BANK FOR INTERNATIONAL SETTLEMENTS

THIRTY-FIFTH ANNUAL REPORT

1st APRIL 1964 — 31st MARCH 1965

BASLE

14th June 1965

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THIRTY-FIFTH ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 14th June 1965.

Gentlemen,

I have the honour to submit herewith the Annual Report of the Bank for International Settlements for the thirty-fifth financial year, which began on 1st April 1964 and ended on 31st March 1965. Details of the results of the year's business operations are given in Part III, together with an analysis of the balance sheet as at 31st March 1965.

The accounts for the thirty-fifth financial year closed with a surplus of 34,519,144 gold francs, against 27,417,055 gold francs for the previous year. After deduction of 1,500,000 gold francs transferred to the provision for exceptional costs of administration and of 10,500,000 gold francs transferred to the provision for contingencies, the net profit amounted to 22,519,144 gold francs, compared with 17,517,055 gold francs for the preceding year.

The Board of Directors recommends that the present General Meeting should decide to distribute, as last year, a dividend of 37.50 gold francs per share. The Board also proposes that, as an exceptional measure, a lump sum should again be applied to the reduction of the amount of the undeclared cumulative dividend. This sum, which has been fixed at 14,000,000 gold francs, will represent an extraordinary distribution of 70 gold francs per share. The total distribution will thus amount this year to 107.50 gold francs, payable in Swiss francs in the amount of 153.60 Swiss francs per share.

Part I of this Report deals with economic developments and policies in Europe and the United States in 1964 and the early months of 1965. In Part II a survey is given of developments in the fields of credit, external payments and reserves and in the foreign exchange and Euro-currency markets; an outline is also given of the working of the European Monetary Agreement. Part III deals with the operations of the Bank and the functions it performs on behalf of the High Authority of the European Coal and Steel Community and as Trustee and Fiscal Agent for international loans. It also touches on the Bank's rôle in promoting co-operation between central banks as well as on its relations with other international institutions.

PART I

CURRENT ECONOMIC TRENDS AND POLICIES 1964–65

For the western industrial countries the main economic problems with which policy had to contend during the past year were the curbing of inflationary pressures in the continental countries, the currency crisis in the United Kingdom and the large increase of capital exports in the United States. In all these respects the situation at present is better than it was six months ago, though it is not yet clear that the difficulties have been fully overcome. On the positive side, output and employment have generally remained high and the outlook in this regard is favourable. In the less-developed countries the improved external position of a year ago has not been fully maintained and a further effort to achieve adequate growth without inflation is indicated. The countries of eastern Europe seem to have had some success in making their planning less rigid and in establishing better market incentives for the allocation of resources.

The dollar.

Recent economic developments in the United States have been dominated by three bold policy experiments — the interest equalisation tax, the tax cut and the voluntary restraint on capital exports. Designed to lead the economy towards the dual goals of adequate growth and external balance, the measures have had a material impact. Business activity has escaped from the previous pattern of short booms and setbacks and the position of the dollar has been much improved.

It will be recalled that in 1961 the government gave immediate priority to domestic recovery. The stimulus was provided by increased public expenditure, which initiated a marked rise in activity. As this impulse tapered off in 1962, the rate of expansion slowed down. The authorities then decided that a major change in the Federal fiscal structure was required to prevent a budget surplus from putting a brake on expansion of the private sector before a full-employment level of activity was reached. To this end a substantial cut in tax rates was proposed in January 1963. Although the tax cut was not enacted in that year, the prospect of its coming into force in the near future was a factor in the rising confidence of both business and consumers.

The tax cut was embodied in the Fiscal Act of February 1964. It provided important reductions in personal and corporate income taxes and thereby gave a considerable boost to both private consumption and investment expenditure. A feature of the reduction was that, even though the cut in personal tax liabilities was spread over 1964 and 1965, the withholding rate on wages and salaries was reduced by the total amount in March 1964. Thus, the full impact on disposable income occurred immediately. From its enactment until the end of the year the tax cut added directly $7.7 milliard to disposable income — a rise of almost 2 per cent. — while the increase in consumer expenditure directly or indirectly related to it has been estimated at about $9 milliard. The results of this could be seen in a growth of retail sales, which in December stood 8 per cent. above their level a year earlier, and in another record year for the motor-car industry, despite the slow-down caused by strikes in the fourth quarter.

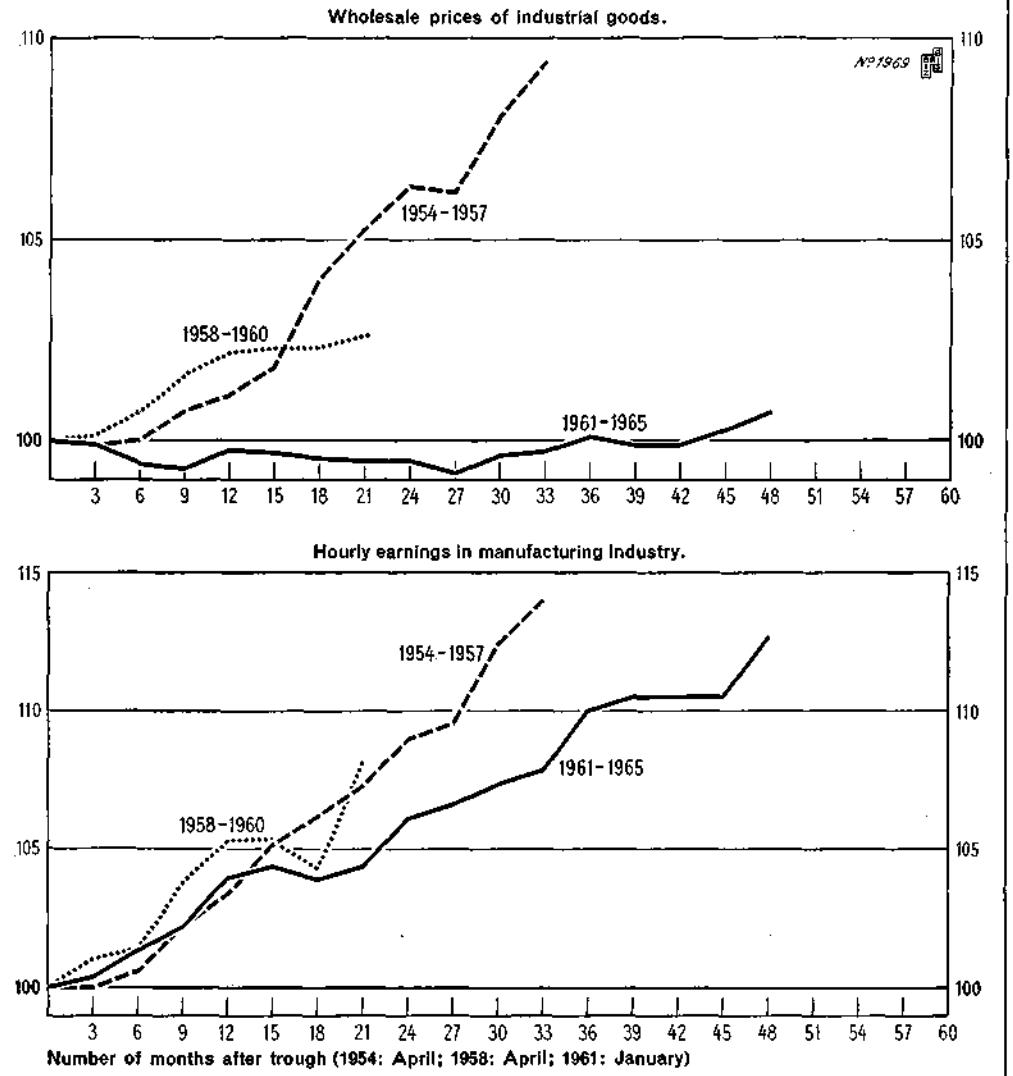
In addition, the reduction in corporate taxes, plus the incentive of rising consumer spending, led to a sharp increase in gross private domestic investment. Most of this was in producers' durable equipment, which went up by twice as much as in 1963.

With the help of these influences, the economy turned in a strong performance in 1964. The real gross national product expanded by 4.5 per cent., as compared with the estimated 3 per cent. rate that seemed likely in the absence of the tax cut. The rate of unemployment moved steadily downward from its average level of 5.7 per cent. in 1963 to about 4.7 per cent. in recent months, and this improvement was accomplished in the face of a large increase in the labour force. The upsurge has continued in 1965, with few signs of weakness in sight. The economy has now been in a continuous cyclical upswing for four and a half years. Except for the war-time expansion of 1938–45, this is the longest phase of expansion in the 110 years for which the National Bureau of Economic Research has analysed the business cycle.

The anatomy of the current expansion shows several distinguishing features that account for its longevity. First of all, the response of the private sector has been well-balanced, without the distortions that have led to trouble in the past. Business investment in plant and equipment has moved up strongly to meet rising capacity requirements, but the rate of increase has on the whole been steady and free from the exaggerated acceleration that took place, for example, in the 1955–57 expansion. The capital goods industries have had little difficulty, therefore, in satisfying the growing stream of demand without the emergence of bottlenecks and inflationary pressures. Inventory investment, which has often aggravated rather than smoothed the swings in overall activity, has also fluctuated more moderately in this upswing and with less perverse timing than in other post-war expansions.

In addition, perhaps the best reflection of sound growth has been the trend of wages and prices. Wage increases have generally stayed within the limits allowed by rising productivity, and labour costs per unit of output have actually declined slightly. In the absence of wage-push, and with business content to secure high profits through larger volume and lower taxes, industrial prices have maintained consistent stability.

United States: Prices and wages in industry during three expansion phases.



In all these respects, therefore, the dangers of a short-lived boom have been avoided.

None the less, the outstanding feature of the present upswing has been stabilisation policy, which has been more purposive than in previous US experience. In the earlier post-war upswings the Federal budget invariably moved into surplus — sometimes quite sharply — as the expansion progressed, with the result that the purchasing power withdrawn from the private sector tended to put a ceiling on the dynamism of business activity — unless overcome by a private investment boom. This tendency was evident in 1963 when there was in fact a slight Federal surplus on a national accounts basis in the fourth quarter. One cannot say precisely what would have happened without the tax cut, but it is evident that further expansion would have had a serious obstacle to overcome. In any event, the tax cut broke this barrier and pitched the budget at an expansionary tilt.

To make doubly sure, monetary policy, too, has given priority to facilitating the economy's advance — despite a continuing outflow of capital. The rate of change in the money supply, which in previous expansions began to drop at an early stage, has been held at a high and steady level — with the exception of a brief decline in 1962. Bank liquidity has been maintained at a high level. The Federal Reserve System has supplied roughly $10 milliard in reserves to the banking system over the period since early 1961 and an additional $1 milliard in reserves was released by a reduction of reserve requirements against time deposits in 1962. About one-fifth of this increase in bank reserves served to offset reserve losses resulting from the US gold outflow, and about half of the total amount to offset the loss of reserves due to the rapid increase in the demand for currency. Thus, about $4 milliard of the reserves supplied was available to support the growth of bank credit.

At the same time, policy aimed to encourage expansion with price stability. The guide-lines set for wage increases, and the pressure brought to bear on prospective price increases that could initiate an inflationary psychology, contributed to the maintenance of stable prices. Without such stability, the easy fiscal and monetary policy itself could not have been continued.

Thus, active domestic expansion has been the background against which the persistent weakness of the dollar has had to be corrected. This meant not only narrowing the existing deficit in the balance of payments itself, but overcoming the rising trend of imports associated with rising internal activity.

The programme to correct the external deficit was limited for several years to the following measures: tying foreign economic aid so as to reduce the free dollars sent abroad; securing economies in defence outlays abroad and arranging offsetting defence purchases in the United States, particularly by Germany; and restraint on wage costs and prices to improve the competitive position of domestic industry. In addition, various techniques were used to hold up short-term interest rates despite the policy of monetary ease, in an attempt to discourage the net outflow of short-term funds. While these measures produced some results, the changes in the external deficit in 1961 and 1962 were dominated by the pattern of cyclical changes. The recession of 1960 led to a reduced deficit in 1961, whereas the domestic recovery accounted for the worsening of the external position in 1962.

As 1963 progressed, price stability at home and mounting inflation in Europe were leading to a significant improvement in the US trade surplus. However, the substantial gap in interest rates and in the availability of long-term capital between the United States and the outside world resulted in a very large outflow on portfolio account in the first half of that year and it was evident that an effective means was needed to keep capital outflow in check. Since the authorities were directing general fiscal and monetary policy towards domestic objectives, it became necessary to secure balance-of-payments equilibrium by unorthodox means.

International transactions of the United States.

Items	1960	1961	1962	1963	1964
	in millions of US dollars				
Current transactions					
Trade balance (excluding exports financed by aid)	+ 2,820	+ 3,200	+ 2,080	+ 2,270	+ 3,740
Net tourist expenditure	— 870	— 860	— 1,020	— 1,140	— 1,090
Net investment income	+ 2,320	+ 2,960	+ 3,330	+ 3,270	+ 3,860
Net defence expenditure	— 2,730	— 2,560	— 1,910	— 1,910	— 1,820
Other invisibles (net)	— 600	— 550	— 1,060	— 970	— 710
Total	+ 940	+ 2,190	+ 1,420	+ 1,520	+ 3,980
Capital transactions					
US Government aid: net dollar outflow	— 1,110	— 1,140	— 1,070	— 890	— 710
Net direct investment	— 1,530	— 1,530	— 1,520	— 1,890	— 2,270
Net long-term portfolio investment	— 370	— 390	— 830	— 770	— 550
Other long-term (including medium-term bank lending)	— 200	— 260	— 260	— 580	— 1,280
Short-term capital reported by US banks	— 1,000	— 1,120	— 330	— 740	— 1,530
Other private short-term	+ 150	+ 830	— 120	+ 580	+ 1,060
Other (including errors and omissions)	— 520	— 560	— 210	+ 440	— 30
Total	— 4,580	— 4,170	— 4,340	— 3,850	— 5,310
Deficit financed by official transactions	— 3,640	— 1,980	— 2,920	— 2,330	— 1,330

This background led to the second policy experiment, the interest equalisation tax proposed in July 1963. This tax on purchases of either new or existing foreign securities was designed to add about one percentage point to the cost of obtaining such long-term funds in the United States. As the tax was to be retroactive, its immediate effect was to almost stop new foreign issues in the New York market, as well as net buying of existing securities.

However, with the exception of the third quarter of 1963, the private capital balance as a whole failed to reflect this improvement in one of its items. Direct investment continued to be active, and short-term capital outflow and medium-term bank lending both rose in the last quarter of 1963 and continued at high levels in 1964. The net private capital outflow in the first quarter of 1964 was larger than in the corresponding quarter of 1963, and the outflow in the second quarter was little short of the level that had prompted the authorities to propose the interest equalisation tax in the previous year. By mid-1964, then, it was clear that the interest equalisation tax had failed to stem the outflow of private US capital. At this point, the opportunity of using monetary policy to diminish the net capital outflow presented itself. With the tax reduction already in force for several months, it appeared that adequate stimulus was being given to the domestic economy from the fiscal side, and that monetary policy could be used to a greater extent to influence international capital flows.

However, no action was taken, perhaps because the overall balance for the first half of 1964 appeared to be evolving satisfactorily. The deficit on regular transactions was at an annual rate of $1.8 milliard during this period, just a little more than half the deficit of the preceding year. This was due to a sharply increased surplus on goods and services, which had already made its appearance in the fourth quarter of 1963. This improvement, in turn, was mainly the result of increased exports and indicated a significant gain in the competitiveness of US industry.

During the first three quarters, then, the failure of the interest equalisation tax to stem the outflow of private capital was offset by improvement in other items. In the fourth quarter, however, a massive outflow of private capital occurred. There were large purchases of new foreign securities when the actual entry into force of the interest equalisation tax released a backlog of issues (mostly Canadian) that had been awaiting clarification of their status. New flotations became very large in October and continued high throughout the quarter, resulting in a capital outflow of $581 million. More important, however, was an increase in both medium and short-term bank lending, which reached more than $1 milliard in the fourth quarter. Although the large outflow due to new security issues was mainly a temporary phenomenon, information on bank loan commitments made it clear that the bulge in bank lending was not likely to be a temporary development. Thus, in the calendar year after the announcement of the interest equalisation tax, the outflow of US private capital jumped from $4,307 to 6,360 million, and showed every indication of continuing at an expanded level.

