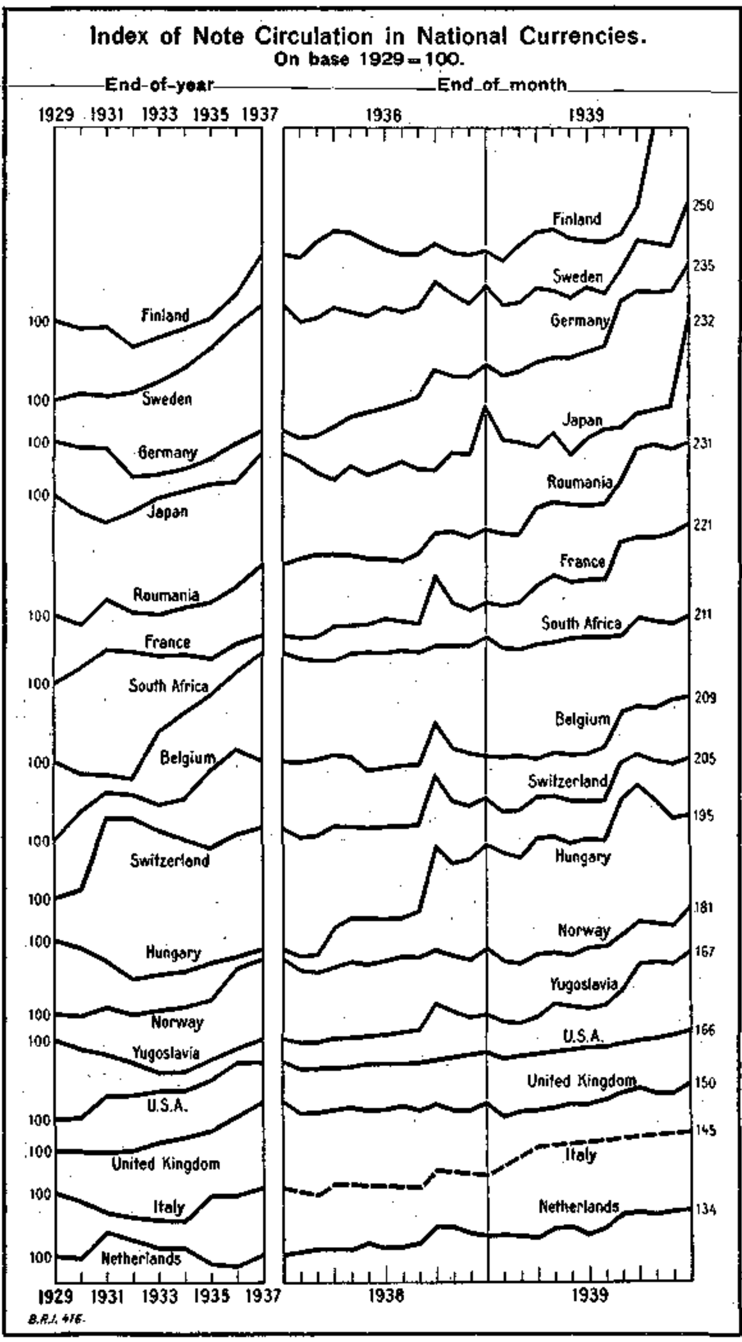
The immense financial requirements of the state and the violent changes in production, distribution and consumption in times of modern warfare have necessarily had a direct influence on the activities of central banks — the ultimate source of liquidity in credit systems. Important changes have taken place in the past year in central banking statutes and practices, related to three main developments:

(i) the intense demand for internal liquidity, which had already arisen temporarily in September 1938, was renewed and accentuated in the latter half of 1939;

(ii) the enormous cost of armaments, mobilisation and actual warfare gave rise to an urgent demand for extraordinary state financing, only to be fully satisfied in many cases by direct resort to central bank credit;

(iii) increased imports and other expenditure abroad made serious inroads into official reserves of gold and foreign exchange.

With the growth of international tension in the summer of 1939 leading up to the outbreak of war, the demand for currency by the public increased *in a measure never before experienced.* *The note circulation* in all European countries and in many countries overseas rose to record figures, as indicated by the graph which also shows the steady advance in the volume of notes issued above the level of 1929. Bank-notes, being used preponderantly for making wage payments and for consumers' buying, tend to fluctuate with changes in business activity and the level of retail prices. The universal trend towards higher note circulations in recent years would seem to indicate a strengthening of wage-earners' incomes almost all over the world, although other factors must also be taken into account. It is probable that in general more cash is held in reserve than previously, partly because the better income position of the broader classes of the population permits many individuals to hold more cash for ordinary purposes than they previously could afford and partly because in times of uncertainty notes are considered to be a suitable form for the holding of an extraordinary reserve, being readily available in any emergency. In Europe the last-mentioned reason has been particularly in evidence since the autumn of 1938 and has led to large increases in the amounts of notes outstanding. Some new hoarding of foreign bank-notes occurred, particularly of Swiss francs and dollars, but the amounts involved were not so important as other forms of hoarding. Furthermore, in those countries where the population was mobilised cash requirements increased with the rise in government payments, and also on account of partial evacuations and voluntary withdrawals from closely-settled areas, which, besides involving extra outlay, took individuals and firms from their usual banking connections. The advance in retail prices in Europe generally may also have contributed to a certain expansion of



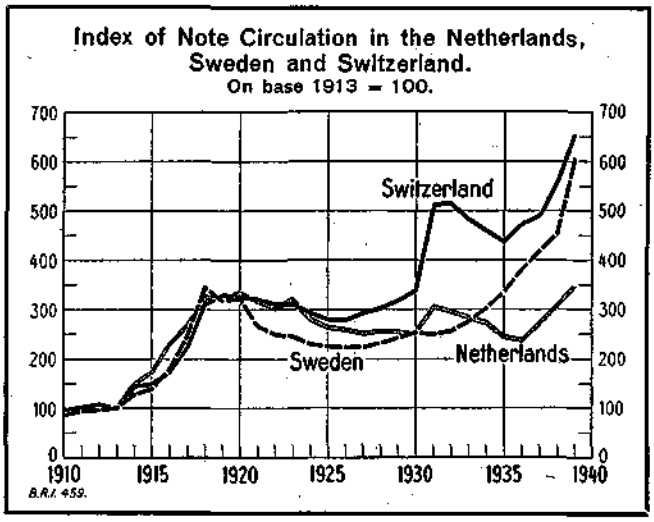
Index of Note Circulation in National Currencies.
On base 1929 = 100.

the note circulation. In the case of the United States and Canada some part of the increase in note circulation during the latter half of 1939 was no doubt due to the rise in industrial activity and the growth in consumers' income.

Notes which are hoarded do not for the time being enter into active circulation; this explains why the sudden upward leaps in the volume of notes, especially in the autumn of 1939, have of themselves had little effect on the actual demand for goods and services. As long as confidence in the stability of a currency remains — and an increased hoarding of notes ought to be a sign of such confidence — there is no reason to fear an inflationary effect as a result of hoarding, which, in a certain degree, may even be an expression of current savings. Should panic-scale buying set in, however, the fact that considerable amounts of notes are already in the hands of the public makes it less easy to check an expansion of active purchasing power than when savings are held as bank deposits or in the form of more permanent investments. One effect of the propensity to hoard, and also of the greater holding of notes generally, is that changes in note circulation no longer form a reliable index of the presence or absence of inflationary tendencies. It then becomes all the more important to consider the general effects of extensions of credit for governments and other borrowers. Inflationary tendencies may be offset by forces acting in the opposite direction, as is the case, for example, when monetary reserves are used for foreign payments, or the inflationary pressure is counteracted by direct control of costs and commodity prices and by appropriate methods of government borrowing designed to recapture for the state any excess of monetary purchasing power in the hands of the public.