In these conditions the President sent a message to Congress in February 1965 setting forth the third experiment in policy. The strongest measure outlined was a voluntary limitation of bank lending to foreigners. Under the guide-lines set down, the growth of outstanding bank credits to foreigners (including trade credits) would be limited to 5 per cent. above the level at the end of 1964. This restriction implies a net outflow of bank money of roughly $500 million for 1965, as compared with the outflow of almost $2.5 milliard for 1964.

Insurance companies, pension funds and finance companies were asked not to grant dollar credits to foreigners or for investment abroad that had already been turned down by the banks. These financial institutions have also been asked to keep the investment of liquid funds abroad unchanged at the end-1964 level for the time being, and to reduce them gradually to the amount outstanding at the end of 1963. Non-financial corporations were asked to reduce their holdings of short-term assets in developed countries and to aim at a 15–20 per cent. improvement in the balance on the rest of their foreign exchange transactions.

The President's message also requested Congress to extend the interest equalisation tax to the end of 1967 and to broaden its scope to include non-bank credits of one year or more to borrowers in industrial countries. Under existing legislation, the tax was immediately applied to bank loans of more than one year's maturity to borrowers in advanced countries.

Hence, a sufficient range of capital transactions abroad now seems to have been brought under official control or scrutiny so that the improvements planned in individual items will be translated into an improvement in the overall balance of payments. And, indeed, the immediate impact of the programme has been satisfactory. Helped by quick withdrawals of US funds from the Euro-dollar market, there was an evident turn-round in the capital flow after mid-February; this became more pronounced in March, as the dollar improved in the exchange markets against all currencies, and there was a significant overall external surplus. It seems likely that the strengthened position of the dollar will be consolidated over the near term as US financial institutions and industrial firms have the opportunity of implementing the co-operative programme.

Thus, the outlook for the US economy appears to be favourable with regard to both the domestic and balance-of-payments situations. On the domestic side, the stimulus to expansion is continuing. Private investment has a strong uptrend and the survey of intended capital outlays points to a larger rise than last year. Continued high sales of motor-cars indicate that the basic demand in this sector has been substantially increased from its level in the late 1950s. Reductions in excise taxes and an increase in social security benefits in July will continue the fiscal incentive to expansion. In addition, a variety of new social programmes in health, education and welfare have been enacted which will help to maintain an active climate of demand.

On the external side also, the strength of the new programme promises to give good results in the months ahead. If doubts exist on the longer-term efficacy of these measures, as they do, they come from two considerations. First, after the extended series of external deficits, the reserve position of the United States needs to be strengthened to restore full confidence in the dollar. This means achieving not only external equilibrium but some period of balance-of-payments surplus. Secondly, it remains a fact that voluntary controls over capital outflows will have to contend with the strong market incentives arising from the continuing disparity in capital availability and interest rates with the outside world. Apart from the possibility that market forces may prevail in the longer run, it is also not satisfactory that the distortions implicit in direct controls be allowed to grow or that capital movements be singled out for the main weight of balance-of-payments adjustment.

Hence, the problem of securing a more fundamental equilibrium still remains.

Sterling.

In presenting the expansionary budget of April 1963, aimed at overcoming the relative stagnation of the economy and assuring an adequate rate of growth, the then Chancellor of the Exchequer said:

> "I absolutely reject the proposition that a vigorous economy and a strong position for sterling are incompatible. A healthy expansion based on increasing efficiency and control of costs is the key to the strength of sterling.... It is, of course, possible that in the early stages of a

programme of more vigorous expansion, imports may rise faster than exports.... In so far as there is a stocking-up movement related to expansion.... it is perfectly reasonable and sensible to finance such a movement out of our reserves or out of our borrowing facilities in the International Monetary Fund and elsewhere."

In stressing the necessity for the United Kingdom to give a high priority to expanding production, the present Prime Minister in January 1964 said:

"If balance-of-payments difficulties arise in the next few months we must meet them — as the government has always said they must be met — by using reserves.... We should not be afraid to use them, nor, in an emergency, to use our very substantial drawing rights under the IMF, to say nothing of other sources which can be mobilised in case of need."

Thus, the basic policy formula of 1963 and 1964 was in accordance with a bipartisan economic model. The budget of 1963 was not just another shift in stabilisation policy; it initiated a new strategy for achieving steady growth with longer-term strength of sterling. The theory was that, even though an external deficit might be inevitable for a time, continued strong expansion would call forth a higher rate of productivity increase and that this, backed up by an effective incomes policy, would improve the international competitiveness of British industry and before long would assure external financial stability. Drawing on reserves or credit facilities in the interval would, in a sense, provide larger working capital for full use of the economic potential.

The budget impulse in 1963, together with other measures taken previously, did produce an active upward trend in output. In the course of a year the level of real gross domestic product was up about 6 per cent., employment was about 1 per cent. higher and the rate of unemployment about ½ per cent. lower. Output of motor-cars was more than a third higher and the upsurge of fixed capital outlays was fast producing an investment boom.

The anticipated deterioration in the balance of payments was not long in materialising. In the second half of 1963 the current account was just about in balance on an adjusted basis, in contrast to a surplus of £100 million in the first half of the year. While exports showed a slight upward trend, this was submerged by the buoyancy of imports. With this movement continuing in the first quarter of 1964, the current account worsened sharply and was deeply in deficit.

In the first quarter of 1964, also, the tendency towards overheating of the economy was becoming more pronounced. Business activity was advancing at a lively pace and unemployment moved well below the 2 per cent. level. Forecasts for the year ahead indicated a continued rise in activity and a significant external deficit on current account alone. Under these circumstances a dose of restraint was introduced into the April budget, after Bank rate had been raised from 4 to 5 per cent. earlier in the year. The intention was not to give up the experiment with sustained growth, but to confine the expansion to the longer-term real growth potential and, thereby, also to limit the external deficit.

For several months some indicators of economic activity did, indeed, seem less buoyant. However, unemployment continued to decline and imports remained high in both the second and third quarters, while exports decreased. Until the end of August 1964, however, the external deficit did not lead to any significant loss of official reserves. Instead, there was a rise in sterling liabilities and a substantial amount of switching into sterling of Euro-currency funds, which also helped to finance the external deficit.

In August the IMF stand-by of $1 milliard was renewed. But, with the general election coming in October, the occasion was passed by without any shift in policy — although the risk of exchange-market difficulties had to be weighed. Even monetary policy remained fairly easy in the face of a substantial contra-seasonal increase in bank advances associated with rising investment.

When the government took office after the election, it was confronted with the hard facts of the balance-of-payments situation; the overall deficit for 1964 was evidently going to be between £700 and 800 million — about equally divided between current and long-term capital account. While some deficit was in conformity with the new economic approach, this was obviously overstepping the mark, since the deficit was far larger than could be accounted for by working capital requirements. Action was needed, and the action decided upon aimed directly at reducing the external deficit by a system of temporary charges of 15 per cent. on imports of manufactured goods, coupled with some rebate of indirect taxes on exports. The import surcharge was estimated to reduce imports by about £250 million in a full year. In addition, new taxes were imposed to mop up the purchasing power that might be shifted to domestic goods because of the reduced supply of imports. While the November budget proposed several tax reforms, as well as higher social expenditure covered by appropriate tax increases, it did not aim at imposing general restraint on economic expansion.

In the White Paper on the economic situation it was stated:

> "Apart from special problems of individual areas and a limited number of industries there is no undue pressure on resources calling for action. Moreover, the Government reject any policy based on a return to stop-go economics."

A concerted effort to improve economic efficiency and determined action in the field of incomes policy were to be the longer-term means of restoring external balance without interrupting steady growth.

Meanwhile, since the early summer there had been growing signs of uneasiness on the exchange markets. Some outflow of funds from London occurred as the election approached, and the deficit itself needed to be financed. Official reserves first declined in June and by September the Bank of England had arranged $1 milliard of credit assistance from other central banks to help support the market as required. These credits were liquidated in December with the help of a drawing on the IMF stand-by. Yet, even after the election, the market in the main seemed to be awaiting developments. As the size of the deficit for the year became known, and as controversy developed about the government's programme, the selling pressure on sterling intensified, though the situation was still in hand. However, when no clear sign appeared that the programme was going to be buttressed by tighter monetary policy, a huge flight from sterling developed. In effect, the market judged the theory of longer-term correction of the deficit as too risky and sought short-term protection. To stem the tide, Bank rate was raised to 7 per cent. on 23rd November and two days later the Bank of England arranged for very substantial assistance from central banks and the BIS to show that it had ample resources to maintain the exchange parity of sterling.

Leaving aside possible misgivings about the basic strategy of policy over the previous two years, there were two essential questions involved in appraising the situation — the first concerning overall excess demand and the second the investment boom.

By the fourth quarter of 1964 unemployment had fallen to 1.5 per cent. This in itself suggested excessive pressure on resources, as experience indicated that in practice full employment was reached at a level of unemployment of about 1.8 to 2 per cent. While a gradual shift of manpower might have allowed this level to be lowered without pressure on the labour market, unemployment in this instance had fallen too rapidly for much movement of labour from depressed areas to take place. Hence, the average of 1.5 per cent. for the country as a whole meant that in the London area, the Midlands and southern England there was a distinct shortage of manpower.

Apart from this, the substantial deterioration of the current balance of payments pointed to excessive overall demand — which in an open economy will always spill over into imports as the pressure on domestic resources mounts. UK imports in 1964 were 15 per cent. above the previous year. But while imports of foodstuffs, fuels and basic materials increased by 8 per cent., semi-finished and finished manufactures rose by 28 per cent. At the same time, the rise of exports was limited to 4.2 per cent. and engineering exports increased by only 1.7 per cent. Thus the speed of the expansion also had a strong effect on the development of foreign trade.

The rise in manufactured imports, as well as the lagging of exports, may be explained partly by a disadvantage in cost and price competitiveness of British industry compared with that of other countries. However, the full utilisation of capacity and labour in the United Kingdom meant that there was not a margin of resources which could have provided the extra volume of goods to fill the payments gap. Such a higher level of output for export or for import substitution would have required the unemployment level to go down to, say, 1 per cent. This degree of over-full employment was obviously not feasible, because the labour was not available in the areas of the country where it would have been needed. To say that this situation could be overcome by longer-term efforts to raise productivity is not to deny the signs of excess demand. This view was implicit in the November budget, which aimed to offset any added demand in the home market that would come from lower supplies of imports.

In assessing the situation from a policy standpoint, it was necessary also to recognise that excess demand was directly related to the investment boom, coming from the nationalised industries as well as from private manufacturing. Fixed investment had risen by 16 per cent. in real terms from 1963 to 1964 and the engineering industries, in particular, were producing at full capacity. Despite this, the backlog of orders from both home and abroad was high and rising steadily. The limitation on capital goods output came also from soaring production of motor-cars, which under boom conditions is a voracious user of men and materials. In addition, domestic investment demand was a crucial factor in the external deficit, as it had induced a substantial rise in capital goods imports and held down their exports. Yet it was considered essential to avoid policy measures that would dampen the investment boom, as higher investment was to be the lever to increased efficiency over the longer term.

Without a clear intent on the part of policy to dampen excess demand or the investment boom, the exchange market evidently found it difficult to see how sufficient correction of the balance of payments could be brought about in time to assure stability of sterling. After the massive central-bank assistance spot selling of sterling fell away, though sporadic pressure continued in the following months and large support of the forward market was required. But it appeared that a strong budget in April 1965 was needed before a return of confidence could be hoped for.

It seemed evident that the situation had gone beyond that envisaged by the new theory of external strength through expansion. The key in this conception was increased competitiveness. While the government secured the agreement of both sides of industry to an incomes policy in January, it was doubtful whether this could work effectively under conditions of excess demand. From October 1963 to October 1964 hourly wage rates had risen more than twice as fast as a year earlier and average hourly earnings (even excluding overtime effects) had jumped by over 8 per cent., with wage drift playing a major rôle. Material improvement of competitiveness in these circumstances could not be expected. Furthermore, while active demand and capital equipment are both necessary for increasing productivity, there was not likely to be much movement of resources towards the export industries if excess demand and high domestic investment were leaving little incentive for the shift.

There was some belief that the tax increases in the autumn budget and the 7 per cent. Bank rate might tend to dampen the expansion of activity and start a movement towards a curtailment of excess demand. However, production continued to expand up to the time of the budget and unemployment was further reduced. In addition, the survey of business investment intentions showed no slackening of the rise in planned outlays. There was, however, some improvement in the trade balance. Imports in the first quarter of this year, which were affected by the New York dock strike as well as by the 15 per cent. import surcharge, fell 4 per cent. below the level for the fourth quarter of 1964. At the same time, exports rose by 1.5 per cent. As a result, the trade deficit narrowed to £186 million, compared with £266 million in the preceding quarter and £272 million in the first quarter of 1964. While these results were encouraging, it was clear that a further effort to improve the external accounts would be necessary.

The budget speech of April 1965 indicated a change in policy emphasis. It announced new taxes on consumption with the aim of limiting this source of demand and also cancelled a defence commitment, thus achieving a sizable saving in expenditure. With total current government outlays rising substantially, however, it was estimated that the increase in the budget surplus above the line would be limited to £100 million, while the overall deficit showed a significant rise in prospect for the present fiscal year, as compared with the outturn in 1964–65. In order for excess demand to be eliminated, therefore, the budget implied that productive resources would be shifted from private to public use and that total demand would rise less than the productive potential of the economy.

To help with the balance-of-payments problem, steps were initiated to reduce the net deficit on long-term capital account by £100 million; this is in addition to an expected decline in capital exports for other reasons.

United Kingdom: The budget.

Items	Financial years			
	1963–64	1964–65	1965–66	
	Results		Estimates before budget changes	Estimates after budget changes
	in millions of £ sterling			
Current revenue				
Tax revenue	6,649	7,431	8,035	8,199
Other receipts	638	726	827	827
Total revenue	7,287	8,157	8,862	9,026
Current expenditure				
Supply services	6,000	6,480	7,134	7,134
Consolidated Fund standing services	1,196	1,233	1,348	1,348
Total expenditure	7,196	7,713	8,482	8,482
Total surplus or deficit (—)	91	444	380	544
Consolidated Fund loans (net)	— 527	— 830	— 1,228	— 1,268 *
Overall deficit (—)	— 436	— 386	— 848	— 724

* £130 million of this figure is attributable to increased access for local authorities to the Public Works Loan Board.

Most important, perhaps, it was stressed in the budget, and in other official statements, that further measures would be taken if they became necessary to restore external equilibrium. In support of this position the Bank of England at the end of April made a call for special deposits from the banks and the Governor suggested that the clearing banks limit their increase in advances over the fiscal year to 5 per cent. and urged similar restraint on other banks. At the beginning of June Bank rate was reduced to 6 per cent. and at the same time the minimum down-payment on hire-purchase agreements was increased.

It has been made clear that substantial resources are available and would be used, if needed, to maintain exchange stability, and a further large drawing on the IMF has been arranged and used in part to pay off the credits received from central banks. The immediate effect of these assurances was to strengthen the market position of sterling and, indeed, the external accounts to date in 1965 have improved over a year ago. However, elimination of the external deficit is not looked for until well into next year, and it is difficult to foresee developments that far ahead.