The amount of notes hoarded is, of course, difficult to indicate with exactitude, but some general estimates are available. In the Annual Report of the Bank of France for 1939 it is said that of approximately Fr.fcs 25,000 million in notes put into circulation between 17th August and 17th September 1939, constituting a 20 per cent. increase in circulation, the greater part went into emergency hoards of private persons. The President of the Board of the Swiss National Bank said in his speech to the General Assembly of the Bank that the volume of domestic and foreign hoarding of Swiss notes was at least Sw.fcs 600 million at the end of 1939, out of a total circulation of Sw.fcs 2,050 million.

It is of some interest to point out that hoarding of bank-notes on a large scale is a relatively recent phenomenon. After the wild inflations in the period following 1914–18 a substantial volume of bank-notes, especially dollars and sterling, was no doubt hoarded by the public in many countries on the continent of Europe; but the subsequent stabilisations of currencies produced a certain reflux as monetary confidence gradually increased. After the depreciations in 1931 the propensity to hoard again made itself felt, reflected, inter alia, in the abrupt rise in the Swiss note circulation in 1930–31. As the graph shows, there was a remarkable similarity in the trends of the note circulation in the Netherlands, Sweden and Switzerland from 1910 to 1930. Thereafter the divergence in the movements is striking, affected as they have been by differences in the extent to which the notes of these countries were subject to hoarding, in the trend of economic activity and in the degree of depreciation sustained by the three currencies. In Sweden and Switzerland the amount of notes outstanding at the end of 1939 was about twice as high as in the years 1918–20, while in the Netherlands the note circulation at the end of 1939 was practically the same as in the earlier period.



In a number of countries an expansion of the note circulation in 1939 was carried through without difficulty by the simple conversion of large amounts of cash held with the central bank in the form of deposits already owned by private credit institutions. Thus in Switzerland, for example, the deposits held with the Swiss National Bank were drawn down Sw.fcs 317 million between 1st August 1939 and the end of the year, while the note issue rose by Sw.fcs 309 million over the same period. In the same way the expansion in the Federal Reserve note circulation in the United States was easily effected out of the excess reserves of the banking system.

Even where the credit system as a whole had sufficient cash at its disposal, however, there were often institutions, as e. g. savings banks in exposed areas threatened with evacuation, which needed assistance. It also happened that not all commercial banks were able to grant from their own resources the credits which would have enabled their customers to increase their stocks of commodities or to finance their import or export trade through domestic institutions rather than by credit accommodation obtained from abroad. For these reasons central bank discounting and rediscounting facilities were called upon to enlarge the supply of credit.

In addition to these methods of credit expansion, borrowing facilities for governments under existing or amended regulations provided in many instances the basis for the increase in note circulation. Occasionally — as in the Netherlands — borrowing by the government could take place within the existing legal framework which fixed the relations between the government and the central bank. Frequently, however, it was found necessary, either as a result of the war itself or even prior to the outbreak of war, to render the existing regulations less stringent in order to increase the government's ability to obtain funds from the central bank, whether directly or indirectly through open-market operations.

The French Government, for example, by a decree of 1st September 1939 approved and put into effect the provisions in the convention of 29th September 1938, under which advances up to Fr.fcs 25 milliard were to be made available by the Bank of France to the Treasury at the time of general mobilisation, the rate of interest being one per cent., to be raised to 3 per cent. one year after the cessation of hostilities. Of this interest payment, the Bank is to retain ½ per cent. as reimbursement for expenses, and the remainder is to be paid in the first place into a special reserve account and thereafter returned to the Treasury. In the further convention between the Bank of France and the French Treasury of 29th February 1940 a new advance up to Fr.fcs 20 milliard was agreed upon in the form of negotiable Treasury bills, carrying no yield while held by the Bank, but receiving interest at market rates when sold. The Bank of France also receives ½ per cent. to cover the costs of this accommodation. In Germany the law of 15th June 1939 concerning the German Reichsbank had already, prior to the war, abolished the fixed limits of RM 100 million for the working credits to the Finance Ministry and RM 400 million for the discounts of Treasury bills and had left it to the Führer and Reich

Chancellor to determine the new limits. In Switzerland the Board of the National Bank increased the upper limit of the discount of the Swiss Government on 15th September 1939 as a precautionary measure. In Belgium amendments to the statutes of the National Bank of 23rd September 1939 (in accordance with the Royal Decree of 24th August) gave the National Bank power to discount, buy and sell short or medium-term paper issued or guaranteed by the Belgian State, by the Congo Colony or by the Grand Duchy of Luxemburg, and to buy and sell national securities issued at long term and quoted on the stock exchanges to an amount of B.fcs 5,000 million as compared with B.fcs 500 million previously. In addition, the National Bank was empowered to buy public securities up to an amount corresponding to its capital reserves and amortisation funds.

Similar changes took place in other countries. In February 1939 when the statutes of the Bank Polski were amended, the Board obtained increased powers to make advances to the government against securities and to discount Treasury bills, and at the end of August these powers were further extended. In Yugoslavia decrees of 24th August and 16th September 1939 widened the powers of the National Bank to lend to the government in the form of advances and discount facilities. In Lithuania the law of the Lietuvos Bankas was modified on 10th November 1939 to permit further investment by the Bank, up to two-thirds of its capital stock, in government bonds of not more than twelve months' maturity. In Spain a decree of 9th November 1939 giving the notes of the Bank of Spain the quality of legal tender was accompanied by another decree permitting the Bank to acquire and sell government securities, subject to the direct control of the Ministry of Finance. Finally, far from the influence of the war, a decree issued late in the spring of 1940 authorised the Bank of Brazil to discount notes of the Brazilian Government up to 370,000 contos, to cover the balances in the accounts of the fiscal year 1939.

The increased demand for internal liquidity in these countries coincided in many cases with measures to introduce foreign exchange control or to tighten such control where it was already in force. It was generally felt that liquid foreign assets, particularly gold and foreign exchange, could be more usefully employed for foreign payments than as internal backing for the note circulation. In the United Kingdom, immediately after the outbreak of the war the Chancellor of the Exchequer announced on 6th September that the Bank of England would transfer almost its entire gold stock to the Exchange Equalisation Account, at the same time raising the fiduciary issue from £300 million to £580 million and abolishing all limitations of the Exchange Equalisation Account's powers to borrow against Treasury bills. A similar transfer of gold and foreign exchange from the Bank of Canada to the Canadian Foreign Exchange Control Board took place in early May 1940 to the amount of $250 million. In France the statutory 35 per cent. gold cover for the note circulation was suspended at the outbreak of war, and at the time of the convention between the Bank of France and the French Treasury in February 1940 Fr.fcs 30 milliard of gold was transferred from the Bank of France to the Exchange Stabilisation Fund against negotiable bills which may be sold or repurchased on the open market. In Germany the law of 15th June 1939 regarding the German Reichsbank finally relieved the Bank of its obligation (previously in suspense) to redeem its notes in gold and foreign exchange and provided that reserves in gold and foreign exchange should be held to the amount that the Reichsbank deemed necessary to provide for the settlement of payments abroad and the maintenance of the value of the currency. In Sweden, a law of 22nd December 1939 changed certain provisions in the law of the Riksbank, and on 31st January 1940, on the basis of these powers, the primary cover of the note circulation, which had previously been limited to gold at home, was extended to comprise also gold abroad, thus permitting the Riksbank to place further amounts of its gold under earmark abroad. In Roumania a decree of 6th September 1939 reduced the statutory 35 per cent. gold and foreign exchange cover of the National Bank to 25 per cent. in gold alone. A government decree of 25th April 1940 permitted the National Bank of Bohemia and Moravia, when computing its statutory ratio of 25 per cent., to deduct from the note circulation and other sight liabilities, coin and small paper currency denominated in crowns including Treasury notes for Kr. 100 and, in addition, means of payment in German currency and certain other Reichsmark assets.

In a number of other countries the legal restrictions of the note issue have also been liberalised. Thus on 13th December 1939 the right of the Bank of Finland to issue notes not covered by gold and foreign exchange was extended by FM 1,800 million in excess of the previous limit. In Japan where the fiduciary issue of the Bank of Japan had been increased from Yen 1,000 million to Yen 1,700 million on 1st April 1938, a further increase to Yen 2,200 million was authorised on 1st April 1939. In December 1939, however, the average note circulation exceeded the amount of the fiduciary note issue plus roughly Yen 500 million in gold held by the Bank of Japan, and under the existing provisions the Bank was then required to pay a 3 per cent. tax to the Treasury on the amount of excess note issue. In Poland the fiduciary issue was raised in early August 1939 to Zl. 1,000 million in agreement with the Minister of Finance and in accordance with the procedure provided for by the amendments in the statutes of February 1939, which fixed this limit at Zl. 800 million. In Lithuania an amendment made on 10th November in the statutes of the Lietuvos Bankas gave the Bank the right to issue notes for Litas 36 million over and above the amount of the note circulation which is covered as to one-third by gold. By a decision of the Egyptian Cabinet in September 1939 the National Bank of Egypt was given the right to use certain Egyptian as well as British securities as cover for the issue of bank-notes. Finally, in Iran a bill was introduced in March 1940 to raise the total limit of note circulation from Rial 1,176 million to Rial 1,500 million and the National Bank was authorised to utilise the crown jewels as cover, without, however, being permitted to sell them.

The increase in the amount of notes a central bank could issue was, however, in some instances brought about through a revaluation of gold holdings. The gold stock of the Bank of France had been revalued on 12th November 1938 at a price of Fr.fcs 40,404 per fine kilogramme (equivalent to a rate of Fr.fcs 35.8 to the dollar). Through the convention of 29th February 1940 already mentioned above, the gold stock of the Bank of France was again revalued at a new rate of Fr.fcs 47,605 or at almost the same price (Fr.fcs 47,608) as had been set by the Bank each day since 13th September 1939 (at the latter price the parity against the dollar works out at Fr.fcs 42.41 according to the U. S. Treasury's net purchase price for gold and the price for gold bought in Paris, whereas the official selling rate of the dollar, i. e. the rate for gold in New York, was Fr.fcs 43.80). The book profits from the revaluation, the fourth undertaken since the devaluation in 1936, amounted to about Fr.fcs 17,300 million, which, together with around Fr.fcs 3,000 million from the resources of the Exchange Stabilisation Fund, were ceded to the government to be used for repaying to the Bank of France temporary advances granted between 1936 and 1938.

On 31st March 1940 the gold stock held by the Nederlandsche Bank was revalued at a price equivalent to the depreciation of the currency by about 18 per cent., compared with the actual 22 per cent. depreciation of the guilder against the dollar. Out of the revaluation profits the government received Fl. 132.5 million and the Nederlandsche Bank Fl. 13.9 million, which were used to the extent of Fl. 7.6 million to write off remaining losses on sterling (from 1931), the balance of Fl. 6.3 million being utilised to replenish the Bank's open reserve. At the end of February 1940 the Minister of Colonies of the Netherlands proposed a similar revaluation for the Fl. 133 million gold stock of the Bank of Java.

When on 31st January 1940 the Swedish Government, in virtue of the law of 22nd December 1939, amended the provisions regarding note cover for the Riksbank, the gold holdings of the Bank were calculated at the current value of S.Kr. 4,726 per kilogramme as compared with the parity value of S.Kr. 2,480, but only for the purposes of calculating the right of note-issue. Actually no formal revaluation took place and hence no formal "profit" was made available. On the weekly statements of the backing for the note circulation of the Riksbank gold has been entered at the current value, whereas on the monthly balance sheets the old valuation has been retained. On 5th October the National Bank of Yugoslavia was permitted, in computing its ratios of gold cover to note circulation and sight obligations, to calculate the value of its gold at the actual dinar value, involving a premium of 60 per cent. above the "stabilised" dinar value compared with the premium of 28½ per cent. at which gold was carried. In the balance-sheet of the National Bank, however, no revaluation of the gold holding was shown.

The changes in central bank regulations and practices indicated above have been associated with the urge for liquidity, the pressure on government finance and increased foreign payments, but changes were also made for other reasons during the year, as e. g. in connection with jurisdiction over areas affected by the war, increase in government control, etc.

A German decree of 5th September provided for the transfer of the management of the Bank of Danzig to the Reichsbank and also made provision for the liquidation of the Bank. On 11th September the Bank ceased issuing gulden notes and its office began operations as a branch of the Reichsbank.

After the outbreak of hostilities between Germany and Poland on 1st September the Bank Polski was evacuated from Warsaw on 5th September. Its gold stock and part of its personnel having been transferred to Paris, the Bank was reopened for business on a modified basis in that city during the month of October. In the territory of Poland occupied by Germany, Reichskreditkassen were organised under the management of the Board of Reichskreditkassen established in Berlin on 26th September 1939. Originally these Reichskreditkassen issued their own notes denominated in Reichsmarks to replace the zloty notes in circulation. When later a distinction was made between the districts of Poland incorporated into the German Reich and those placed under the Governor-General, the Reichskreditkassen in the districts incorporated into the Reich were transformed into branches of the Reichsbank. From 20th November the German provisions regarding foreign exchange control were applied to these districts; Reichsmark currency was introduced by a decree of 22nd November; on 27th November the zloty ceased to be legal tender and on 21st December the German Reichsbank Law was introduced. In the Governor-Generalship a decree of 15th December provided for a Bank of Issue in Poland. Until this Bank was opened in April 1940 Reichskreditkassen operated on a zloty basis with a head office first at Lodz and then at Cracow. The new Bank is directed by a Polish president and deputies appointed by the Governor-General, together with a German Bankdirigent, who has power to grant or withhold approval of the operations of the Bank, especially with regard to the opening of credits and the fixing of interest rates. The Bank issues its own notes denominated in zlotys, the former Bank Polski notes and the notes of the Reichskreditkassen being gradually withdrawn. A distinction is made between notes of the new Bank exchanged for old zloty notes and those placed in circulation as a result of the Bank's own operations. Notes of the latter category will be covered by the loans and discounts which give rise to their issue and by the Bank's holdings of German means of payment in the form of Reichsbank notes, balances with the Reichsbank and balances with the Clearing Office in Berlin. The notes exchanged for those of the Bank Polski are to be covered by a special mortgage up to the amount of Zl. 3,000 million on all real estate in the territory, with priority over all taxes and other charges.

The trend towards government control of central banking has naturally been accentuated by the exigencies of the war and may be illustrated by the emergency powers given to governments to make changes by decree in central bank regulations, as under the Defence (Finance) Act in England and the enactments of the law of 22nd December in Sweden. The German Reichsbank Law of 15th June 1939 contains the provision that the Bank is to be managed and directed in accordance with and under the direct supervision of the Führer and Reich Chancellor, a provision which incidentally gives the Bank equal status with the various government departments. By the same law the name of the Bank was altered from the Reichsbank to the German Reichsbank; holdings of shares were restricted to German nationals eligible for citizenship and to legal persons or concerns within the German Reich. Within the Bank itself the position of the President was strengthened by his being given the decisive voice on the Board of Directors. The former Central (Advisory) Committee of the shareholders was replaced by an Advisory Council, which serves as a link with German trade and industry.

Further changes were made in the statutes of the German Reichsbank on 30th September 1939 covering a number of minor matters including the management of branches, the rights of shareholders, the procedure for the annual meeting and so forth. The terms were fixed for the constitution of the Advisory Council and provision was made for the establishment of Regional Advisory Councils associated with the more important branch offices of the Bank. At a meeting of the Advisory Council on 29th October 1939 a general committee was formed and in addition special committees for credit, capital market, stock exchange, currency and foreign trade.

The tendency to increase government control over the central bank, which began to make itself felt in New Zealand in 1935, reached its culmination in the Reserve Bank of New Zealand Amendment Act of 1939, passed as a part of the war finance legislation. This Act requires the Governor and the Bank Board to give effect to government decisions, empowers the Minister of Finance to suspend or vary the reserve ratio and authorises the revaluation of the Bank's gold to market value and the holding of the profit thereon in a special reserve on behalf of the government.