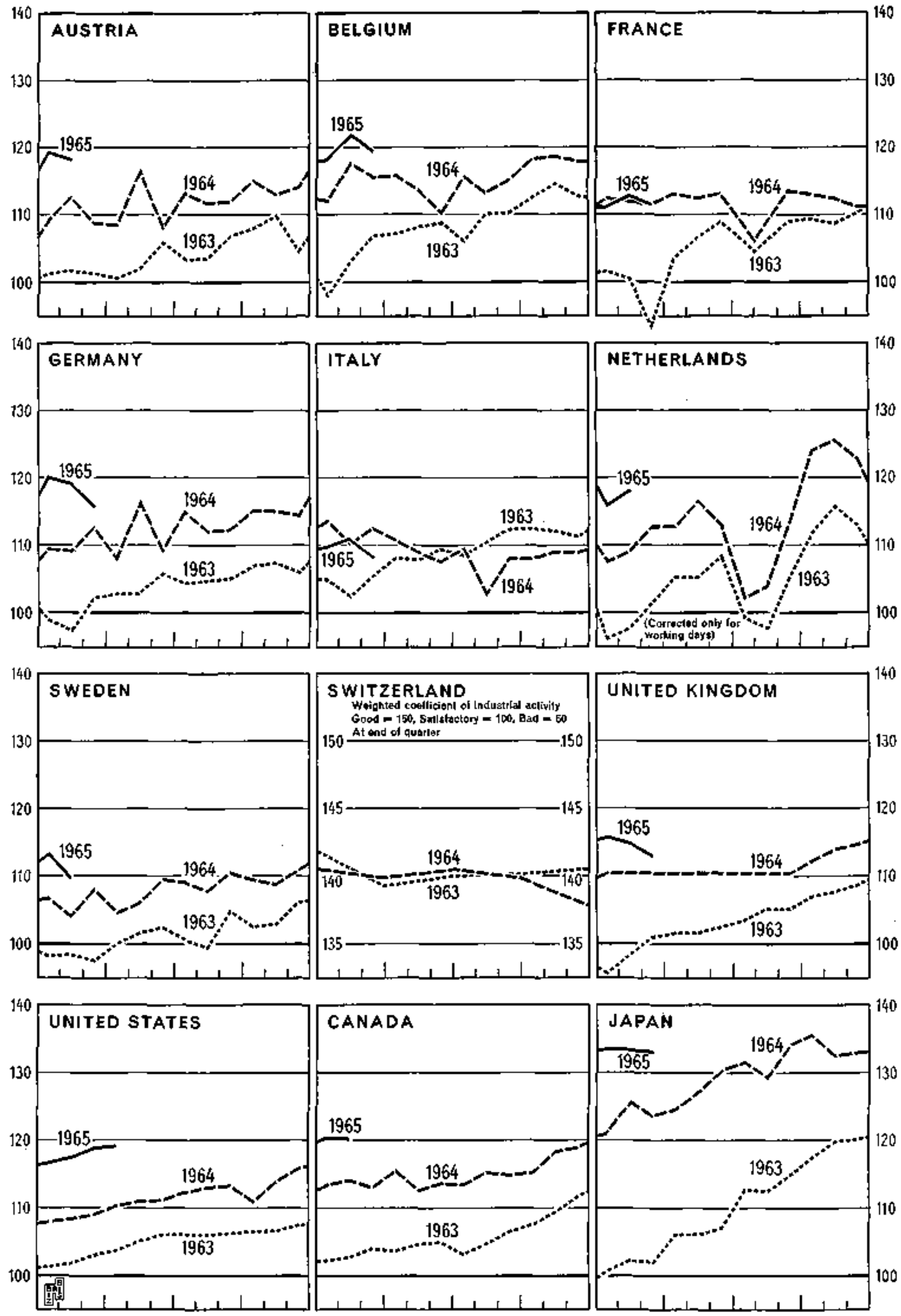
Developments in continental western Europe.

The economic situation in western Europe during the past year was heavily influenced by the rather general policy emphasis on restraint aimed at curbing inflation. As a result, there was something of a pause, or at least a slower expansion of economic activity, in most countries. At the same time inflationary pressures were substantially lessened, although it would be too much to say that they were brought under full control.

The signs of inflation were evident early in 1963, most markedly in Italy and France, but also clearly in several other countries. Owing to the close interdependence of these open economies, the pressures spread relatively quickly in the course of the year and by early in 1964 there were no exceptions to the overheated state of demand. Price and wage increases were generally large, though it was only in Italy and the Netherlands that a deficit in the balance of payments occurred. In response to these developments, policy turned to corrective action. Measures to dampen overall demand appeared in the latter months of 1963, mainly in the form of monetary and credit restraints, although in France and Italy more extensive programmes were initiated.

Over the past year policy has generally aimed at reinforcing the restraint previously initiated. As before, credit policy played the primary rôle in stabilisation. Interest rates tended to rise throughout the Continent, and in many countries this movement was associated with increases in official discount rates. In addition to monetary restraint, several countries acted to scale down public investment programmes and some placed price movements under direct control. Taxes were increased in a few countries and the need for fiscal policy to contribute to stabilisation was recognised in the EEC's

Industrial production.
Adjusted monthly indexes: 1962 = 100.



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prescriptions in April 1964; however, the countries made unequal use of this possibility.

The combination of strained capacity and official restraint noticeably changed the composition of the demand for real resources over the past year. Consumption demand emanating from both the private and the public sector grew less rapidly than in 1963, when it had been one of the mainstays of economic growth. In most countries, particularly in Germany and Italy, the public-sector demand for resources advanced less than in 1963. In a few countries, however, namely, Austria, Denmark, Norway and Switzerland, public consumption rose slightly more. Private consumption, too, generally increased less last year than in 1963, except in Belgium, Denmark and Germany; in the case of Italy the decrease in the rate of growth was quite sharp. On the other hand, the full use of capacity provided the incentive, and the more favourable weather conditions the opportunity, for a larger rise in investment expenditure. Except in Italy and Norway, gross fixed domestic investment expanded more last year than in 1963, and its rate of growth continued to surpass that of the real gross national product. In some countries, particularly the Netherlands, Denmark, Belgium and France, the sharp increase was associated with substantial gains in residential construction. All countries except Italy and Norway showed a larger year-to-year rise in investment in plant and equipment.

Generally high levels of activity, led by especially strong performances in residential construction and agriculture, resulted in a greater year-to-year gain in real gross national product last year. In the main, however, this reflected a maintenance of levels reached following the sharp increases that had occurred in the course of the previous year rather than a dynamic movement within 1964. As the year progressed the effects of official restraint on the growth of demand became increasingly evident. Industrial production, for example, levelled off in the continental OECD countries early in the year and failed to advance until the fourth quarter. This flattening-out of industrial production was a less marked version of the pause that took place during the 1958 recession. At that time, the slow-down of industrial activity lasted thirteen months, while last year the signs of renewed upward movement appeared after nine months. And, as in 1958, last year's outcome was mainly the result of efforts by the authorities to curb an excess demand situation.

Industrial production was most adversely affected in Italy and France, where stabilisation measures had been applied with most vigour. Production in other countries generally grew less rapidly, both as a result of domestic restraint and because the demand impulse from exports tended to be reduced by the measures taken among the main trading partners. The incidence and timing of the slow-down in industrial activity varied considerably, then, from country to country. The dampening effects of restraint on production appeared first in Italy, where production levelled off in the fourth quarter of 1963 and started moving down at the year-end; the decline in output continued in 1964 until September, when output turned up again. In France production stopped

Changes in the gross national product and its components, at constant prices.

Countries	Years	Sources of demand						Resources	
		Consumption		Gross fixed domestic investment			Exports of goods and services	Imports of goods and services	Gross national product
		Private	Public	Total	of which in plant and equipment	of which in dwellings			
		in percentages							
Austria	1962	5.3	1.9	— 0.9	— 1.5	2.0	8.1	5.0	1.6
	1963	5.0	5.6	2.4	2.1	3.4	8.9	9.8	4.4
	1964	3.6	6.0	9.1	8.0	10.5	7.9	9.2	6.0
Belgium.	1962	4.2	5.2	3.8	8.4	— 9.5	9.2	8.0	4.3
	1963	4.6	6.7	1.6	4.6	— 8.3	7.9	9.2	3.6
	1964	5.0	2.5	10.5	6.5	17.5	10.0	11.0	5.5
Denmark[1]	1962	6.8	12.1	8.3	8.3	8.0	5.4	14.0	5.5
	1963	0.4	4.6	— 2.2	— 1.8	— 4.1	10.4	— 1.3	1.8
	1964	6.0	5.0	16.1	14.4	25.0	7.9	18.4	6.7
France	1962	6.9	4.3	7.6	8.4	6.1	3.1	8.6	6.6
	1963	6.6	2.7	6.8	5.9	9.6	8.6	12.9	5.1
	1964	4.3	2.8	8.4	6.0	15.8	7.5	11.8	5.4
Germany	1962	6.0	12.1	5.8	6.6	1.9	4.3	11.4	4.1
	1963	2.8	8.0	2.2	2.3	1.5	9.6	8.3	3.2
	1964	5.3	0.1	11.0	10.8	11.8	10.1	11.3	6.5
Italy	1962	7.4	4.3	8.8	6.7	15.3	10.7	15.1	6.3
	1963	9.7	7.7	7.4	5.8	12.3	6.7	21.8	5.2
	1964	2.4	3.9	— 9.2	—14.8	5.0	10.9	— 5.9	2.7
Netherlands. . .	1962	4.9	6.7	3.1	4.8	— 5.5	6.3	7.5	2.6
	1963	7.1	2.8	3.9	3.4	6.4	6.4	9.6	3.6
	1964	6.0	0.1	15.0	12.7	26.9	11.0	13.9	7.4
Norway[1]	1962	3.7	5.4	5.5	6.5	— 0.1	5.9	6.1	3.0
	1963	4.1	4.3	8.1	9.4	0.4	10.4	9.0	5.3
	1964	3.6	5.1	2.9	3.3	0.7	9.8	7.0	6.3
Sweden[1]	1962	3.5	7.0	4.8	3.6	8.8	7.8	6.8	3.6
	1963	5.2	5.7	7.5	7.0	8.9	7.3	7.0	5.0
	1964	4.4	5.1	7.9	7.1	10.2	8.4	6.8	6.0
Switzerland . . .	1962	6.6	8.9	10.7	15.7	— 1.8	6.0	10.4	5.1
	1963	5.9	5.9	6.4	6.1	1.3	5.2	5.2	4.7
	1964	4.3	6.7	9.3	9.5	8.8	5.3	8.6	4.8
Total for above countries . .	1962	6.0	7.5	6.4	7.0	4.5	5.8	10.0	5.0
	1963	5.4	5.4	4.6	4.6	4.6	6.1	10.2	4.1
	1964	4.4	2.4	6.8	5.4	11.5	9.5	9.1	5.4
United Kingdom .	1962	1.9	2.7	— 1.0	— 1.8	2.8	3.0	2.0	0.9
	1963	4.3	2.1	3.2	3.0	3.8	5.0	3.9	4.2
	1964	3.7	2.5	16.0	13.6	25.9	3.3	7.8	5.7
United States . .	1962	4.8	7.0	8.0[2]	7.0	10.6	6.6	8.6	6.4
	1963	3.8	2.5	4.4[2]	4.3	4.8	5.8	5.9	3.4
	1964	5.1	0.0	6.2[2]	8.6	0.1	14.8	7.1	4.8

[1] In the case of Denmark, Norway and Sweden the official data for domestic investment include maintenance and repairs; these are excluded from the above figures. [2] Private investment and new civil public construction.

rising in the first quarter of 1964, oscillated around the same level throughout the year, and in January 1965 stood below its level of a year earlier; signs of a recovery began to appear in March and April. In Belgium production flattened out in the second quarter and remained virtually stable until the end of 1964, while in Sweden production increased further, but at a slower pace than in 1963. In Germany and the Netherlands, on the other hand, industrial activity continued to rise strongly.

As the measures of restraint created a pause in the advance of industrial activity, they were reasonably successful in reducing the overhang of excess demand and thus in easing the pressures on prices and wages. As a result, the upward trend of prices and wages slackened over the past year. The progress made in dampening price rises was accomplished in the face of higher world-market prices for certain key raw materials that western Europe imports in large quantities.

The effect of reduced demand on the pace of price advances, like its effect on output, had a different incidence and timing in different countries. As was to be expected, results were evident first in France and Italy, beginning in the early months of 1964. Both countries registered smaller rises in wholesale and consumer prices during the past year than in 1963. In France, in fact, the rate of increase was reduced substantially with the aid of broad official intervention to block prices. In Italy, on the other hand, even though the rate of advance was diminished somewhat, this was a relatively poor performance given the sharp reduction in demand and output, and the continued rise in consumer prices at a rate exceeding 6 per cent. per annum was hardly satisfactory.

Switzerland, too, achieved early in 1964 a reduction in the rate of price increases that continued throughout the year. In Belgium and the Netherlands the turning-point for prices came somewhat later. In Belgium prices rose in the last quarter of 1963 and upward pressures continued during the first half of 1964. In the second half of 1964, however, the upward movement of wholesale prices subsided considerably, and in the fourth quarter of 1964 and first quarter of 1965 the pace of consumer-price advance also slackened. In the Netherlands, likewise, prices began to rise sharply in the fourth quarter of 1963 and continued to move up vigorously in the opening months of 1964. By the second quarter, however, the advance of wholesale prices had returned to modest levels, and by the third quarter the advance of consumer prices slackened. In Sweden and Germany consumer and wholesale prices last year continued to increase at about the same rates as in the past; some intensification of the upward pressure has occurred in recent months. Thus, price developments on the Continent appear much more satisfactory now than they did a year ago, even though the signs of inflation have not disappeared in all countries.

On the other hand, the development of wages over the past year has been much less satisfactory. Only in France and Switzerland did the rise in wages slacken, although the increase in France, at more than 6 per cent., was still substantial. In Germany, Belgium and the Netherlands the advance in wages accelerated in 1964, while in Italy and Sweden it was about the same as in 1963. In Italy, however, the continued rapid rise in wages in the face of reduced demand for labour still presents a problem for stabilisation policy, though it may be explained in part by a follow-through of the earlier wage outburst.

Prices and wages.

Periods		Consumer prices	Wholesale prices	Hourly wage rates[1]	Consumer prices	Wholesale prices	Hourly wage rates[1]
		Indexes: 1962 = 100					
		Austria			Italy		
1963	1st half	102.6	98.7	102.2	106.2	104.3	107.7
	2nd half	103.0	98.1	108.9	108.7	106.2	113.7
1964	1st half	105.0	102.4	110.9	112.1	108.4	123.6
	2nd half	107.5	104.9	110.9	115.5	109.0	130.0
1965	1st quarter	108.5	104.9	115.9	111.7	109.7	134.1
		Belgium			Netherlands		
1963	1st half	101.4	102.1	106.2	103.8	101.3	107.1
	2nd half	102.9	102.9	110.4	103.3	103.6	108.7
1964	1st half	105.1	106.5	116.6	108.7	108.3	122.4
	2nd half	107.7	109.1	122.7	110.5	109.1	128.3
1965	1st quarter	109.0	108.3	127.3	111.7	.	132.3
		Denmark			Norway		
1963	1st half	105.1	103.5	106.5	102.7	100.0	105.8
	2nd half	105.7	103.0	109.4	102.5	101.0	104.6
1964	1st half	108.3	104.7	115.4	106.8	103.2	110.8
	2nd half	110.5	106.0	.	110.0	106.4	111.4
1965	1st quarter	113.2	106.2	.	111.7	106.6	.
		France			Sweden		
1963	1st half	103.6	102.9	106.8	102.2	102.3	107.4
	2nd half	106.1	104.4	111.2	103.5	104.2	109.7
1964	1st half	107.6	105.1	115.1	105.3	106.6	113.7
	2nd half	108.9	105.5	118.8	107.5	109.6	117.4
1965	1st quarter	110.0	106.8	121.2	108.9	111.5	124.6
		Germany[2]			Switzerland		
1963	1st half	103.0	100.4	105.3	102.5	103.7	104.9
	2nd half	103.0	100.6	108.0	104.4	104.0	107.1
1964	1st half	105.0	101.1	112.9	106.0	105.6	111.0
	2nd half	105.8	102.1	116.9	107.2	106.1	112.9
1965	1st quarter	107.2	103.3	.	108.1	105.8	115.9

[1] Hourly wage rates of all wage-earners in manufacturing or total industry (for Italy, Netherlands and Norway, male workers only; for Belgium, Denmark, Norway and Sweden, hourly earnings). [2] Wholesale prices are producers' prices of industrial products.

The continued rise in wages made for increases in industrial unit labour costs on the Continent, despite productivity gains. Higher unit labour costs, together with rising raw-material prices and only slightly rising industrial prices, led to reduced profit margins in manufacturing. Now that the countries have only a small current-account surplus in the balance of payments, this process could lead to external difficulties in the future from reduced competitiveness of industry.

The combination of a levelling-off in production and continued increases in prices and wages posed a difficult problem for policy in the latter months of 1964. The lagged effect of restrained demand on prices and wages was such that the reduction in their upward movement had not yet been fully satisfactory. On the other hand, the pause in output, even at the relatively high levels attained early in 1964, could not be accepted indefinitely. In the closing months of 1964 and the beginning of 1965 the dilemma posed by this situation was gradually being resolved by cautious moves to relax the degree of restraint imposed on the economy. As in most other developments, this stage was reached first by Italy, which had already taken preliminary steps to relax monetary restraint in the summer of 1964. Reflationary measures were intensified as the year progressed and were rewarded by an upturn in industrial activity in the fourth quarter of 1964. In the spring of 1965 France and Belgium also began to make token moves towards easing the degree of credit restraint in force.

The actions of Italy, and to a lesser extent France, in relaxing restraint measures before price and wage developments had given full satisfaction point to the difficulty that faces many continental countries. Despite the wide range of policy instruments at their disposal, the authorities have experienced difficulty in reconciling domestic growth with reasonable price and wage stability even after total demand ceased to be excessive. Undoubtedly, the missing policy instrument that would facilitate the attainment of these twin domestic aims, as well as help reconcile domestic aims with external balance, is an adequate incomes policy. The need for incomes policies has already been recognised in several countries, and it is to be hoped that all the parties involved — industry, labour and government — will see that their own longer-term advantage lies in making such policies effective.

As regards international payments, 1964 was another year of substantial surplus for the continental countries. The overall surplus of the area rose by $700 million to almost $3 milliard. As in previous years, most of the reserve increase was concentrated in the EEC countries, where the sharp improvement in Italian reserves more than compensated the smaller rise in German reserves. As for the current account, the Continent as a whole moved from a deficit of $970 million in 1963 to one of $500 million last year. Again, a large part of this improvement was in the EEC's current balance, and again this development can be accounted for entirely in terms of the sharp improvement in the Italian current account, which more than offset the deterioration in the combined accounts of the other EEC members.

Thus, in the field of international payments the most notable development last year on the Continent was the rapid response of the Italian balance of payments to the corrective measures undertaken by the Italian authorities. Aided by the financial assistance made available by several other countries and the IMF, the authorities were able to fend off speculation against the lira. The elimination of the excess demand situation in the Italian economy had the desired effect on the external accounts. In the last three quarters of 1964 imports decreased at an annual rate of 10 per cent., while exports expanded at a rate of 20 per cent. This rapid and substantial recovery of the trade balance, along with an inflow of long-term capital, brought the Italian balance of payments back into surplus. A second important development of the past year was the return of the German payments position to virtual balance following the measures taken to discourage capital inflows. The success of these measures prevented the large German surplus that seemed imminent in early 1964 from materialising and thereby eliminated a potential major source of imbalance in the payments system.

In recent months the increase in reserves of the continental countries has been at a lower rate, reflecting the measures taken in the United States and the United Kingdom to correct the balance-of-payments situation. However, the change does not yet appear to be a decisive one, partly because the flow of funds to the United States has to a large extent come from the Euro-dollar market.

In sum, then, the price rises in the continental countries have generally been much reduced and the pressure of demand has considerably lessened. This has been accompanied by slower growth of output — amounting in a few countries, particularly Italy and France, to near-stagnation. While stronger measures to stimulate demand in those countries would seem appropriate, the tendency for wage increases to be excessive must inhibit a forthright expansionary policy.

In addition, the mixture of policy measures to dampen domestic demand has not been such as to facilitate a basic adjustment of the external disequilibrium. In France balancing the budget was a major factor in the measures of restraint, and indirect taxes were raised in Sweden and, to a lesser extent, in the Netherlands. Generally, however, reliance has been placed on monetary restriction, with the result that interest rates rose significantly at a time when the inflow of capital from abroad was already a problem. In Germany income taxes were reduced at the beginning of this year, despite overheating of the economy, thereby increasing the burden of domestic stabilisation on monetary policy. In the Netherlands, too, income-tax reductions are scheduled to come into force this year — although monetary policy is still restrictive. In some countries, also, the high rate of investment in the public sector relative to public saving, as well as special incentives to housing, have for some years been a dominant factor in the high level of interest rates. Thus, there is a continuing problem of finding means for managing domestic demand that would allow monetary policy to be oriented more to the external situation.

Eastern Europe.

Developments in this part of Europe in 1964 can be regarded as generally favourable. In some respects the improvement last year was connected with better weather conditions than in 1963, when both industry and agriculture were severely hit by the extremely cold winter.

Results in a few of the countries in the area, however, did not match up to the targets set in the annual plan, and it seems that in a number of cases attempts are being made to shift from rigid administrative norms in favour of market-type incentives — in the direction, that is, of partial replacement of quantitative targets by higher standards of quality and financial return. This process implies greater flexibility in price-fixing techniques and much more reliance on trade with the rest of the world.

In 1964 the expansion of foreign trade continued, and indeed accelerated somewhat, both within the area and in relation to outside countries. The expansion, however (between 8 and 9 per cent.), is lower than that achieved by most industrialised countries of the West; this is particularly true in the case of the USSR, where the rise was 5.5 per cent.

In the *USSR* national income rose by 7 per cent. in 1964. This represents a recovery from the declining trend of growth since 1961. It was achieved mainly because of the better performance in agriculture, where output rose by 12 per cent., after falling by 7 per cent. in 1963. The favourable results in 1964 made it possible to reduce cereal imports and reconstitute stocks, and to make good some of the previous year's losses of cattle. Industrial output, while still expanding at a relatively high rate, shows a tendency to decelerate. Between 1955 and 1960 the rate of growth of industrial output had averaged close on 11 per cent.; in the three-year period 1961–63 the average was 9 per cent. and in 1964 7.1 per cent. The branch in which expansion in 1964 clearly exceeded the average was the chemical industry, while branches which fared less well than the average were light industry and, more especially, the clothing industry, whose output actually declined.

The plan for 1965 sets rather high targets. Real income of households is to rise by 7.3 per cent., industrial output by 8.1 per cent. and the national income by 8 per cent. to a level of Roubles 190 milliard, or — at the official parity — some $210 milliard.

In *Czechoslovakia* agricultural output in 1964 remained at about the same level as in 1963, as a shortfall in the vegetable crop due to the summer drought was offset by higher output of animal products. Better results were obtained in industry, where output rose by over 4 per cent. — more than was planned for — after the setback in 1963. The process of correcting the maladjustments that had arisen out of the hectic investment activity up to 1961 is still continuing and has influenced the plan for 1965, under which nearly all the increase in output is to be allocated to new investments in the sectors in which bottlenecks are still impeding the full exploitation of the country's resources.

At 9.3 per cent., the rise of industrial output in *Poland* in 1964 was well above both the plan targets and the 1963 results. Most of the increase was due to higher productivity, the best results being achieved by the consumer goods industries. Less favourable results were recorded in agriculture, whose output went up by less than 1 per cent., notwithstanding the sector's increasing share of the country's investment outlays. The need to reduce

Centrally-planned economies:
National income, industrial production and productivity.

Countries	National income[1]			Industrial production[2]			Productivity[3]		
	1962	1963	1964	1962	1963	1964	1962	1963	1964
	annual increases, in percentages								
Bulgaria	6.2	7.3	6.0	11.0	10.0	11.1	7.9	4.6	8.1
Czechoslovakia	1.4	−2.2	0.0	6.3	−0.6	4.1	3.2	−0.9	3.5
Eastern Germany	2.1	2.7	4.7	6.2	4.3	6.7	6.6	4.8	6.5
Hungary	4.7	5.7	5.0	8.4	7.1	8.8	4.6	2.9	4.9
Poland	2.0	6.5	5.0	8.6	5.4	9.3	3.2	1.6	7.1
Rumania	4.5	10.0	10.0	14.8	12.3	14.1	6.7	7.1	10.0
USSR	5.7	4.2	7.0	9.7	8.1	7.1	6.2	4.9	4.0
Yugoslavia	4.0	14.0	12.2	6.8	15.6	16.0	3.4	10.2	7.5

[1] Net material income. [2] Gross output. [3] Output per man in industry.

production costs has for some time now been leading to the adoption of rationalisation measures, which has caused the emergence of unemployment in urban districts and under-employment in rural areas. In order to alleviate this situation, policy is aiming at substantial increases in exports, particularly to the West, of products with a high labour content.

In *eastern Germany* the labour situation, while still tight, seems to have eased somewhat in 1964. Whereas both in 1962 and 1963 the number of workers in industry had declined, last year there was a slight increase. This, combined with a 6.5 per cent. rise in output per man, brought about a 6.7 per cent. growth of industrial output. Results seem to have been good also in agriculture, so that the national income increased by 4.7 per cent. — the highest rate recorded since 1959. Thus, after the decline registered in 1963 personal income rose by over 4 per cent.

In the southern part of eastern Europe, *Rumania* achieved the highest rate of growth, as regards both national income (+10 per cent.) and industrial production (+14.1 per cent.), and it seems that agriculture also had a good year. Since 1959 industrial output has doubled and nearly two-thirds of the gain has been due to the rise in productivity. The most dynamic branches have been the chemical, electricity and engineering industries. The plan for 1965 has set as a target for industry a rise in output of 13 per cent. and in labour productivity of 9 per cent.

At 6 per cent., the growth of national income in *Bulgaria* was lower than planned and below the results for the previous year, but still above the average for the group. Thanks to favourable weather conditions, and also to technological improvements and the bringing into cultivation of certain marginal areas, the gross output of agriculture increased substantially; the net value of output, however, rose much less. Industry continued to expand vigorously. In 1964 its global output was 11.1 per cent. up on 1963, with output per man 8 per cent. higher, thanks to the coming into operation of extensive plant in the producer-goods sector.

In *Hungary* the higher growth of industrial output in 1964 over 1963 (8.8 against 7.1 per cent.) was offset by the decline in agricultural production following the severe summer drought, and national income expanded by 5 per cent., compared with 5.7 per cent. the year before and a 6.7 per cent. plan target.

The plan for 1965 — with a 3 per cent. growth target for national income — is indicative of retrenchment reflecting, possibly, the relatively less favourable development of investment goods sales to other parts of the area and also the desire to concentrate on the necessary readjustment in the various branches of industry.

In *Yugoslavia* 1964 was a year of overheating of the economy, and in the course of the year the policy of "relance", which had been initiated in the second half of 1962 and carried on in 1963, had to be reversed so sharply as to greatly influence the plan targets for 1965.

On the supply side the year under review was generally favourable. Agricultural production, after an increase of 9 per cent. in 1963, rose further in 1964 by nearly half that amount. And the record of industry has been impressive, an upward jump of 16 per cent. last year following upon that of 15.6 per cent. the year before. The branches that rose fastest were the basic-products industries, while the main consumer goods industries, though expanding rapidly by any other standard, increased less than the average. The rate of industrial growth seems to have reached its peak towards the middle of the year, and since then a certain deceleration has set in.

Demand expanded even faster than supply, the way being led by an upsurge in investments; in the first half of 1964 they were more than 40 per cent. above the level twelve months earlier. This development was a response to the various stimulating measures taken in 1962 and 1963 and also reflected the huge outlays in connection with the reconstruction of Skoplje.

Consumer demand was also much stronger. With personal incomes rising by between 25 and 30 per cent. — because of increased employment and higher wage rates — it is not surprising that the cost of living went up by 15 per cent. between the last quarters of 1963 and of 1964 and that the trade balance deteriorated by $160 million to produce a deficit of $430 million.

Beginning in the second half of 1964, the authorities had recourse to measures of restraint by tightening consumer-credit conditions, limiting the banks' freedom to grant investment credit and freezing part of the banks' loanable resources. Furthermore, the Federal budget for 1965 has also been shaped so as to have some restraining effect.

The plan for 1965, while setting targets of 9 and 11 per cent. for the rise in the national product and in industrial production, and of 11 per cent. for private consumption, actually provides for a reduction in investment — particularly productive investment. Housing construction, however, should continue to increase.

Debate on the international monetary system.

After a year of intensive study, three reports on the international monetary system were published in the summer of 1964. They have contributed to a deeper understanding of the mechanics of the system, but in clarifying various points of view they have also sharpened the controversy about what is wrong and what ought to be done.

The report of the non-official economists is very helpful in searching out the assumptions and value judgments which lie behind the diversity of views in the economics profession. It does not aim, however, at agreed proposals to guide the future of the system.

The study by the IMF concentrates on possible extensions of IMF facilities to supply liquid resources for the overall requirements of the system as well as to countries in need. While the ideas are stimulating, they are not in the form of concrete proposals for immediate action.

The Group of Ten report presents official views on the matter. While it ostensibly deals with more distant quantitative requirements of the system, the background of the US deficit inhibited commitments for the future which might have practical implications for the present. Its negotiated language also reflects differences in attitudes towards the present functioning of the system, differences that have been highlighted by statements at the Tokyo meeting of the IMF and subsequently. Despite affirmation in the report that the system has shown great flexibility and that international liquidity is adequate for present needs, an impression emerges that action to improve matters is required but that there is little agreement about which way to go.

The proposals of the Group of Ten represent a compromise close to stalemate. It was agreed, first, that Working Party No. 3 of the OECD, with the help of information gathered by the BIS and of discussions among the Governors, should exercise multilateral surveillance over the financing of external deficits and surpluses. This may be considered a positive step which should help focus discussion on the essential questions. It recognises that bilateral financing and liquidity creation affect the system as a whole and are therefore a proper subject for multilateral discussion. While the "surveillance" does not infringe any country's sovereignty, it is intended to bring international opinion to bear, not just on the means of financing employed, but on the deficits and surpluses that the financing facilitates. It was, in a sense, a counterbalance to the second proposal, namely, that of supporting an increase in IMF quotas. The 25 per cent. general increase, later agreed upon, was itself a middle course between the much larger and much smaller quota increases that various countries favoured. The other two proposals agreed to by the Ten were that studies be undertaken of the process by which deficits and surpluses are adjusted and of possible new reserve assets; these steps in effect postpone questions that could not be resolved during the preceding year and which, under present conditions, are not likely to be resolved by a few months of further discussion.

While more notice has been taken of the impasse on what the future changes in the international monetary system should be, the fundamental debate is on what the real problems of the system are. In the face of disagreement on the problems, it is indeed difficult to agree on their solution. In effect, the various solutions offered move in rather opposite directions, so that the balance of forces tends to result in a standstill.

The issue hinges on the character of the balance-of-payments disequilibria, with the persistent US deficit being the principal casus belli. To over-simplify somewhat, one side believes that balance-of-payments deficits can usually be reversed only over a considerable period of time — especially as there is not an equivalent compulsion on the surplus countries to adjust their surpluses. They consider it inappropriate to use corrective measures that interfere unduly with domestic economic growth — let alone those which would cause internal deflation or unemployment. Furthermore, they have disliked direct controls over capital movements and have all but excluded exchange rate changes as a means of adjustment, especially for reserve currencies. Hence, they consider that international reserves must be amply supplemented by borrowing facilities to give enough time for longer-term adjustments in the domestic economy.

For the other side, all this is an excuse for feeble measures. They believe the deficit countries are over-cautious in using monetary and fiscal policy to help the adjustment process and that they give excessive priority to the domestic situation. Consequently, this side considers that the surplus countries have been left to make the adjustment through imported inflation. They accept the idea of direct capital controls in case of need and consider that a deficit caused by capital outflows, apart from a sudden flight of funds, should not be financed by international assistance. Although less shocked by the idea of exchange rate adjustments, they naturally hesitate in practice to judge particular cases as fundamental disequilibria. As they see it, borrowing facilities should have rather strict limits, for if the surplus countries continue to finance the deficit countries there will never be an end to it.

The two bones of contention, therefore, are the adjustment process and international liquidity. While appraisal of these questions must be a matter of judgment rather than of definitive proof, the experience of various countries over the past decade throws much light on them.

The adjustment process. With regard to the adjustment process, it is abundantly clear that imbalances cannot simply be left to correct themselves with the passage of time and that effective policy measures must be brought to bear. But it is equally clear that the main impediments to prompt and effective action are not economic but political. In case after case one has seen deficit countries delay action and play around with half-measures while reserves were drawn down and liquid resources were borrowed from abroad — to avoid political difficulties. But, as the means of financing became scarce and a crisis developed, the doubts were somehow resolved and the policy measures that were impossible and could not work became possible and did work. In the surplus countries also, appropriate fiscal measures, for example, have often been avoided because of political considerations, while the burden of containing inflation was left to monetary policy — to the detriment of international equilibrium. To see the importance of the political factor vividly, one has only to recall some of the inconsistent policy positions that have blossomed in election years.

There is, to be sure, no possibility of making stabilisation policy in a political vacuum. But it should be feasible, none the less, to improve on present practice. It is evident, for example, that the whole mechanism of the annual budget, which involves forecasting economic developments a year to eighteen months in advance, and which largely freezes fiscal policy over that period, is no longer adapted to the rôle that fiscal changes have to play in the management of the economy. This inflexibility could be reduced by delegation of circumscribed powers to the stabilisation authorities, which would also give a more technical character to current policy action. In present circumstances, however, the political brake on the adjustment process does support the case of the advocates of international hard money — as the liquidity pinch seems so often the only spur to action.