In Bolivia nationalisation of the central bank was decreed by the government at the beginning of August and came into effect in the middle of the month. The government formerly owned 70 per cent. of the shares of the Bank; the remaining 30 per cent. owned by private shareholders was now repaid at par and the dividend reserve fund was distributed, the 30 per cent. due to private shareholders being taxed at a rate of 20 per cent. The Bank is under the direction of a Board of 12 members consisting of a President appointed by the government, six representatives of the government and one representative each from mining, manufacturing, agriculture, trade and private banking. Credits in favour of the government and public undertakings are to be arranged by the Bank through the Minister of Finance and will be granted only when in the opinion of the directors adequate funds are available and their use for this purpose does not affect monetary stability. A revaluation of the gold holdings of the Bank was undertaken in virtue of a decree of 5th September 1939, changing the basis of the valuation from Bs. 80 to Bs. 120 to the £, at the sterling price for gold of 148s. The proceeds of the revaluation were used partly to pay off the private shareholders, partly to cover extraordinary expenses of the government and partly to increase the capital of the Bank from slightly over Bs. 25 million to Bs. 50 million.

The transformation of the National Bank of Egypt into a central bank has made further progress during the year. In June 1939 the stockholders of the Bank unanimously voted in favour of the proposed change. In March

1940 the Chamber of Deputies approved the settlement of the note issue privilege of the Bank for a period of 40 years and the Minister of Finance announced his intention to bring in a law in the near future authorising the complete transformation of the Bank into a central bank. In April 1939 the general meeting of the Bank of Brazil approved a decision taken in 1936 to increase the Bank's capital from 100,000 to 200,000 contos, of which one-half is to be contributed by the Federal Government. At a meeting of the Governors of the 21 Brazilian States at the end of November 1939 the Federal Minister of Finance announced that steps would be taken to convert the Bank of Brazil into a central bank with the aid of the gold held by the Brazilian Government and the Bank of Brazil in Rio de Janeiro and further gold purchased from the U. S. Treasury and held in the United States.

Cooperation among central banks has, of course, been interrupted for the time being between the institutions of the belligerent countries, but in other directions some developments are to be found, largely regional in character. In January 1939 the Governors of the national banks of the Balkan Union (Yugoslavia, Roumania, Greece and Turkey) met in Belgrade to discuss technical financial questions of common interest and arranged for closer collaboration in the financial sphere. On 14th and 15th October 1939 meetings took place in Copenhagen between representatives of the central banks of Denmark, Finland, Iceland, Norway and Sweden. Akin to this regional cooperation among central banks, although different in form, have been the conferences among representatives of the 21 American Republics, which have led to the establishment of an Inter-American Economic and Financial Advisory Committee maintained in Washington for the discussion of problems of trade and finance arising from the war in Europe. This Committee was established by a resolution of a meeting of Foreign Ministers of American States, which took place in Panama in September 1939; acting in accordance with a further resolution adopted by a Pan-American Conference of Treasury Department Representatives in Guatemala in November, the Committee has drawn up plans for the establishment of an Inter-American Bank. The main purposes of this Bank are to stimulate trade between the countries of Latin America and the United States, to increase intra-hemisphere investment, to assist in maintaining the currencies of the participating countries and to undertake research on problems of public finance, exchange, money and banking as they relate specifically to the problems of the American Republics. Under the draft plan the powers of the Bank include the following: to make loans at short, medium or long term in gold or in any currency to governments and to their central banks, political subdivisions and nationals, provided that all loans carry the guarantee of the government concerned; to buy, sell and deal in obligations and securities of participating governments not in default, and in undefaulted securities guaranteed by them; to guarantee loans; to act as a clearing house; to issue securities or debentures; to accept deposits from participating governments and others, provided that the government concerned makes no timely objection, and so forth.

The capital of the Bank will be $100 million with shares of $100,000 each to be subscribed in proportion to the total dollar value of the foreign trade of the Republics in 1938, but no country is to hold more than 50 shares. The Bank will not become operative until at least five governments subscribing as many as 145 shares ratify the convention for the establishment of the bank. On 11th May 1940 the convention was signed by Colombia, the Dominican Republic, Ecuador, Mexico, Nicaragua and the United States. Since these countries were committed to the subscription of more than the minimum number of shares of the Bank's capital, the work of drafting the definite instrument for the Bank has begun.

In the plan for the Inter-American Bank a considerable part is allotted to the governments, as regards both the direction and the transactions to be undertaken; and the establishment of this Bank thus provides another example of the tendency to increase government influence in the sphere of central banking. In European countries this tendency more clearly reflects the urge to strengthen government authority in times of national emergency when monetary policy becomes increasingly subordinated to the immediate needs of the state. Although the formal independence of central banks — as part of the system of safeguards which has gradually been developed to guarantee monetary stability — is generally reduced by these emergency measures, the actual field of activity of most central banks is perhaps rather expanded. In so far as authority tends to be centralised in times of great difficulty, the central banks acquire new functions to perform, which they, by reason of their close association with money and exchange markets, are better fitted to carry out than the ordinary government departments. Moreover, the part which central banks play as advisers to their governments assumes greater importance. When government control is extended to previously unregulated sections of the national economy and pressing fiscal and financial problems have to be solved, the central banks, with their specialised knowledge, become an indispensable adjunct of government, owing to the intricacy of the problems involved and the indissoluble connection between economic and financial policy.

VII. CURRENT ACTIVITIES OF THE BANK.

1. OPERATIONS OF THE BANKING DEPARTMENT.

The balance sheet of the Bank as on 31st March 1940, examined and found correct by the auditors, is reproduced in Annex II to the present Report. It shows a total of 469.9 million Swiss gold francs (units of 0.2903 grammes of fine gold) against 606.5 million on 31st March 1939. No change has been made during the year in the method of conversion into Swiss gold francs of the various currencies in which the Bank's assets and liabilities are denominated. As before, the calculation is based on the U. S. Treasury's official selling price for gold and on the exchange rates quoted for the various currencies against dollars on the date of closing of the Bank's accounts. It is true that, in terms of our statutory unit of account, the value of certain currencies on 31st March 1940 differs appreciably from their value on 31st March 1939. But the relative importance in the latest balance sheet of the currencies thus affected is extremely slight, so that the figures in Swiss gold francs on the two dates in question may be considered as fully comparable.

In the preceding two years the movements of the Bank's resources were already determined by the development of factors influencing the international political situation. The events of 1939, and more especially those of September last, could hardly fail to emphasise this correlation.

In the year under review, deposits entrusted to us by central banks were again the only variable item on the liabilities side of the balance sheet, apart from the withdrawal of the French Government Guarantee Fund. The deposits of central banks showed a more or less regular decline until the end of October. They then regained ground up to 31st December, to fall to their minimum at the end of February 1940 and finish the financial year at approximately the level recorded at the end of January.

Up to the end of last year the volume of the gold held with or by the Bank followed a course almost exactly parallel to the movement of currency deposits of central banks, except that the rise in November and December was much less marked. A continual drain took place during the first three months of the new year and the minimum was reached on 31st March 1940. These changes are shown in the first table on the following page.

On 31st March 1940 deposits of central banks for their own account actually represented less than a quarter of their volume of a year before. On the other hand, earmarked gold (not entered in the balance sheet) amounted to about one-third of last year's figure. Thus current events have considerably reduced the assets entrusted to the Bank.