On the other hand, there have been cases of disequilibrium in recent years that, even with prompt action, would have taken a certain time to overcome. Full employment, economic growth and price stability do deserve priority and it is evident that neither deficit nor surplus countries are willing wholly to sacrifice these objectives to external balance. Indeed, the difficulties of reconciling objectives arise because all countries want to maintain a shock-absorbing cushion around the domestic economy to isolate it in some degree from outside forces. But, if there is to be any sort of adjustment process, domestic priorities cannot be absolute; emphasis of policy must be able to be shifted at times to promote correction of external disequilibrium.

So far as the current account is concerned, the difficult situation occurs when the cost and price level has become somewhat out of line and thereby weakened the competitive position of the economy. In such a situation, exports tend to lag and rising imports tend to deteriorate the current external balance. The adjustment process requires that domestic incomes, particularly wages, be held in check for some period of time while the continuous rise in productivity operates to strengthen the competitive position. Both wage policy and some ease in the labour market have been effective in a number of cases in securing this result, though in other cases the standard achieved for wage restraint has been too lax to accomplish much. To correct the disequilibrium of this kind between two large areas, as between the United States and western Europe a few years ago, some upward movement of prices in the surplus countries also helps the adjustment process.

All this means that an adjustment of cost levels cannot be accomplished overnight, even though signs of improvement should emerge without unreasonable delay. If action produces no results, then either it is not action or the problem is one of an overvalued currency. And, of course, if the price of the currency is to be a matter of prestige, the price of foodstuffs a matter of politics and the price of labour a matter of monopoly — with some cartel pricing thrown in here and there — one may wait a long time indeed for the adjustment process to show itself.

For imbalance due to excessive flows of capital funds, the outstanding case since the restoration of convertibility has been that between the United States and continental Europe, complicated by the rapid growth of the Euro-dollar market. The classic remedy of narrowing interest differentials seemed indicated and some progress was made in this direction by 1963 with regard to short-term rates. But with the United States reluctant to effectively tighten domestic liquidity and western Europe shifting to monetary restraint to combat inflation, first Europe and now the United States has introduced special techniques to limit excessive capital flows.

In order that the authorities may have a margin of freedom to use monetary policy for domestic purposes, it does seem that they need to be able to have some means of control over flows of capital funds to help manage the balance of payments. At the same time, the use of such measures is a retreat from convertibility which holds dangers of its own. It would be unfortunate if the policy-makers in both the deficit and the surplus countries should wholly succumb to this easy way out, instead of experimenting more daringly with the mixture of fiscal and monetary policy that the logic of convertibility calls for. There is a true equilibrium for a market economy, and national policies cannot be considered successful unless they are providing the incentives to market forces to move towards it. It must be recognised that such a true equilibrium of interest rates and capital flows can likewise be attained only through a relatively slow process of adjustment and structural change, unless other objectives are drastically sacrificed.

To sum up the matter, experience indicates that neither side in the debate on the adjustment process has the whole truth. While perhaps the main difficulty has been that countries have been dilatory in promoting equilibrium, it is also clear that there have been situations of imbalance that could not have been overcome in the short run in the best of circumstances. Access to international credit to finance such swings was essential, even though the swinging could have started earlier and gone faster. To improve the adjustment process it is necessary for the pot to stop calling the kettle black and to get down to realistic appraisal of respective adjustment responsibilities.

* * *

It is relative to the adjustment process that a return to the gold standard by the principal countries has recently been advocated. The idea is that the gold exchange standard allows inconspicuous financing of the reserve centres' deficits until a danger point is reached, and that their policy action would be firmer if they had to use gold at an early stage. There is some truth in this argument and indeed it may be said that the relatively lax use of the gold exchange standard has had inflationary consequences, although this is in no way unavoidable. In any event, several considerations limit the appeal of the gold standard.

First, the practice of holding foreign assets in reserves arose not from a formal decision but from the free choice of central banks, motivated by the benefits that they found in doing so. To give up the practice would also be to give up the benefits — which include not only the possibility of holding earning assets in reserves but also having access in case of need to a large international banking centre, the flexibility of which would be very much restricted if it were threatened with loss of gold for every large foreign borrowing on its market. For the system as a whole, it is evident that the gold exchange standard made possible the re-establishment of European reserves in the 1950s. This, in turn, greatly facilitated the rapid reconstruction and economic expansion of Europe and the achievement of high employment levels. In this period, when there was widespread discrimination against dollar goods and a general condition of dollar shortage, the moderate increase in US liabilities to foreign official holders reflected the initiative of other countries to build up reserves rather than an initiative by the United States to finance its deficit.

Secondly, any of the main countries has a combined reserves and credit potential that allows it to exercise a major impact on its trading partners. This would not be greatly different under the gold standard from what it is under the gold exchange standard, unless credit were drastically curtailed in the system. In this context, it can be noted that since the end of 1960, as the rise in official dollar balances was becoming excessive, the policy of the main central banks has limited further increase. Since that time, in spite of continuing US deficits, the accumulation of dollars by the European central banks in the Group of Ten has accounted for only a small part of the US official financing — under a milliard dollars. The bulk has been through gold sales and overt use of credit such as IMF facilities, Roosa bonds and debt prepayment by foreign countries, with swings financed through the swap network.

Of course, with purely mechanical rules and elimination of international credit in the system, the effect of the gold standard would be to give overriding priority to external adjustment over domestic considerations. This, however, would be to reverse the longer-term progress that has been made towards achieving multiple policy objectives and it is not likely that either debtors or creditors would risk it. Few advocates of the gold standard would be in favour of complete automaticity. To attempt to impose such a system on a broad scale would be more apt to lead countries to explore payments systems reducing the rôle of gold than to ensure its exclusive status.

International liquidity. With regard to liquidity, the Group of Ten report concluded that the present amount was fully adequate for overall needs but that a shortage was likely some time in the future, given the limited supply of new gold for reserves and the prospect that dollar holdings would not increase at their former pace.

With a US deficit of large size, the increase in gross reserves in the system has necessarily been large and, indeed, contributed to the inflationary tendency in the surplus countries. Hence, it is easy enough to agree that a better balance in payments, rather than liquidity, is the pressing problem of the system. To say this more forcefully, it is not so much the system that has been at fault as the policies countries have followed in using it.

Behind this, however, is a sharp difference of views. For some countries, the present "adequacy of liquidity" means that there is already enough and that a hardening of international credit is essential if the payments disequilibrium is to be ended. A similar attitude developed in the later stages of the European Payments Union in the face of persistent imbalance. For other countries, however, the present "adequacy of liquidity" means not only the existing size of aggregate reserves but the process by which this aggregate could be increased through use of credit facilities. To them, this use of international credit arrangements is the essential factor which prevents a general liquidity shortage and allows payments swings to be financed.

Because of this difference of opinion about the present situation, no agreed view on the future mechanics of reserve creation has emerged, even though it is accepted that a future problem is likely.

This future problem has two aspects. The aspect on which attention has usually focused concerns the mass of overall reserves. With limited increase in new gold and in holdings of reserve currencies, this mass will tend to shrink in relation to the expected rising volume of international transactions. A possible shortage of liquidity arising in this way, however, does not seem particularly pressing for two reasons. First, the functional relationship between the volume of transactions and the volume of reserves cannot be demonstrated and is necessarily rather vague. Secondly, this ratio would be only marginally reduced by the changes in any one year, so that it would take considerable time to affect the system as a whole. From this standpoint, then, there is little force to fears that world monetary liquidity may not keep pace with the demands of expanding trade or to complaints that the process of reserve creation is haphazard.

The other aspect of the problem concerns the norm for the annual increment to reserves. As countries generally would like to stay on the right side of equilibrium, and as it is quite appropriate that they aim normally at a moderate increase in reserves, this aspect of the matter would be likely to be more immediate.

In the system at present, new gold output (or dishoarding) is the only asset which provides increased reserves without some country or other being in deficit. This is because gold is a current-account export for the gold-producing countries, whereas other reserve assets arise from credit transactions which involve liabilities corresponding to increases in reserve assets. But, at the same time, no country is expected to pile up liquid liabilities continuously and no country can be pleased to be in deficit for an extended time. Equilibrium in the system may, therefore, be defined as a situation in which the sum of all countries' surpluses is equal to the annual flow of gold into reserves and no countries are in deficit.

The flow of gold into reserves has been running at under $650 million a year, and, even without unusual private hoarding, it would not be much larger. It is hard to envisage that, at any given time, the sum of surpluses of the Group of Ten — let alone of all convertible currency countries that happened to be in surplus — could normally be limited to the amount of new gold alone, even with the deficit countries pursuing active policies of adjustment. Monetary policy for a sizable group of countries cannot be expected to secure such precise results. To the extent that it did not, the difference would be reflected in deficits of other countries. One might say that deficits in the countries which happen to form the weakest links in the chain are almost a norm of the system. From this standpoint, the continuous deficit of the United States since the early 1950s has provided a cover for other countries; when it is eliminated, the need for an adequate margin for increasing reserves, which would at the same time finance reasonable balance-of-payments swings by acceptable means, is likely to become clearly evident before too long.

While there is no dearth of suggestions, it must be said that a simple, self-evident solution to these problems does not stand out as a shining light. For the time being, the don'ts are more evident than the dos. Thus, to infringe sovereignty is not acceptable; neither is utilising liquid resources for long-term capital needs; neither is meeting the overall needs of the system by financing persistent deficits; and neither are schemes which upset market confidence or give large reserve-holding countries a needless potential for exporting inflation.

All this does not mean that co-operative means will not be found to meet real needs when they arise. For, without the complication of an excessive US deficit, it should not be impossible to improve existing arrangements and to devise new ones which offer reciprocity, coverage of exchange risks and flexibility in the terms of the asset/liability relationships, and at the same time incorporate safeguards against abuse. The point is that we are likely to see the system develop by an evolutionary process of concrete and limited steps in several directions, rather than by enactment one bright day of a new-model system. It is not in the nature of the case that institutional arrangements can be perfectly logical or that financial problems can be definitively solved. To banish financial difficulties, the only permanent way is barter; and to banish balance-of-payments difficulties, the only permanent way is autarky.

Problems of developing countries.

In the period since post-war reconstruction the foremost economic problem has been the economic development of the less-developed countries. In significance and challenge, it is a problem for the present time comparable to what depression and unemployment were in the 1930s.

While the developing countries as a group have made visible progress over the past decade, it must be considered only moderate progress, which has somehow missed exploiting fully the opportunity that was given by the dynamic growth of the industrial countries and by the potential of the less-developed countries themselves. The average rate of growth has been under 4.5 per cent. and tended to be somewhat higher in the earlier years of the decade than in the later years. In the face of very rapid population increase, the rise in output on a per capita basis has slowed down from about 2.5 to under 2 per cent.

This experience has led to a reappraisal of the difficulties of economic development and to better understanding of the many facets of the problem. The deterioration of the terms of trade of the raw-material-exporting countries since 1954 has put an end to any idea that concentration on primary products would automatically generate an adequate rate of growth. The hope that reasonably substantial foreign aid would lead to a rapid rise in living standards and soon make such aid unnecessary has also proved to be an illusion.

Although the handicap they cause differs substantially from country to country, it is clear that certain problems are bound to take considerable time to resolve. Education and population control are in this category, as is the development of entrepreneurs and efficient administration, and, in a few countries, more realistic orientation of governmental aims and reform of feudalistic barriers to a modern economic society. Despite such social and political difficulties, however, it is evident that the economic performance can be substantially improved upon; this can be seen from the wide differences in growth rates among the various countries. To make greater headway it is necessary that the industrial countries give this problem a priority in their policies commensurate with its importance; it is equally necessary that the less-developed countries adhere to policies which give scope and incentive to progressive market forces.

As an economic matter, the various factors in development come together in the balance of payments. What is needed here is not a static equilibrium, however, but a dynamic rise in imports and exports. The capital-equipment needs for growth in less-developed countries require imports, as do the needs for replacement parts, raw materials and even consumption; even with the help of outside capital and aid, this must be financed by a healthy growth of exports. In the typical case of a country experiencing slow growth, balance-of-payments difficulties have been the major obstacle.

From the point of view of development priorities, two problems stand out: food production and industrialisation. Besides being insufficient to support an industrial society, food output has tended to lag behind the growth of population, so that improvement in agriculture is needed to prevent a growing drain on foreign exchange earnings. And, given the limits to raw-material development, industrialisation must be the principal means of expanding exports and of achieving internal growth itself.

In the years after the Korean war, maintenance of the balance-of-payments position of most of the less-developed countries was a constant uphill struggle against deterioration in the terms of trade. The price trend of their primary products exports was downward, whereas their import prices steadily increased. Despite greater assistance from abroad in these years, the external accounts were often in deficit and reserves were drawn down. From 1955 to 1961 total reserves of these countries fell from $11 to 9 milliard, and, in the main, it was only the oil-producing countries that were able not to lose reserves.

The situation in this respect has shown a marked improvement in more recent years. With economic activity rising sharply in both North America and western Europe, primary products prices have strengthened and the terms of trade of the less-developed countries have improved. In addition, after a few indifferent years, 1963–64 was a relatively good year for food output, with the important exception of India. As a result, the overall trade deficit of these countries declined from $3.4 and 2.5 milliard in 1961 and 1962 to $1.0 and 0.3 milliard in 1963 and 1964. Reserves increased by $1.2 milliard from the end of 1962 to mid-1964, although there was some reversal of this movement in the second half of 1964.

As it may be hoped that the earlier downward trend in the terms of trade has now been ended, conditions are more favourable for a substantial increase in the rate of economic growth. This depends, however, on the strength and focus of economic policies. Both the industrial and the less-developed countries need to make a realistic appraisal of what it takes to do the job.

For the industrial countries it is in the areas of aid and trade that their policy assistance is required. The need for outside development assistance has not diminished, but, owing to rising payments for interest and amortisation of past credits, the net inflow of grants and loans has tended to decline. To at least offset this trend, it is essential that a still larger proportion of assistance be on a grant basis and that the terms of loan capital be substantially lengthened.

But a sound development which will have the possibility of enduring and of allowing a future tapering-off of economic aid requires that expanding channels of trade be opened up. Trade policy of the industrial countries must contribute to this end by removing barriers that block off the light-industry exports of the less-developed countries. These countries require the advanced manufactures of the industrial countries in increasing amounts and there is mutual benefit to be gained in fostering this trade.

For the less-developed countries the problem is no doubt many-sided, each with its own difficulties. But there is one crucial aspect that may be emphasised here, as it lies in the sphere of financial policy.

It is a striking fact that about a third of the less-developed countries have an overvalued currency at the official rates of exchange (and the proportion is much higher if the countries are weighted by population). This is attested to by the scope of exchange controls and quantitative restrictions, as well as, in some cases, by export subsidies or multiple rates. Even for highly-developed countries, a relatively small disadvantage in cost and price levels usually shows itself in some stagnation of output, unemployment and a tendency to balance-of-payments troubles. How much more important is this handicap for those less-developed countries where the degree of overvaluation is very much greater and where the process of growth also has to contend with the basic difficulties of shortage of capital, lack of technological know-how, the smaller number of entrepreneurs and limited skilled labour.

The reason for this condition is, of course, inflation. It is a sad fact that fairly steady inflation has been a characteristic of the post-war world. For most industrial countries, and for some of the less-developed, the situation has been aptly described as creeping inflation. This is an evil in itself which we have not yet learnt to cope with. But at least there have been some compensations: economic expansion has been generally rapid and a high level of employment has been maintained — though even creeping inflation has led various countries into difficulties at one time or another.

But when inflation is large enough to lead to an overvalued rate of exchange — with all the artificiality that follows — that is when it really interferes with economic progress. It can just about be stated as an economic law that the farther a country allows the exchange rate to become overvalued, the greater is the obstacle put in the path of economic development.

The typical consequences are very familiar: import restrictions and exchange controls are made tighter and tighter; investment is directed to import saving, and export promotion schemes are introduced; and, as the private sector stagnates for want of essential materials and equipment, planning tends to concentrate resources on the public sector. Apart from the fact that overvaluation of the currency creates a leakage in the external accounts by driving savings abroad, the trouble with this process is that the industries in the public sector by and large do not produce for export.

It is repeatedly said in this kind of situation — sometimes even by exporters — that export prices are competitive. This, of course, is missing the point. It is not the prices of goods that can be exported that are uncompetitive, but of those that cannot be exported. The crux of the matter is that the uncompetitive level of costs prevents potential new export production from even getting serious consideration in business circles. Overvaluation of the currency basically overprices manpower in money terms, and it is in the mobilisation of this resource that such countries must find flourishing exports and an adequate rate of growth.

It is highly relevant that in the fully planned economies there has been a definite movement towards establishing more realistic exchange rates, as well as towards decentralised planning. This has been found desirable so as to give market forces and market prices an important function in determining the allocation of resources and in providing a standard for productive efficiency.

The experience of the less-developed countries themselves bears out this view of the matter. It is precisely the countries that have limited inflation and avoided artificial exchange rates without a vast control apparatus that have shown the better results in economic development.

The record of such countries also shows that inflation is not inherent in the development process. In the main, it has had two important causes. The first is insufficient revenue from taxation to help finance investment in the public sector without inflationary financing. While certain tax rates are often very high, the tax structure is generally not broadly enough based and enforcement inadequate. The second is the pricing policies in the public enterprises. Such prices have often been held down in the face of rising costs, due to inflation itself. The consequence is that public enterprises have not earned a rate of return that enables them to contribute to the financing of their further investment. They become, in effect, a mechanism for subsidising consumption — and that is not the road to economic development.

It should be noted that, given the foreign assistance and capital received from abroad, the investment programmes of the less-developed countries generally have not constituted too large a proportion of their national products. It is rather their financing that has led to inflation and unrealistic exchange rates. Correction of these distortions is essential to a development process which gives an opportunity for growth of exports.

As much has been said and written on this subject, the aim of the brief discussion here is not to cast new light on the problems of the developing countries; it is rather to help give these problems wider attention and to stress, again, the importance of policy in their solution.

PART II

MONETARY AND ECONOMIC SURVEY.

I. CREDIT DEVELOPMENTS AND POLICIES.

In most countries monetary policies over the past year or so have been largely dominated by domestic considerations.

In continental western Europe, where external surpluses were widespread, credit restraint policies have been applied almost universally as a means of combating domestic inflationary pressures. One exception was Italy, where the swing from deficit to surplus, combined with a falling-off in domestic demand, permitted a return to easy credit after the spring of 1964. A similar development occurred in Japan towards the end of 1964.

In the United Kingdom a key aim of monetary policy, following the precautionary rise in Bank rate early in 1964, was to facilitate the upswing in fixed investment then in progress. In the autumn, however, external considerations thrust themselves into the foreground, leading the authorities to raise Bank rate to 7 per cent. and in the spring of 1965 to make a call for special deposits and impose quantitative limits on bank credit.

In the United States, despite the impetus given by fiscal policy to economic expansion over the last two years, the monetary authorities continued in 1964 to keep credit in essentially easy supply. With unemployment still a problem, they refrained from a general tightening of credit on balance-of-payments grounds. Early in 1965, however, concurrently with the introduction of the voluntary programme for limiting capital outflows, the authorities moved to bring the banks under increased reserve pressure.

Viewed broadly, the problem of conflicting external and domestic considerations of policy has continued to be a rather pervasive one. Where it has not seemed practicable to resolve policy conflicts by a more flexible use of general policy instruments, countries have tended to fall back on selective measures that work more directly on the balance of payments, particularly on capital movements. Selective instruments may help in the short run to suppress such conflicts, but as a rule their purpose should not be more than to afford reasonable time for adjustments of a more fundamental nature.

This chapter looks first at comparative saving/investment developments and their implications for capital markets, interest rates, bank credit and liquidity formation. The second part describes, by countries, the objectives and policies which helped to shape these results.

Comparative credit and capital-market developments.

Changing patterns of saving and investment. On the Continent the marked rise in interest rate levels over recent years has reflected a buoyant demand for investment combined with a relative weakening of national saving formation. Saving tended to decline in relation to the national product in many countries from about 1960 to 1963. This process was largely one in which wage increases tended to outstrip productivity gains, under circumstances in which business firms, particularly those in export trades, were unable fully to pass on rising costs through higher prices. The resulting decline in business saving was not offset to any significant extent by a growth of household saving. Moreover, budget policy was not as a rule sufficiently restrictive to produce a compensating rise in public-sector saving, and there was in some cases even a relative decline.

It is striking that domestic investment in the years 1960–63 remained high, and often increased, as a proportion of the national product. Despite a narrowing of profit margins, the growth of final demand, together with the availability of alternative means of finance, helped to sustain plant and equipment outlays. The demand for housing boomed in most countries because of rising household incomes and plentiful credit. Hence in these years the decline in saving relative to fixed investment had as its main counterpart a deterioration in the external balance on goods and services account. But there was also a marked fall in some countries in the rate of inventory accumulation.

Increasingly during 1963 and throughout most of 1964, however, saving/investment relationships in continental western Europe moved along rather different lines. In quite a large number of countries plant and equipment outlays accelerated substantially, and investment became a more active demand factor than consumption. In some of them, including Germany, the Netherlands, Belgium and Finland, the acceleration went hand in hand with a more rapid growth of exports. In other countries where such outlays showed a sharp rise — Austria, Denmark and Switzerland — the expansion of exports, though not greater than in 1963, was nevertheless large. In Italy, on the other hand, investment in plant and equipment was very much lower in 1964, while in France private company outlays levelled off towards the end of the year. In Sweden industrial investment tended to stagnate, though at a high level.

Although the data in the table do not distinguish between public and private investment, fixed capital outlays by the public sector, particularly by local authorities, appear to have recorded unusually large increases in many countries.

In the housing sector, where activity was favoured by especially good weather conditions in 1964, investment in most continental countries also rose considerably relative to the gross national product. Even in Italy the number of completions increased, though new starts were markedly lower.

Finally, although credit restraint prevailed, investment in inventories on the Continent was generally greater than in 1963. Good agricultural harvests,

Gross national saving and investment.

Countries	Years	Gross national saving: Households	Gross national saving: Enterprises	Gross national saving: Public authorities	Total saving and investment	Gross national investment: Gross domestic fixed capital formation: Housing	Gross national investment: Gross domestic fixed capital formation: Plant and equipment	Gross national investment: Change in stocks	Gross national investment: Net external balance
		as percentages of gross national product at market prices							
Belgium	1960	7.7	11.6	— 0.5	18.8	5.1	13.5	— 0.0	0.2
	1963	6.7	11.7	1.1	19.5	4.2	15.5	0.1	— 0.3
	1964	6.6	11.4	1.9	19.9	4.5	16.2	0.3	— 1.1
Denmark	1960	15.6		6.1	21.7	3.2	16.2	3.4	— 1.1
	1963	15.3		4.5	19.8	3.4	16.1	0.0	0.3
	1964	.		.	21.1	3.2	17.9	2.1	— 2.1
Finland	1960	7.6	9.9	11.5	29.0	5.7	23.3	0.9	— 0.9
	1963	8.8	11.3	5.1	25.2	6.2	18.0	1.3	— 0.3
	1964	7.2	10.6	5.8	23.6	4.9	21.1		— 2.4
France	1960	8.9	8.8	3.7	21.4	4.7	13.9	2.4	0.4
	1963	8.9	7.9	3.6	20.3	5.2	14.8	1.1	— 0.8
	1964	8.8	7.9	4.7	21.4	5.7	14.8	2.1	— 1.2
Germany	1960	6.4[1]	13.8	7.8	28.0	5.8	18.0	2.9	1.3
	1963	7.4[1]	11.4	7.1	25.9	6.0	19.2	0.6	0.1
	1964	8.1[1]	11.9	7.7	27.7	6.3	20.6	0.7	0.1
Italy	1960	21.4		3.4	24.8	5.5	16.8	1.5	1.0
	1963	19.1		3.6	22.7	6.6	16.8	0.8	— 1.5
	1964	19.2		3.7	22.9	7.1	14.0	0.5	1.3
Netherlands	1960	9.5	14.3	5.9	29.7	4.2	19.3	3.3	2.9
	1963	7.7	12.5	5.8	26.0	4.0	20.0	1.3	0.7
	1964	8.0	12.2	6.8	27.0	4.8	20.6	2.7	— 1.1
Norway	1960	18.9		6.4	25.3	4.1	22.2	1.2	— 2.2
	1963	19.9		6.7	26.6	4.3	26.1	— 0.4	— 3.4
	1964	21.2		6.6	27.8	4.0	24.7	0.3	— 1.2
Sweden	1960	6.6	9.9	7.0	23.5	5.1	17.1	2.2	— 0.9
	1963	6.6	7.1	9.1	22.8	5.7	17.7	— 0.2	— 0.4
	1964	6.3	8.6	9.0	23.9	6.0	17.8	0.5	— 0.3
Switzerland	1960	4.0	12.5	10.4	26.9	7.0	16.4	2.7	0.8
	1963	5.0	11.9	9.7	26.6	7.0	21.5	1.4	— 3.3
	1964	.	.	.	27.5	7.7	22.1	1.5	— 3.8
United Kingdom	1960	5.3	11.1	1.7	17.3[2]	3.0	13.1	2.3	— 1.1
	1963	5.6	10.0	1.7	17.1[2]	3.2	13.1	0.5	0.3
	1964	5.7	10.8	2.4	18.3[2]	3.7	14.1	1.6	— 1.1
United States	1960	4.3	10.1	3.7[3]	17.5[2]	4.3[3]	12.2[3]	0.7	0.3
	1963	4.7	10.1	2.7[3]	17.5[2]	4.5[3]	11.8[3]	0.7	0.5
	1964	5.2	10.4	2.1[3]	17.9[2]	4.3[3]	12.2[3]	0.6	0.8
Canada	1960	4.2	14.3	2.4	20.8[2]	4.0	18.8	1.1	— 3.2
	1963	5.7	14.1	2.7	22.1[2]	4.0	17.8	1.1	— 1.2
	1964	4.6	14.6	3.9	23.0[2]	4.3	18.7	0.8	— 0.9
Japan	1960	17.1	13.2	6.2	37.0[2]	2.3	29.1	5.0	0.4
	1963	17.4	13.4	9.0	36.8[2]	3.2	29.8	5.1	— 1.3
	1964[4]	16.3	13.8	8.1	38.2	3.8	31.5	4.1	— 1.2

[1] Includes depreciation charged on residential buildings. [2] Including a residual error. [3] Including, as an element of both saving and investment, new civil public construction. [4] Estimated.

rising world commodity prices earlier in the year and, in a few cases, involuntary accumulation played a part.

Gross national saving recovered to some extent relative to the gross national product in practically all continental countries. In many of them the rapid growth of investment and exports appears to have helped generate higher business saving, which in turn stimulated the investment process. It also seems, however, that the erosion of profit margins in various countries slowed down somewhat as the result of more moderate wage demands, substantial productivity gains and, not least, upward price adjustments. In Italy, on the other hand, the extent to which profit margins had been squeezed tended last year to impede a recovery of investment. Also in France, where price control was extensive, and in some sectors in Belgium, the scope for self-financing appears to have become more limited in 1964.

The household sector's saving relative to the gross national product increased considerably in Germany and to a lesser extent in the Netherlands. However, in some other countries as well, such as Belgium and France, household saving propensities improved. For, although budgetary developments in these countries limited the relative growth of personal disposable incomes, the household sector's saving turned out to be much the same in relation to the gross national product as in 1963.

Public-sector saving increased appreciably in only a few countries, such as Belgium, France, Germany and the Netherlands. In the Common Market countries the policy aim in 1964 was to keep the growth of public expenditure within the limits set by the growth of the real national product. While the authorities generally had difficulty in meeting this standard, in some cases because of large increases in salaries, they did manage to hold down the growth of real public consumption relative to that in other continental countries. Among the latter public consumption increased most, relative to the real national product, in Switzerland, Austria and Finland.

It is not easy to discern the ways in which recent changes in national saving and domestic investment have been causally related to the external balance. While in most continental countries saving increased relative to the national product, domestic fixed investment usually rose substantially more. This development was associated — in many cases rather directly — with a marked increase in imports and, to a lesser extent, with some deterioration in the net balance on goods and services account. In the Netherlands and Denmark, and probably also in France, the accumulation of imported stocks was a factor in this deterioration.

The evolution in certain continental countries, however, was along rather different lines. In Sweden saving rose commensurately with domestic investment, though not without rising costs and prices, and the external balance showed no marked change. In Italy the saving ratio tended to stabilise in 1964, while a large fall in domestic investment helped to produce an improvement on external account. In Norway the saving ratio improved, while at the same time investment, mainly that in new ships, slowed down, thus contributing to a better external balance.

In the United States the slackness of demand in earlier years reflected an unrealised potential of both saving and investment. Thus, last year's tax reduction, while it resulted in a somewhat larger Federal Government deficit, contributed to a more than offsetting rise in private investment and saving. The larger current-account surplus worked in the same direction.

In the United Kingdom 1964 saw a substantial increase in investment of all categories: company fixed investment and stock accumulation, private housing, nationalised industries' plant and equipment outlays, and investment by the central government and local authorities. In the public sector, as in the private sector, saving lagged behind, thereby contributing to the deterioration on external current account.

Capital markets and long-term interest rates. On the Continent long-term interest rates are now substantially higher than they were some two years ago, when the general move towards credit restraint was getting under way. The changes in most countries have reflected the tendency for investment to outrun saving, with an inflationary environment also contributing in some cases to a stronger preference for liquid assets. In so far as general policy measures are concerned, any easing of upward pressures on interest rates has been dependent, apart from a slowing-down in the investment process itself, on essentially two possibilities: greater budget restraint and more effective incomes policies.

None the less, against a background of rising economic activity, the shift to a higher level of long-term interest yields served to attract a larger volume of funds to the capital market in many countries. In Switzerland total new issues increased again in 1964 after an already substantial rise in 1963, while in Belgium new issue activity made an impressive recovery from the low level of the previous year. In Germany, too, total new issues rose buoyantly, even though net foreign purchases of German bonds dropped to an insignificant figure. Markedly higher yields in Sweden and the Netherlands also brought forth an appreciably larger volume of longer-term funds — though these took the form more of loans than of new issues. In Spain the large amount of capital issues was facilitated by the comfortable liquidity position of the banks, which were active in adding to their security holdings.

The ways in which budget and debt-management policies have impinged on the capital markets are reflected in part in the behaviour of new issues. In France, where the budget moved from a deficit in 1963 to virtual balance in 1964, the Treasury floated only one public loan, as against two in the preceding year. In Belgium the overall budget deficit was somewhat reduced, but the Treasury substantially increased its borrowing on the capital market. This was a reflection, however, of the market's improved receptivity, which enabled the Treasury to curtail its short-term foreign borrowing. In Germany the Federal Government, with a smaller cash deficit in 1964, borrowed less on the capital market, while in general public-sector issues encountered market resistance. In Italy, where the public's demand for long-term securities remained depressed, the Treasury limited its net direct and indirect recourse to the capital market.

Capital market: Net issues.