The volume of current operations has not, however, been reduced to the same extent. An analysis of total operations effected is given in the

In millions of Swiss gold francs	1939							1940
	31st March	30th June	31st July	31st August	30th Sept.	31st Oct.	31st Dec.	31st March
Deposits of central banks for their own account:								
Sight	46.3	87.6	79.0	21.6	28.4	17.5	46.4	32.0
Not exceeding 3 months . . .	97.2	34.5	35.7	32.2	11.8	2.7	0.1	—
Total . .	143.5	122.1	114.7	53.8	40.2	20.2	46.5	32.0
Gold deposits . . .	9.7	13.3	14.4	14.1	10.7	10.7	10.3	12.9
Bank's own gold stock	29.0	49.3	41.4	14.5	5.8	6.8	12.3	17.6
Earmarked gold not entered in the balance sheet	236.7	172.3	193.7	135.4	101.2	89.8	89.0	73.2
Total . .	275.4	234.9	249.5	164.0	117.7	107.3	111.6	103.7

following table, in comparison with the development in the preceding two years, the total volume of operations in 1937–38 being represented by 100:

In percentages of total volume of operations 1937–38	Financial year 1937–38	Financial year 1938–39	Financial year 1939–40
Movements on deposit accounts . . .	47.4	49.1	59.0
Foreign exchange transactions	7.1	12.6	9.8
Purchases, sales and exchanges of gold	23.1	32.6	18.7
Movements of earmarked gold	22.4	42.7	31.5
Total . . .	100.0	137.0	119.0

The total volume of the Bank's operations in 1939–40 thus corresponds approximately to the average for the preceding two years; the development of movements on deposit accounts is significant and the volume of gold operations, although lower by about one-third than in the financial year 1938–39, is higher than two years ago. Moreover, the conditions under which these operations were effected in the year under review made them appreciably more profitable for the Bank, while every precaution was taken to reduce to a minimum the risk attaching to activities directly connected with the unusual requirements which certain central banks experienced as a result of political developments.

A comparison of the principal items of the Bank's balance sheet on 31st March 1939 and on 31st March 1940 calls for the following observations:

1. Liabilities.

The total of long-term deposits has fallen from 255.2 million Swiss gold francs on 31st March 1939 to 229.6 million on 31st March 1940. On the latter date the Annuity Trust Account Deposits and the German Government Deposit were the only remaining items. The French Government Guarantee Fund was repaid during September 1939, since there appeared no further need to maintain it under the terms of Art. 199 of the Annexes to the Young Plan. By the arbitral award given on 30th January 1935 the value of the Fund had been fixed at about Fr.fcs 305 million.

The first table on the preceding page shows the movement of deposits constituted by central banks in currencies for their own account. The attitude of these depositors has not been uniform: since August certain central banks have withdrawn the whole of their deposits; others have progressively reduced their holdings or have left with us balances which are still comparatively large. Already before September a regrouping process had begun in the accounts of certain institutions, which have, in particular, put an end to a number of inactive deposits. On the other hand, since the beginning of September the Bank has received certain new deposits which seem likely to be of a permanent nature, while it has been entrusted with a number of operations in which its rôle has been principally that of an intermediary for the movement of funds.

Current events have also led certain institutions on the continent of America to cut down their commitments and holdings in Europe as far as possible. There has been a consequent decrease in the Bank's resources, together with the disappearance from both sides of the balance sheet of the items "Guaranty of central banks on bills sold" and "Guaranty on commercial bills sold", which represented sales of bills from our portfolio in connection with the special employment of certain deposits in currencies.

It is to be noted that deposits of central banks for their own account are now solely in the form of sight accounts. Deposits for a term not exceeding three months followed a regular downward course and appeared for the last time — at an insignificant figure — in the Bank's statement of account on 31st December 1939.

Deposits of central banks for the account of third parties, which throughout the year have taken the form of sight accounts, have not fluctuated to any great extent. From 1.8 million Swiss gold francs on 31st March 1939 they declined to 1.6 million on 31st March 1940, after having reached their maximum at 2.0 million on 31st July 1939 and their minimum at 1.1 million on 31st January 1940.

A much larger decrease has taken place in the deposits of others than central banks. The level reached on 31st March 1939, 4.4 million Swiss gold francs, was the maximum figure for the financial year; the figure recorded on 31st March 1940, 1.1 million, would have been the minimum for the financial year, but for a temporary fall to 0.7 million on 31st August 1939.

Rather larger fluctuations have occurred in bank deposits expressed in a weight of gold, which rose from 9.7 million Swiss gold francs on 31st March 1939 to 14.4 million on 31st July, the maximum for the financial year. They reached their minimum of 10.3 million on 30th November, since when a slow but regular advance has brought the figure to nearly 13 million Swiss gold francs on 31st March 1940. This total includes time deposits, amounting to 1.8 million, which item appeared for the first time in January 1940.

As in past years, these gold accounts have continued to play a not unimportant part in connection with the settlement of international postal transactions through the Bank, as well as with operations for the adjustment or transfer of foreign exchange, sometimes in very small amounts, which it would have been difficult to handle otherwise. During the year we suggested to the central banks which kept gold sight accounts in our books, for the purpose of settling international postal payments, that they should temporarily substitute delivery Berne for delivery London, to ensure a smooth working of the system even in the difficult circumstances prevailing at present.

As regards the settlement both of international postal payments and of payments between telephone and telegraph administrations, the Bank has continued to effect operations entailing transfers between currency accounts and the utilisation of the deposit accounts expressed in a weight of gold opened for the central banks of the countries concerned. Creditors and debtors applying the latter method need not, as explained in more detail in last year's Annual Report, agree beforehand upon a currency for the settlement and conversion of the amounts to be paid in gold francs. Payments are made by a mere transfer to the weight-of-gold account in question; nor is there any need for an actual movement of gold. The safety, cheapness and speed offered by the new system have led to an increase, during the year, in the number of administrations and central banks which have adopted it. The volume of movements on the accounts concerned has been distinctly larger than in the preceding year; the payments for which the gold deposit accounts have been employed have considerably exceeded those for which previously currency accounts alone were employed, and such payments have continued to be made regularly after the outbreak of hostilities.

2. Assets.

The following table shows the movement, on certain characteristic dates during the year, of the items making up the total of the Bank's easily realisable assets:

In millions of Swiss gold francs	31st March 1939	30th June 1939	31st Oct. 1939	31st March 1940
Gold in bars	38.8	62.6	17.5	30.6
Currency reserve	23.6	23.1	15.9	34.8
Sight funds	32.7	22.4	13.8	16.3
Rediscountable portfolio:				
Bills and acceptances	142.2	144.5	109.5	93.5
Treasury bills	74.7	80.9	48.5	68.4
Total	312.0	333.5	205.2	243.6

Generally speaking, it will be found that the variations in the total of the Bank's easily realisable assets correspond more or less to the changes in the total of its resources. Between the total in the return for 30th June 1939, 589.3 million Swiss gold francs, and the corresponding total in the return for 31st October, 452.3 million, the difference is 137.0 million Swiss gold francs, while the difference between the totals of the Bank's easily realisable assets on the same dates is 128.3 million. Thus the attention to maximum liquidity, which has been a fundamental principle in all the Bank's operations, as well as the maintenance of a considerable liquidity surplus, have given proof of their expediency; thanks to the strict adherence to these liquidity principles, the Bank has at no time been obliged to have recourse to the additional ready-cash facilities which it had secured with a majority of its correspondents.

The movement of the above items of the balance sheet calls for the following observations:

The figures given in the table for gold in bars correspond approximately to the widest movements registered under this heading in the course of the financial year. The maximum actually occurred on 31st May 1939 at 64.7 million Swiss gold francs, and the minimum on 30th September at 16.5 million. Between these dates the movement was regular: increase from March 1939 to May, decline from May to September, new increase from September to March 1940.

The Bank's own gold stock, representing the surplus of its holding of gold in bars over its commitments expressed in a weight of gold, fluctuated in the proportions shown in the first table on page 148 above. A maximum was reached on 31st May, with 51.5 million Swiss gold francs; there was a steady decline to 5.8 million on 30th September, followed by an equally regular rise to 17.6 million on 31st March 1940. The average of the five last months of the financial year, however, has barely exceeded 15 million Swiss gold francs, this being equivalent to less than 5000 kilogrammes of fine gold.

Precautionary measures and self-imposed limitations have made it possible for the Bank to compress its total stock of gold to the minimum volume specified above; but experience in connection with its gold operations has shown that the maintenance of a stock of such a size is only just sufficient to enable the Bank to meet all the demands made upon it. In the preceding Annual Report, at a time when many of the present problems had not arisen, it was estimated that the maintenance of a stock averaging at least 25 million Swiss gold francs was desirable.

During the year the Bank's gold stock has retained the rôle described in the preceding Annual Report: its existence permits the gold operations undertaken for account of central bank clients to be effected in the best possible conditions. Furthermore, the distribution of the Bank's own holdings in gold on various markets and the maintenance of certain minima serve the purpose of making cash margins available, where necessary, or providing special reserves by means of which some of the risks and delays entailed in shipments of gold effected for the Bank's own account can be avoided.

The Bank's currency reserve has likewise fluctuated fairly considerably during the year. From 23.6 million Swiss gold francs on 31st March 1939 it fell to the very low level of 6.8 million on 31st May, amounted to some 27 million at the end of August and the end of September, declined again to 15.9 million on 31st October and, rising once more, reached an amount of more than 50 million, the maximum for the year, on 31st December 1939. The highest figure recorded since then is 34.8 million, on 31st March 1940.

Sight funds invested at interest have shown, on the whole, a fairly steady tendency to decline since the beginning of the financial year; 32.7 million Swiss gold francs, the figure registered on 31st March 1939, was the maximum for the financial year, the minimum being recorded on 28th February 1940, at 10.4 million. The figure for 31st March 1940, 16.3 million, is higher than the average of the preceding eight months.

The movements of the rediscountable portfolio have been rather characteristic. From 216.9 million Swiss gold francs on 31st March 1939, the figure rose slowly to 228.1 million on 31st July, fell to 177.2 million on 31st August, 176.1 million on 30th September and further declined to 158 million on 31st October, from which figure it has varied only slightly up to 31st March 1940, when it amounted to 161.9 million. Whereas the proportion of bills of exchange and bank acceptances to Treasury bills was approximately two to one on 31st March 1939, a reversal of the ratio was apparent on 30th November and the tendency to hold relatively more Treasury bills reached its peak on 31st January 1940 when bills of exchange amounted to 57.8 million Swiss gold francs while Treasury bills totalled 101.8 million. By 31st March 1940 the portfolio had resumed a more normal aspect; bills of exchange totalled 93.5 million against 68.4 million in Treasury bills.

Time funds invested at interest fluctuated to an appreciable extent only from October. On 31st March 1939 they totalled 32.8 million Swiss gold francs; they went up to 35.6 million on 31st August and still amounted to 33.0 million on 30th September. Later they declined to 8.6 million on 28th February 1940 but recovered to 17.4 million on 31st March.

The volume of sundry bills and investments declined, between 31st March 1939 and 31st March 1940, from 258.7 to 206.6 million Swiss gold francs. These two figures represent the maximum and minimum for the financial year. On the two dates this item was made up as follows:

In millions of Swiss gold francs	31st March 1939	31st March 1940
Maturing within 3 months	126.3	110.1
Between 3 and 6 months' maturity	63.9	80.0
Over 6 months' maturity	68.5	16.5
Total . . .	258.7	206.6

Thus the proportion of investments maturing within three months to the total of investments was higher on 31st March 1940 than on 31st March 1939, and investments at more than six months represented only 8 per cent. of the total on 31st March 1940 against 26 per cent on 31st March 1939.

* * *

Under the influence of the events occurring in the latter half of 1939, the range of problems which the Bank had to face has been more complex than previously. Considerations of yield have had to take second place in comparison with questions of safety and liquidity. The changes which have occurred in the relations between leading currencies called, moreover, for an even more rigid observance of the rules regarding the supervising and the greatest possible limitation of the exchange positions which the Bank, by the structure of its assets and liabilities, was obliged to maintain in gold or in currencies with regard to which we have received a gold commitment by our debtor.

A number of other problems entailed by the state of belligerency between various countries: the delays which, in the nature of things, occurred in the execution of most transactions, and questions arising in relation to countries whose status had been changed, confronted the Bank with a number of difficulties. It is satisfactory to be able to state that these difficulties have been surmounted with due regard to the interests both of the Bank and of its clients. The guarantees and assurances which the Bank procured in this connection and the goodwill and sympathy shown by the central banks directly or indirectly concerned with these problems were in each case of great assistance in arriving at the most satisfactory solution possible in the circumstances.

As a consequence of the events of September the Bank was obliged to take certain decisions regarding the principles governing its operations. Apart from decisions of a more or less internal order, arising automatically out of the need to maintain a high degree of liquidity to meet the extreme contingency of a complete withdrawal of the deposits entrusted to the Bank, the nature of the Bank's position led it to adopt certain new rules of conduct. The Bank for International Settlements maintains business relations with most central banks. These relationships make it imperative that the Bank should undertake only such operations as are irreproachable from the point of view both of the belligerent and of other countries. In December 1939 certain rules of conduct which the Bank had, as a matter of fact, observed since the month of September were codified and brought to the knowledge of its clients.

* * *

As appears from the second table on page 148 above, the volume of the Bank's gold transactions during the year under review was slightly smaller than in the preceding year. But the special circumstances in which these transactions were effected give them a greater significance, perhaps, than in the past. They were particularly numerous during the first months of the financial year. The total volume of the transactions in question amounted to the equivalent of some 400 million in April and to 300 million Swiss gold francs in May 1939. The decline which afterwards set in became particularly noticeable from December 1939. As a matter of fact, the proposals and requests which the Bank received all through the financial year were concerned with operations almost exclusively in one direction: transfers of gold for account of central banks had nearly all as their destination the only market which remained free for sales of gold, New York. From the second half of September onwards it became more and more difficult to make shipments of gold and to arrange for insurance against war risks. Moreover, the measures taken in the great European money markets with regard to gold dealings made transactions in gold difficult and even uncertain. Institutions wishing to realise gold earmarked at the Bank for International Settlements had therefore to ship it to New York. The insurance rates covering war risks on neutral vessels rose very considerably with the result that the total costs for a shipment of gold between Europe and America on certain occasions reached 4 per cent.

Consequently, most of the operations which the Bank was asked to effect consisted either in exchanging gold deposited in Europe for gold in New York, or in direct purchases of such gold against dollars, or in taking steps to expedite in some way or other the realisation of such gold against foreign exchange — in the large majority of cases, against dollars. To the extent to which it was possible for the Bank, in connection with some isolated operations affecting gold already deposited with it before September 1939, to enter itself as counter-party, it was able to expedite, for certain central banks of neutral countries, the process of realisation or transfer of the gold in question. Thus the Bank had occasion — increasingly as time went on — to choose between different routes and to negotiate for the execution of actual transfers on the least onerous terms. Here again the fullest and most valuable assistance was rendered by the central banks which were approached in this connection. The same applies to the monetary authorities on the other side of the Atlantic, whose active co-operation was always forthcoming.

All these operations were of course conducted in the spirit and according to the methods mentioned above, that is to say, only to the extent to which they were irreproachable from the standpoint both of belligerents and of neutrals. The Bank has obtained all possible guarantees to safeguard its position from a general point of view and with regard to the special risks which it has been called upon to assume.

In the absence of suitable market facilities for movements of gold by routes which were often new and unusual, the action of the Bank for International Settlements as an intermediary would seem to have demonstrated its utility; the fact that more and more central banks of neutral countries have had recourse to it may be taken to prove that in some respects it has been able to render definite services of which the Bank's clients stood in real need.

* * *

As regards commercial credit operations, the field has been less fruitful in new experience and in the development of new technique. The turn of events has not permitted us to make use of all the possibilities of refinancing which were offered to us. Difficulties in the employment of certain currencies in connection with possible credit instruments likewise tended to reduce the volume of transactions undertaken or to prevent the renewal of some of them.

We have the impression, however, that in more ordinary circumstances the system which the Bank has worked out and which has already begun to operate may be of real interest to most of the central banks with which we have active connections. Operations recently handled, though for small amounts, are valuable as a source of continued experience. They have shown that many central banks have, in this sphere, definite needs which they have made known to the Bank and which the Bank in the future may be called upon to satisfy. In present circumstances, however, such operations could only partially be undertaken and had then always to be carried out with even stricter precautions than in normal times.

2. TRUSTEE AND AGENCY FUNCTIONS OF THE BANK.

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

The situation in connection with the service of the German External Loan 1924, the German Government International 5½ % Loan 1930 and the Austrian Government International Loan 1930, for which the Bank is Trustee or Fiscal Agent for the Trustees, has also remained unchanged during the year under review, in so far as the respective Trustees are concerned. They have not received any of the funds required in the currencies of the various issues for the service of these Loans.