Countries	Years	Public: State	Public: Local authorities and public bodies	Private[1]: Shares	Private[1]: Bonds	Foreign issues	Total	Private and foreign issues	Total new issues
		in milliards of national currency units						as percentages of GNP	
Belgium	1962	17.90	11.50	8.85	12.83[2]	0.30	51.38	3.4	8.0
	1963	2.87	7.17	6.69	10.98[2]	0.08	27.79	2.6	4.0
	1964	7.90	12.78	8.70	5.77[2]	.	35.15	1.9	4.6
Denmark	1962	−0.18	—	0.13	2.63	—	2.58	5.4	5.0
	1963	−0.19	—	0.13	3.43	—	3.37	6.5	6.2
	1964	−0.17	—	0.24	3.79	—	3.86	6.6	6.3
France	1962	−0.86	0.08	3.99	4.24	—	7.45	2.3	2.1
	1963	2.09	0.15	4.17	4.92	0.06	11.39	2.3	2.9
	1964	0.55	0.17	5.01	5.44	0.15	11.32	2.5	2.6
Germany	1962	0.66[3]	1.81	1.51	7.06	0.10	11.14	2.4	3.1
	1963	1.80[3]	1.78	1.02	8.48	0.11	13.19	2.6	3.5
	1964	1.51[3]	1.79	1.61	10.19	0.89	15.99	3.1	3.9
Italy	1962	− 109	171[4]	715	984	30	1,791	7.0	7.2
	1963	− 200	129[4]	398	1,144	14	1,485	5.5	5.2
	1964	− 8	159[4]	555	1,221	—	1,927	5.7	6.2
Netherlands	1962	−0.09[5]	0.20	0.46	0.30	0.14	1.01	1.9	2.1
	1963	0.61[5]	0.40	0.07	−0.02	−0.12	0.94	—	1.8
	1964	0.19[5]	0.29	0.21	0.14	−0.05	0.78	0.5	1.3
Spain	1962	0.47	4.90	14.50	11.08	—	30.95	3.2	3.9
	1963	5.00	8.59	19.30	20.70	—	53.59	4.8	6.5
	1964	15.00	8.33	20.12	19.93	—	63.38	4.4	6.9
Sweden	1962	0.24	0.31	0.43	3.08	—	4.05	4.7	5.4
	1963	1.88	0.35	0.36	1.95	—	4.53	2.8	5.6
	1964	0.11	0.57	0.49	2.94	—	4.11	3.8	4.6
Switzerland[6]	1962	−0.23	0.18	1.81	1.11	0.44	3.30	7.3	7.2
	1963	−0.33	0.26	1.53	2.19	0.53	4.19	8.4	8.3
	1964	−0.16	0.66	1.54	2.11	0.28	4.43	7.1	8.0
United Kingdom	1962	0.57[7]	0.14	0.26	0.17	—	1.14	1.5	4.0
	1963	−0.12[7]	0.09	0.20	0.24	0.02	0.42	1.5	1.4
	1964	−0.11[7]	0.09	0.23	0.28	0.06	0.55	1.7	1.7
United States[8]	1962	1.50[9]	4.60	2.40	5.00	1.00	14.50	1.5	2.6
	1963	2.50[9]	6.00	1.00	5.30	1.00	15.80	1.3	2.7
	1964	0.80[9]	5.40	3.00	6.10	0.80	16.10	1.6	2.6
Canada	1962	0.77[10]	0.93	0.34	0.42	—	2.46	1.9	6.1
	1963	0.98[10]	1.30	−0.06	0.56	—	2.78	1.2	6.5
	1964	0.20[10]	1.36	0.26	0.70	—	2.52	2.1	5.4
Japan	1962	− 4	255	873	402	− 4	1,522	6.7	8.0
	1963	16	355	732	537	5	1,645	5.9	7.7
	1964	18	411	860	564	6	1,859	5.8	7.6

[1] Includes issues of semi-public credit institutions and nationalised industries. [2] Includes deposit-bank issues of medium-term savings bonds. [3] Change in market holdings of bonded loans and premium Treasury bonds. [4] Includes indirect Treasury borrowing. [5] Excludes payments into pre-subscription accounts. [6] Includes privately-placed issues. [7] Change in marketable debt (excluding Treasury bills) in public hands. [8] Based on Federal Reserve flow-of-funds data, excluding mortgage loans. [9] Change in public holdings of marketable debt having a maturity of one year or more. [10] Held outside government accounts.

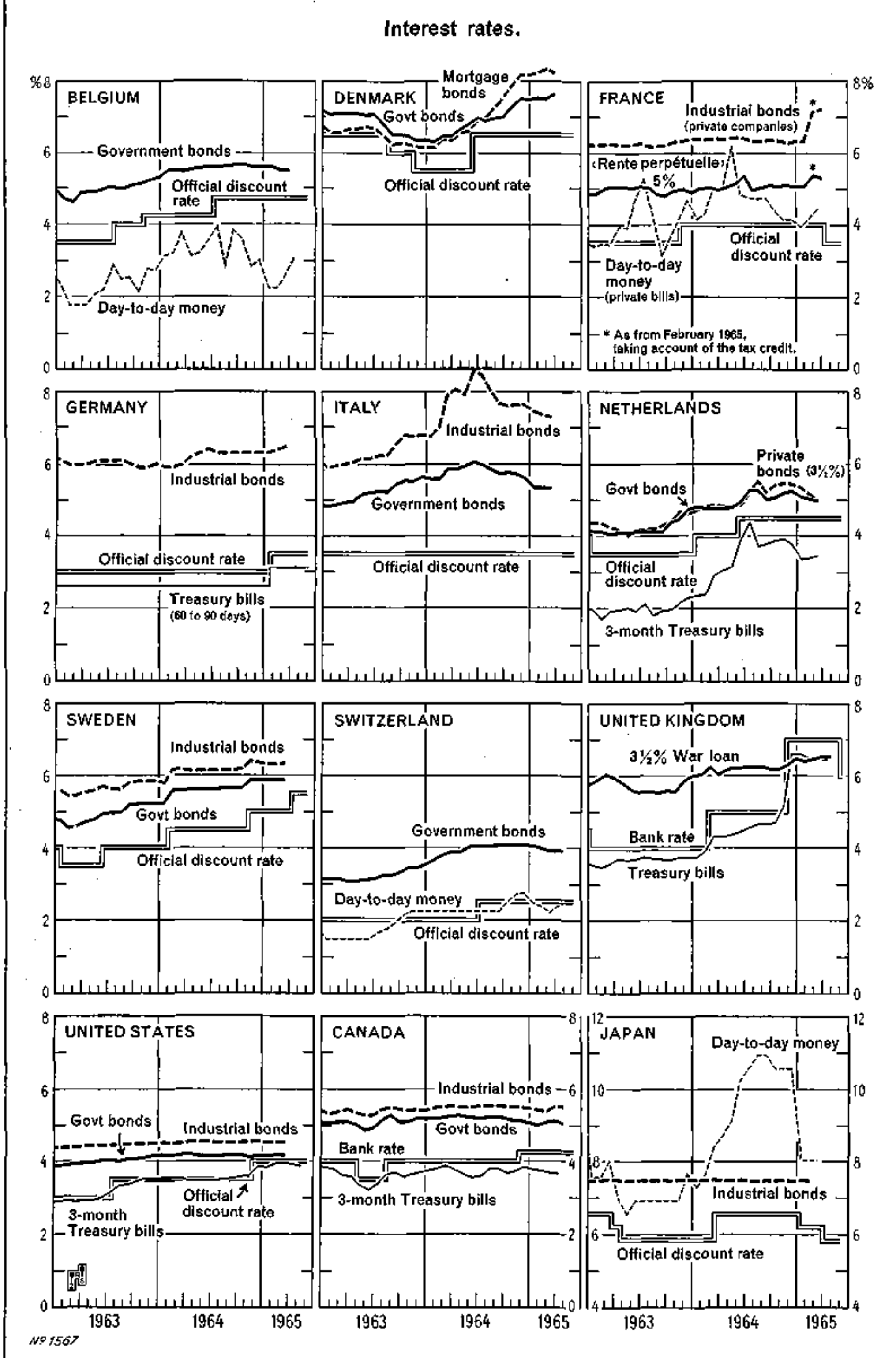
In the Netherlands the central government, even though its net financing needs had increased, reduced its net new issues in 1964. Whereas in 1963 a balance-of-payments surplus had prompted the authorities to borrow at long term in excess of needs in order to sterilise liquidity, an external deficit and strong demand for capital led the government last year to play a more neutral rôle. In Switzerland the Confederation's net repayment of debt to the market was somewhat smaller in 1964 than in the previous year. In Sweden, while the government's net bond issues declined sharply in 1964, the amount placed outside the Riksbank and the commercial banks came to S.kr. 695 million, against only S.kr. 175 million in 1963.

Broadly speaking, the central government's limited recourse to the capital market tended in such countries as France, Germany, Italy, the Netherlands and Switzerland to make room for issues by other sectors. At all events, where other types of issue registered a rise, this consisted mainly of local authority issues (e.g. Belgium, Sweden and Switzerland) and private mortgage bond issues (e.g. Germany, Denmark and Sweden). Industrial issues did not as a rule show very significant changes. In such countries as Germany, the Netherlands and Switzerland this may have reflected relatively favourable self-financing possibilities, as well as the deterrent effect of high long-term borrowing rates. Among some of these countries there was a shift towards share financing.

Foreign issues on the German capital market increased significantly last year, largely because they are exempt from the withholding tax imposed on coupons of non-resident bond holdings. On the other hand, foreign issues on the Swiss market were restricted on domestic policy grounds. The Dutch market, where some issues had been permitted in the years 1961–62, was again closed to foreign flotations last year. Perhaps the most significant development in the international capital market was the further growth in dollar loans issued in London, cash subscriptions for which came to approximately £335 million in 1964. Since the introduction of the US interest equalisation tax in July 1963, recourse to dollar loans abroad has served as one alternative to borrowing in the New York market.

Long-term interest rates, after rising substantially in 1963 and early 1964, reached a peak in most continental countries later in the year and thereafter dropped off somewhat. In France, Switzerland and Belgium this marked an easing of investment demand. In Italy it was more than this, for the reappearance of an external surplus permitted a shift back to easier credit conditions. In the Netherlands an upsurge of foreign buying of securities, mostly public issues, brought long-term rates down somewhat in the autumn, but they tended to remain close to their new highs. In Germany the announcement of the withholding tax on the coupons of non-resident holdings of German bonds was largely responsible for a rise in long-term rates in the first half of 1964. In Sweden, where consumption and public expenditure have recently been increasing rapidly, long-term rates continued to move upwards in late 1964 and early 1965. In Denmark yields on long-term securities rose steeply to reach new high levels at the turn of the year.

In the United States the yield on long-term government securities, which had edged up somewhat in 1963, remained relatively stable in 1964. The increased flow of internal funds kept down the corporate sector's need for


Interest rates.
BELGIUM
Government bonds
Official discount rate
Day-to-day money
DENMARK
Mortgage bonds
Govt bonds
Official discount rate
FRANCE
Industrial bonds (private companies)
Rente perpétuelle 5%
Official discount rate
Day-to-day money (private bills)
* As from February 1965, taking account of the tax credit.
GERMANY
Industrial bonds
Official discount rate
Treasury bills (60 to 90 days)
ITALY
Industrial bonds
Government bonds
Official discount rate
NETHERLANDS
Private bonds (3½%)
Govt bonds
Official discount rate
3-month Treasury bills
SWEDEN
Industrial bonds
Govt bonds
Official discount rate
SWITZERLAND
Government bonds
Day-to-day money
Official discount rate
UNITED KINGDOM
3½% War loan
Bank rate
Treasury bills
UNITED STATES
Govt bonds
Industrial bonds
Official discount rate
3-month Treasury bills
CANADA
Industrial bonds
Govt bonds
Bank rate
3-month Treasury bills
JAPAN
Day-to-day money
Industrial bonds
Official discount rate
1963
1964
1965
Nº 1567

outside financing. At the same time, the demand for mortgage funds weakened somewhat, while the flow of longer-term funds from households and insurance and pension funds increased appreciably.

In the United Kingdom the yield on long-term government stock, after rising along with the February 1964 increase in Bank rate, moved up only slightly until the late autumn. Companies borrowed heavily on the capital market during this period, but upward pressures on interest rates were eased as a result of a reduction in the outstanding volume of government stock. With the November rise in Bank rate, long-term yields moved upwards and new capital issues dropped off sharply.

Bank credit and liquid-asset formation. In virtually all continental countries the banking system's net foreign assets, and more particularly the official central reserves, increased in 1964, thereby tending to augment the money supply and bank liquidity. To some extent domestic credit restraint and high interest rates appear to have been responsible for external payments surpluses. In Sweden, Germany and Belgium, for instance, there was a marked favourable shift in payments leads and lags, as so often occurs under conditions of domestic monetary tightness. In Switzerland the official reserve gains in 1964 reflected largely the repatriation of funds held abroad, which was connected partly with developments in other centres, but partly also with the shortage of domestic liquidity. In the Netherlands, Denmark and Finland, all of which recorded sizable current-account deficits in 1964, capital inflows in response partly to high interest rates were quite substantial.

As a general rule, however, the inflows of funds prompted by domestic monetary tightness do not appear to have undermined credit restraint to any great extent. All countries now have at their disposal various selective controls or techniques which they use from time to time to regulate capital movements and hence bank liquidity. These include operations in the foreign exchange market, limitations on interest payments on foreign deposits in domestic currencies, regulation of bank positions in foreign currencies, regulations on borrowing abroad by residents, and so on.

With the help of such defences as these, and in almost every case primarily on domestic grounds, central-bank discount rates were further raised in a number of continental countries in 1964 and early 1965. In Sweden the Riksbank, after having increased its rate in January 1964, raised it again in November and then once more, to 5½ per cent., in April 1965. In the late spring and early summer of 1964 the rate was increased in the Netherlands, Belgium and Switzerland by ½ per cent. and in Denmark by 1 per cent. In Germany the Bundesbank, after having kept its rate at 3 per cent. since 1961, raised it in January 1965 to 3½ per cent. In certain cases, particularly in the Netherlands and Denmark, the increases occurred at a time of substantial current-account deficit. The only reduction on the Continent was that made in April 1965 by the Bank of France, which lowered its rate from 4 to 3½ per cent.

The banking system: Monetary survey.

Countries	Years	Net foreign assets	Credit to public sector	Credit to private sector	Monetary and quasi-monetary liabilities		Money[1]	Money and quasi-money[1]
		Annual changes				Outstanding at end of period		
		In milliards of national currency units					as percentages of GNP	
Austria	1962	6.25	— 1.54	5.98	11.09	94.37	20.6	46.8
	1963	4.54	3.42	4.96	10.52	104.89	20.8	48.7
	1964	2.51	2.38	11.40	13.50	118.39	20.7	49.9
Belgium	1962	2.70	5.80	12.20	21.40	310.40	38.0	46.7
	1963	— 1.60	22.50	16.10	32.70	343.10	38.9	47.7
	1964	9.10	9.20	10.20	25.80	368.90	37.5	46.5
Denmark	1962	— 0.55	0.35	2.56	2.11	25.13	23.6	47.7
	1963	1.66	— 0.35	2.09	3.01	28.14	24.3	49.2
	1964	0.81	— 0.89	3.60	2.86	31.00	24.2	48.8
Finland[2]	1962	— 220	— 91	668	506	8,138	9.5	45.8
	1963	140	56	468	730	8,868	9.7	44.9
	1964	103	— 46	1,127	1,012	9,880	9.1	43.8
France	1962	3.61	4.11	14.35	22.25	144.58	33.3	37.0
	1963	4.16	3.78	10.70	19.75	164.33	34.9	38.6
	1964	3.80	— 0.24	10.68	14.70	179.03	35.3	39.0
Germany	1962	0.30	2.30	19.30	12.90	134.60	15.3	35.6
	1963	3.20	5.10	19.20	16.20	150.80	15.4	37.3
	1964	2.00	8.40	21.70	19.30	170.10	15.2	38.3
Italy	1962	37	321	2,528	2,712	17,721	36.9	65.4
	1963	— 778	809	2,595	2,434	20,155	37.9	66.7
	1964	483	514	842	1,585	21,740	36.8	65.7
Netherlands	1962	0.09	0.66	1.10	2.76	29.91	26.0	59.8
	1963	0.65	0.30	1.53	3.36	33.27	26.3	61.1
	1964	0.08	0.57	2.01	3.41	36.68	24.8	58.3
Norway	1962	— 0.17	0.38	1.15	1.39	21.71	21.2	54.2
	1963	0.39	0.21	1.00	1.49	23.20	20.9	54.1
	1964	0.27	0.20	1.39	1.79	24.99	20.5	54.2
Spain	1962	10.90	5.80	75.10	94.40	554.50	30.2	62.2
	1963	5.10	12.00	76.80	95.50	650.00	34.1	71.2
	1964	20.40	27.20	91.20	139.60	789.60	36.2	76.3
Sweden	1962	0.52	— 0.03	4.06	4.94	56.46	17.2	71.0
	1963	— 0.13	— 0.63	5.65	4.20	60.66	17.0	70.8
	1964	1.06	— 0.34	2.51	4.69	65.35	16.8	70.0
Switzerland	1962	0.69	1.00	4.44	6.16	60.08	49.1	122.1
	1963	0.88	0.83	3.96	6.34	66.42	48.8	123.5
	1964	0.85	0.13	3.91	5.56	71.98	47.9	124.0
United Kingdom[2]	1962[3]	194	— 86	410	303	.	.	.
	1963[3]	— 57	38	599	540	.	.	.
	1964	— 103	— 232	997	592	11,798[4]	32.3	.
United States	1962	— 1.50	6.50	13.90	18.10	244.70	26.2	42.6
	1963	— 0.50	5.90	17.80	19.30	264.00	25.8	43.8
	1964	— 0.10	7.00	16.30	20.20	284.20	25.1	44.3
Canada	1962	0.23	— 0.56	0.88	0.54	15.12	16.6	36.2
	1963	0.15	0.25	0.49	1.03	16.15	16.8	36.2
	1964	0.35	— 0.27	1.02	1.21	17.36	16.4	35.0
Japan	1962	146	162	3,038	3,164	19,517	27.6	92.7
	1963	39	337	4,871	4,962	24,479	33.3	103.5
	1964	— 274	1,404	3,791	3,949	28,428	33.8	107.0

[1] Annual averages of money and money plus quasi-money in relation to the gross national product at market prices. [2] In millions of national currency units. [3] Based on series not strictly comparable with figures for 1964. [4] Money supply, including deposits at short notice.