The Bank has continued to act as an intermediary for the settlement of the financial questions involved as a result of the transfer of the Saar Territory to Germany. The German Government undertook to repurchase the mines, railways etc. in the Saar from France for a lump sum of 900 million French francs to be paid over a period of five years, mainly through free deliveries of coal and from the exchange for reichsmarks of French francs and other foreign currencies collected in the Saar when the territory was transferred.

Up to 31st March 1939, the total amount paid by Germany in this connection was 789.8 million French francs. Free deliveries of coal continued on a normal basis until the outbreak of war and as at 31st March 1940, the total sum paid amounted to 855.3 million French francs.

The Bank has also continued to act as intermediary for the service in Switzerland of the French National Security 4½ % Loan 1937 and has regularly and punctually received from the French Government and has transferred to the various Paying Agents, as and when necessary, the funds required to pay the coupons and drawn bonds of the Loan presented in Switzerland.

3. NET PROFITS AND DISTRIBUTION.

It is for the present General Meeting to consider the declaration of a dividend and to make appropriations to reserves. The net profit for the year, after making allowance for contingencies, is 7,962,180.65 Swiss gold francs, the Swiss gold franc being as defined by Article 5 of the Bank's Statutes i. e. the equivalent of 0.29032258... grammes fine gold. This compares with a figure of 8,583,864.63 Swiss gold francs for the ninth fiscal year. For the purpose of the Balance Sheet as at 31st March 1940, the foreign currency amounts of the assets and liabilities have been converted into Swiss gold francs on the basis of the quoted or official rates of exchange for the respective currencies on that date, and all assets are valued at or below market quotations, if any, or at or below cost.

After providing for the Legal Reserve that is required by Article 53 of the Statutes, to an amount equal to 5 per cent. of the net profits, i. e. 398,109.03 Swiss gold francs (1939: 429,193.23 Swiss gold francs) it is recommended that the General Meeting declare a dividend at the rate of 6 per cent. per annum in respect of the tenth fiscal year. The payment of this dividend requires 7,500,000 Swiss gold francs (1939: 7,500,000 Swiss gold francs). The net profits still remaining after the declaration of the dividend would amount to 64,071.62 Swiss gold francs, the appropriation of which is fixed by Article 53 of the Statutes.

Exercising the discretion vested in it by paragraph (c) of Article 53 of the Statutes, the Board of Directors has determined to place to the credit of the Special Dividend Reserve Fund provided for by the Statutes, the sum of 12,814.32 Swiss gold francs, which is the maximum amount which it is permissible, under the Statutes, to set aside for this purpose out of the net profits of the present year (1939: 130,934.28 Swiss gold francs).

After making provision for the foregoing items, you are requested, from the balance still remaining, to make an appropriation to the General Reserve Fund in the manner stipulated by paragraph (d) of Article 53, to the amount of 25,628.65 Swiss gold francs (1939: 261,868.56 Swiss gold francs). The aggregate of the Legal, Dividend and General Reserves at the end of the tenth year would then be 25,529,482.89 Swiss gold francs.

The same article of the Statutes lays down the distribution of the sum finally remaining, namely 25,628.65 Swiss gold francs, between such of the Governments or central banks of Germany and the countries entitled to share in the annuities payable under the New Plan, defined in the Hague Agreement of January 1930, as shall have maintained time deposits at the Bank subject to withdrawal in not less than five years. No central bank has had such time deposits during the year but the following Governments have had such deposits and are entitled, in view of this minimum duration of their deposits, to participate in the residual amount of 25,628.65 Swiss gold francs (1939: 261,868.56 Swiss gold francs) in the following sums:

	Swiss gold francs			
Annuity Trust account deposits in accordance with Article IV (e) of the Trust Agreement:—		1939/40		1938/39
France	8,784.24		85,270.87	
Great Britain	3,432.68		33,321.91	
Italy	1,793.—		17,405.10	
Belgium	969.93		9,415.36	
Rumania	169.45		1,644.95	
Yugoslavia	705.25		6,846.11	
Greece	58.10		563.98	
Portugal	111.36		1,080.96	
Japan	111.36		1,080.96	
Poland	3.23		31.33	
		16,138.60		156,661.53
German Government non-interest-bearing deposit in accordance with Article IX of the Trust Agreement		8,069.30		78,330.76
French Government deposit (Saar)		71.81		853.22
French Government Guarantee Fund in accordance with Article XIII of the Trust Agreement		1,348.94		26,023.05
		25,628.65		261,868.56

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

4. CHANGES IN THE BOARD OF DIRECTORS AND EXECUTIVE OFFICERS.

The members of the Board appointed by the ex-officio Directors hold office under the Statutes for three years and are eligible for re-appointment. The Bank having been founded in May 1930, certain re-appointments to the Board were made in May 1939 for the fourth period of three years. At the same time M. Galopin and Mr Kano were elected Vice-Chairmen in place of Professor Beneduce and M. de Vogüé, whose term of office had expired.

The resignation from the Board of Professor G. Bachmann, President of the Direktorium of the Swiss National Bank, upon his designation as President of the Bankrat of that institution, already referred to in the last Annual Report, became effective on 8th May 1939 and Herr E. Weber, who had succeeded Professor Bachmann in his previous functions at the Swiss National Bank, was elected on 12th June 1939 to serve on the Board in his stead. In October last the Governor of the Bank of Japan appointed Mr Kichio Futami as his substitute nominee upon the recall to Japan of Mr Seijiro Yanagita, who had served in that capacity since March 1937 with much distinction. The departure of Mr Yanagita is greatly regretted.

On 9th May the Board had to deplore the death of Dr. Pasquale Troise, Director General of the Banca d'Italia, who for a number of years had acted as the Alternate of the Governor of the Banca d'Italia.

The resignation by Dr. J. W. Beyen of his functions as President of the Bank became effective on 31st December 1939. Dr. Beyen had been associated with the Bank since May 1935; during the first two years he acted as Alternate of the President and after the amendment of the Statutes, approved by the Annual General Meeting in May 1937, Dr. Beyen became President. The whole period during which Dr. Beyen held office was one of great difficulty for international banking and the developments which after successive political crises finally ended in war increased the responsibilities and the burden of the President in no small measure. The fact that the Bank was able to overcome the difficulties with which it was faced at the outbreak of hostilities must be attributed largely to the ability and judgment of Dr. Beyen.

The undersigned, who had been elected by the Board on 12th June 1939 to succeed Dr. Beyen as President, assumed office on 1st January 1940.

VIII. CONCLUSION.

In a large part of the world ordinary economic and financial considerations are now overshadowed by the necessities of war. Much of the intensified government control, the diversion of trade and the disruption of the economic and financial systems will, it must be hoped, be only temporary in character; but below the tumult of the war no doubt more fundamental changes are taking place which will have repercussions on the future life not only of Europe but of the whole world. What these developments may be necessarily escapes in large measure the contemporary observer; but the post-war generation will have to face all the immediate problems created by the war and will in addition feel the impact of the more deep-seated long-trend changes.

It is of paramount importance to have ready at the end of hostilities as clear a picture as can possibly be made of the economic and financial situation and the problems to be dealt with. Not only must delay be avoided but such mistakes as are due to insufficient knowledge and lack of skilled organisation should be reduced to a minimum. Post-war relief and reconstruction — with the means available to the modern world and especially if accumulated resources are put to active use — should not be too great a task, however formidable the disruption may have been. With all the practical experience gained in the past twenty-five years much more is known about monetary and commercial problems than in the period following the last war, and the world is in many respects far better equipped to grapple with the questions at issue.

It is remarkable to what extent men's minds in nearly all nations have turned to the problems of economic and financial organisation which will beset the world when the war is over. Apart from certain data kept secret for military or similar reasons the amount of information available as to the tendencies and problems in the various countries is not inconsiderable, and, with the help of national institutions, the possibilities of presenting an analysis of the situation prevailing at the end of the war should be great. In the end the desire of nations to cooperate and organise the world in a reasonable manner is, of course, the decisive factor without which no amount of specialised skill can achieve results; but, given the will to cooperate, adequate means should be ready at hand for the pressing work of reconstruction.

Respectfully submitted,

THOMAS H. McKITTRICK,
President.

ANNEXES

BALANCE SHEET

IN SWISS GOLD FRANCS (UNITS OF 0.29032258...

ASSETS			%
I—GOLD IN BARS		30,564,120.08	6.5
II—CASH			
On hand and on current account with Banks		34,819,882.44	7.4
III—SIGHT FUNDS at interest . .		16,257,974.69	3.5
IV—REDISCOUNTABLE BILLS AND ACCEPTANCES			
1. Commercial Bills and Bankers' Acceptances	93,510,934.14		19.9
2. Treasury Bills	68,412,117.53		14.6
		161,923,051.67	
V—TIME FUNDS at interest			
Not exceeding 3 months . . .		17,371,232.96	3.7
VI—SUNDRY BILLS AND INVESTMENTS			
1. Treasury Bills	84,809,098.43		18.0
2. Railway, Postal Administration and Other Bills and Sundry Investments	121,829,515.58		25.9
		206,638,614.01	
VII—OTHER ASSETS		2,357,354.72	0.5
		469,932,230.57	100.0

NOTE — The Bank holds in bar gold or in currencies free of exchange restrictions assets greatly in excess of its short term and sight deposits (Items IV and V — Liabilities). The remaining assets of the Bank are held in countries whose currencies are now subject to exchange restrictions, but as regards the Bank's assets in those countries, the Governments concerned have, either as signatories of the Hague Agreement of 1930 (Article X) or by special measures, declared the Bank to be immune "from any disabilities and from any restrictive measures such as censorship, requisition, seizure or confiscation, in time of peace or war, reprisals, prohibition or restriction of export of gold or currency and other similar interferences, restrictions or prohibitions". Moreover, after providing for the German Government Deposit out of investments in Germany, over 60% of the assets then remaining are secured by special contracts guaranteeing their gold value.

The Bank's commitment in respect of the Annuity Trust Account Deposits is not clearly established, but it is stated at its maximum amount in Swiss Gold Francs.

For Balance Sheet purposes the foreign currency amounts of the assets and liabilities have been converted into Swiss Gold Francs on the basis of the quoted or official rates of exchange for the respective currencies.

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

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

ZURICH, May 3, 1940.

AS AT MARCH 31, 1940

GRAMMES FINE GOLD — ART. 5 OF THE STATUTES)

LIABILITIES			%
I—CAPITAL			
Authorised and issued 200,000 shares, each of 2,500 Swiss gold francs	500,000,000.—		
of which 25 % paid up		125,000,000.—	26.6
II—RESERVES			
1. Legal Reserve Fund	5,117,398.66		
2. Dividend Reserve Fund . . .	6,658,510.75		
3. General Reserve Fund . . .	13,317,021.48		
		25,092,930.89	5.3
III—LONG TERM DEPOSITS			
1. Annuity Trust Account Deposits	153,050,000.—		32.6
2. German Government Deposit	76,525,000.—		16.3
		229,575,000.—	
IV—SHORT TERM AND SIGHT DEPOSITS (various currencies)			
1. Central Banks for their own account:			
Sight		31,994,834.22	6.8
2. Central Banks for the account of others:			
Sight		1,645,497.74	0.4
3. Other depositors:			
(a) Not exceeding 3 months	25,881.03		0.0
(b) Sight	1,114,010.44		0.2
		1,139,891.47	
V—SHORT TERM AND SIGHT DEPOSITS (Gold)			
1. Not exceeding 3 months . .	1,764,219.48		0.4
2. Sight	11,182,591.36		2.4
		12,946,810.84	
VI—MISCELLANEOUS		34,575,084.76	7.3
VII—SURPLUS			
Profit for the financial year ended March 31, 1940		7,962,180.65	1.7
		469,932,230.57	100.0

of the Bank for the financial year ending March 31, 1940, and we report that we have obtained all the inform-
with the Note, is properly drawn up so as to exhibit a true and correct view of the state of the Bank's
books of the Bank, as expressed in the above-described Swiss gold franc equivalents of the currencies

PRICE, WATERHOUSE & Co.
Chartered Accountants.

PROFIT AND LOSS ACCOUNT

for the financial year ended March 31, 1940

		Swiss gold francs
Net Income from the use of the Bank's capital and the deposits entrusted to it, after necessary allowance for contingencies		9,793,039.34
Commissions earned:—		
As Trustee (or Fiscal Agent to Trustees) for International Loans		122,402.02
In connection with special credits		34,242.87
Transfer fees		298.55
		9,949,982.78
Costs of Administration:—		
Board of Directors — fees and travelling expenses	136,987.67	
Executives and staff — salaries and travelling expenses	1,451,086.63	
Rent, insurance, heating, light and water	112,755.14	
Consumable office supplies, books, publications	100,305.69	
Telephone, telegraph and postage	69,079.29	
Experts' fees (Auditors, interpreters, etc.)	13,042.82	
Cantonal taxation	34,273.76	
Tax on French issue of Bank's shares	30,008.85	
Miscellaneous	40,262.28	1,987,802.13
NET PROFIT:—		7,962,180.65

APPROPRIATION ACCOUNT

	Swiss gold francs
NET PROFIT FOR THE FINANCIAL YEAR ENDED MARCH 31, 1940	7,962,180.65
Applied in accordance with Article 53 (a) (b) (c) and (d) of the Statutes, as follows:—	
To the Legal Reserve Fund — 5 % of 7,962,180.65	398,109.03
	7,564,071.62
Dividend at the rate of 6 % per annum on paid-up capital	7,500,000.—
	64,071.62
To the Dividend Reserve Fund — 20 % of 64,071.62	12,814.32
	51,257.30
To the General Reserve Fund — 50 % of 51,257.30	25,628.65
Remainder	25,628.65

Distributed in accordance with Article 53 (e) (1) of the Statutes, as follows:—

		Swiss gold francs	
Annuity Trust Account deposits in accordance with Article IV (e) of the Trust Agreement:—			
France	8,784.24		
Great Britain	3,432.68		
Italy	1,793.—		
Belgium	969.93		
Rumania	169.45		
Yugoslavia	705.25		
Greece	58.10		
Portugal	111.36		
Japan	111.36		
Poland	3.23	16,138.60	
German Government non-interest-bearing deposit in accordance with Article IX of the Trust Agreement		8,069.30	
French Government deposit (Saar)		71.81	
French Government Guarantee Fund in accordance with Article XIII of the Trust Agreement		1,348.94	25,628.65

BOARD OF DIRECTORS

* Sir Otto Niemeyer, London	Chairman.
Alexandre Galopin, Brussels Hisaakira Kano, London	Vice-Chairmen.

Dott. V. Azzolini, Rome.
Baron Brincard, Paris.
Pierre Fournier, Paris.
Walther Funk, Berlin.
Kichio Futami, London.
Prof. Francesco Giordani, Rome.
Georges Janssen, Brussels.
Montagu Collet Norman, London.
Ivar Rooth, Stockholm.
Dr. Hermann Schmitz, Berlin.
Kurt Freiherr von Schröder, Cologne.
Dr. L. J. A. Trip, Amsterdam.
Marquis de Vogüé, Paris.
Ernst Weber, Zurich.

Alternates

Adolphe Baudewyns, Brussels.
Yves Bréart de Boisanger, Paris.
Cameron F. Cobbold, London.
Emil Puhl, Berlin.
Dott. Mario Pennachio, Rome.

EXECUTIVE OFFICERS

Thomas H. McKittrick	President.
Roger Auboin	General Manager.
Paul Hechler	Assistant General Manager.
Dott. Raffaele Pilotti	Secretary General.
Marcel van Zeeland	Manager.

Dr. Per Jacobsson	Economic Adviser.
Dr. Felix Weiser	Legal Adviser.

27th May 1940.

* Sir Otto Niemeyer's office expired in May 1940. His successor has not been elected.