Source: IMF, *International Financial Statistics*.

Another expression of monetary restraint is found in the behaviour of bank credit to the public sector. In France the Treasury, which in the past has depended to a considerable extent on bank credit, was able last year to refrain from recourse to the banks and even to reduce the volume of bank-held Treasury paper outstanding. In Denmark the government used its larger cash surplus in 1964 to increase its deposits with the central bank. In Belgium last year the Treasury curtailed its short-term borrowing abroad via the banking system. In Sweden, although the decline in bank credit to the public sector was smaller in 1964 than in 1963, it represented, in contrast to the preceding year, a repayment of credit to the central bank.

In Germany, Switzerland and the Netherlands the central governments played a rather neutral rôle in respect of monetary creation via the banking system. In Germany, however, the local authorities satisfied a greater proportion of their borrowing needs by means of bank credit than in 1963, while the opposite was true in Switzerland. A more intermediate position was occupied by the Netherlands, where the local authorities borrowed substantially more in 1964 at both long and short term.

Some continental countries chose also to use more direct means to limit the growth of bank credit to the private sector. France and Switzerland, in 1964 as in 1963, applied quantitative ceilings on the permissible rate of growth of bank credit. In the Netherlands a similar ceiling was reintroduced in October 1963 and has since remained in force. The Belgian authorities turned to such a system in early 1964, requesting the banks voluntarily to limit the growth in their lending to about one-half that in 1963. Quantitative restrictions on credit have also been applied in Norway and, more recently, Finland.

The primary purpose of ceilings on bank credit expansion has been to enhance the effectiveness of credit control. To rely on increases in interest rates alone would tend to induce inflows of funds from abroad, on the initiative particularly of domestic banks but also of lenders and borrowers generally. Nor would higher interest rates necessarily deter bank borrowing from the central banks. The use of quantitative credit controls has probably helped to keep interest rates lower and capital inflows smaller than they otherwise would have been.

In the United Kingdom bank advances rose sharply in 1964, but the growth of the banking sector's deposit liabilities was more moderate. In conjunction with the external deficit, the supply of Treasury bills to the domestic market was reduced and this helped to bring the banks under liquidity pressure. However, market holdings of government stock declined for the second year in succession.

The increase in the UK Bank rate from 4 to 5 per cent. towards the end of February 1964 was a precautionary step taken on both domestic and external grounds. In late November, when the rate was raised from 5 to

7 per cent., the move was prompted predominantly by external considerations. This adjustment was immediately followed by increases in the US discount rate from 3½ to 4 per cent. and in the Canadian rate from 4 to 4¼ per cent., in both cases so as to keep rates in line internationally. About six months later, on 3rd June 1965, the UK Bank rate was brought down to 6 per cent.

In the United States, despite the external deficit, the monetary authorities provided the reserves needed for another substantial increase in bank credit, which rose last year at the same rate as in the two preceding years. Deposit formation lagged only slightly behind, and the banks' government security holdings showed a modest decline.

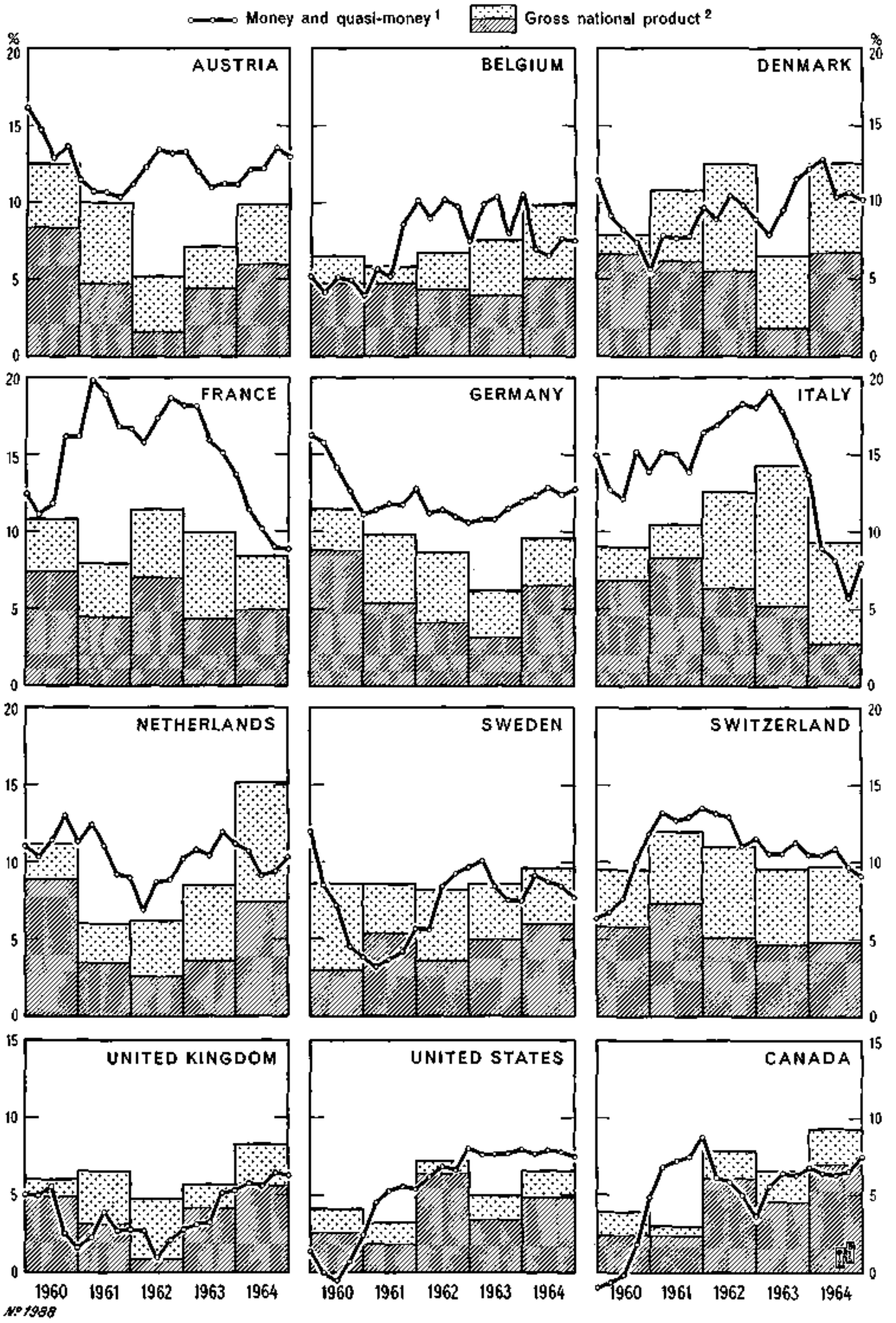
In Canada bank credit to the private sector accelerated in 1964. However, the government's budget position recorded a big improvement, permitting a repayment of debt to the banking system.

In the graph on the following page the growth of money and quasi-money is shown relative to the change in the national product in real and money terms. Because of differences in financial structures, and hence in the significance of liquid-asset growth rates, attention should be focused mainly on the evolution within individual countries. In France, for instance, monetary restraint began early in 1963, when inflationary tensions were still moderate, and was tightened progressively over the next two years. In Italy an even more pronounced tightening occurred from the middle of 1963 to the spring of 1964, but this action came only after a sharp rise in wages and prices in 1962. In Belgium, Denmark, Germany, the Netherlands, Sweden and Switzerland monetary restraint last year expressed itself partly in a slower growth of liquid assets, which was notable when viewed relative to the large increases in the real national product in those countries.

In practically all continental countries the rate of liquid asset formation from about 1960 or 1961 onwards has been quite high, reflecting not only the impact of external surpluses but also strong domestic credit demand. Although monetary restraint over the past year or two has generally tended to slow down this high rate of growth, the striking fact is that liquidity formation in most countries is still proceeding quite rapidly. On the other hand, as the graph helps to show, the growth of the gross national product in money terms has been increasing in most continental countries at a rate not far short of 10 per cent. a year, of which close to one-half has represented price inflation. In short, credit expansion, though not always or necessarily the cause of inflation, has facilitated its development.

In the United Kingdom, despite a large expansion of bank credit in 1963 and 1964, the growth of the money supply and of deposits at short notice has moved closely parallel to the increase in the real national product. Over the same period in the United States the banking system's money and deposit liabilities have continued to increase relative to the national product in money terms.

Growth of money and quasi-money relative to the gross national product.



[1] As defined in the IMF's *International Financial Statistics*. Quarterly changes relative to corresponding quarter of preceding year. [2] The shaded area shows annual growth in real terms, while the dotted area shows change in the price factor.

Credit policies in individual countries.

United Kingdom. By early 1964 the external current account had shifted moderately into deficit and domestic demand was advancing at a rate that was not sustainable. As a precautionary move, the Bank of England raised Bank rate towards the end of February from 4 to 5 per cent. Subsequently, in the April budget certain indirect taxes were increased in an effort to damp down the growth of demand. None the less, the conflict between domestic and external policy considerations tended to heighten in the succeeding months. On the one hand, the authorities did not wish to impede the upswing under way in industrial investment, which was considered essential to the longer-term solution of the external problem. Moreover, consumption was advancing at only a moderate pace, the budget deficit was not emerging on the scale anticipated and a stable industrial production index gave the impression of stagnating domestic demand. On the other hand, and in contrast to the crisis year 1961, the external basic balance was moving substantially into deficit, reflecting a deterioration on both current and long-term capital account.

In these circumstances the policy pursued was such that the credit situation remained relatively easy up to the autumn of 1964. This is evident primarily in the marked growth of clearing-bank advances, which, seasonally adjusted, accelerated from about May onwards and picked up further in September and October. In order to accommodate this movement, the banks reduced their government stock holdings and brought their liquid assets near to the minimum ratio. Moreover, in the first three quarters of 1964, capital-market issues by non-financial companies were about half as large again as in the same period of 1963. The picture began to change from about August onwards, as companies curtailed their new issue activity in favour of more borrowing from the banks. From the end of February (after the rise in Bank rate) to the end of October, the yield on a representative long-dated stock rose only from 5.78 to 5.87 per cent., but that on medium-dated stock went up from 5.46 to 5.78 per cent. While the authorities were limiting their support to the gilt-edged market, a more positive policy of restraint, apart from a reduction in the size of the Exchequer deficit itself, would have implied a more active effort to finance the deficit through sales of long-term securities. This would have been possible, of course, only at higher interest rates.

In the autumn the new government's strategy to increase competitiveness and productivity was viewed to depend on keeping output and employment at a high level. Thus, the import surcharge was a measure to improve the external balance without necessitating a reduction of domestic demand. The November budget, which incorporated both the surcharge and the new indirect tax rebates on exports, increased the tax on petrol, but this tax was intended mainly to offset the expansionary side-effects of the other two measures. Soon after, however, monetary restraint was brought increasingly to bear. On 23rd November Bank rate was raised from 5 to 7 per cent. From about October onwards, moreover, the Exchequer's market borrowing requirement was further reduced as a result of sterling acquisitions by way of official transactions in foreign exchange. Consequently, the size of new issues of Treasury bills offered for tender dropped off, thus reducing the supply of liquid assets to the banks and confronting them with the need to curb their lending activity. To reinforce this squeeze the Bank of England on 8th December requested the banks in future to give priority in their advances to exports and productive investment projects. Yields on government stock increased appreciably in consequence of the Bank rate adjustment, and the market also came under the shadow of the capital gains tax announced for the following spring. At the end of the year the yield on a representative long-dated government stock stood at 6.23 per cent., as against 5.53 per cent. a year earlier.

Bank advances to residents over 1964 as a whole rose by around 15 per cent., reaching a total of close on £6,500 million by the end of the year. Moreover, discounts of commercial paper, which augment the banks' liquid assets and hence also their lending potential, rose in 1964 by some £165 million. Advances to residents by domestic banks (including the discount houses) went up by about 12½ per cent. to reach almost £5,150 million. The other £1,350 million of advances outstanding were those of the accepting houses and overseas banks, whose lending in this form to residents, mainly to local authorities and companies, appears to have increased by about £400 million last year. Moreover, these institutions' foreign assets rose by about £150 million less than their foreign liabilities — the difference reflecting the extent to which the increase in their domestic loans was financed by switching borrowed foreign funds into sterling. The banking sector's domestic deposit liabilities increased last year by 5 per cent., thus falling markedly short of the growth in bank lending. The difference was reflected largely in a reduction of £214 million in government stock holdings and of £320 million in Treasury bill portfolios. By mid-December the London clearing banks' investments/deposits ratio was down to 13.1 per cent., from 15.4 per cent. a year earlier, while their liquid assets ratio had declined to 30.6 from 32.7 per cent.

On a calendar year basis, the Exchequer accounts moved from an overall deficit of £142 million in 1963 to one of £556 million in 1964, part of the increase representing lending to local authorities as an alternative to their borrowing in the market. In covering this deficit, net funds raised by means of National Savings, the note issue, extra-budgetary receipts, etc. (i.e. by means other than the placing of marketable debt) came to £514 million in 1964, compared with £228 million in 1963. A further £532 million flowed to the Exchequer through official sales of foreign exchange against sterling. On the other hand, market holdings of government stock, after a decline of £128 million in 1963, dropped further by £114 million in 1964. Treasury bills outstanding, which had increased in 1963 by £114 million, declined in 1964 by £375 million. Given the fact that the banks' liquidity ratio, and hence their potential for credit expansion, depends largely on the volume of Exchequer Treasury bill financing, the reduced supply of bills last year helped to restrain the growth of bank deposits.

United Kingdom: Private and public-sector saving and investment.

Items	Years	Private sector	Public sector[1]	Rest of the world[2]
		in millions of £ sterling		
Gross saving[3]	1962	3,397[4]	1,459	
	1963	3,859[4]	1,301	
	1964	4,379[4]	1,576	
Gross investment	1962	2,815	1,951	
	1963	2,946	2,118	
	1964	3,707	2,622	
Financial surplus or deficit (—)	1962	582	— 492	90
	1963	913	— 817	96
	1964	672	—1,046	—374

[1] Includes nationalised industries. [2] Positive figure indicates current surplus on goods and services account vis-à-vis the rest of the world. [3] Including net capital transfers and adjusted for stock appreciation. [4] Includes the national accounts statistical discrepancy item.

Viewed in orthodox terms, the external deficit has been associated with strong domestic demand, both private and public, and hence has called for greater monetary and budget restraint. The solution sought, however, has not closely followed the orthodox pattern. Consistently since the April 1963 budget the aim of policy has been to increase the rate of fixed investment relative to the national product and, within the context of sustained expansion, to lay the foundation for longer-term strength of sterling. The measures presented in the April 1965 budget were designed selectively to curb the outflow of capital and, concurrently with further increases in public investment, to make room for higher exports by restraining consumption. Thus, while the budget's current surplus is to increase in the year 1965–66, there is to be a more than offsetting expansion in public lending, mainly to the nationalised industries and local authorities. The borrowing requirement is estimated to rise from £386 million in 1964–65 to £724 million in 1965–66. However, allowance must be made for the fact that £130 million of this increase is expected to be matched by a decrease in local-authority borrowing from the market and also that extra-budgetary receipts will go up by some £100 million, mainly accounted for by a larger net inflow into the National Insurance Fund. Nevertheless, the rise in the borrowing requirement, while much smaller than it appears, is still significant. The authorities expect that a sizable proportion of the Exchequer's financial needs will be covered by the further growth in non-marketable debt, the note issue, etc. Moreover, the continuing, but declining, external deficit will bring in additional sterling, as also will the recent call for special deposits. They anticipate, therefore, that the amount of marketable debt which will have to be placed with the public will be of moderate proportions.

Clearing-bank advances, after slowing down considerably in the early months of 1965, accelerated again in the spring. This development was quickly followed by new credit restrictions. On 29th April the Bank of England made a call for special deposits amounting for the London clearing banks to 1 per cent. of their deposit liabilities and for the Scottish banks to ½ per cent., equivalent overall to some £95 million. A week later the Bank of England issued a directive to the banks indicating how the reinforced credit squeeze is expected to be applied. The clearing banks have been asked to keep the growth in their advances to the private sector in the twelve-month period to March 1966 to not more than 5 per cent. and to apply comparable restraint in their discounting of commercial bills. Similar requests have been directed to the other main banking and financial organisations. Subsequently, on 3rd June, Bank rate was brought down from 7 to 6 per cent. and hire-purchase terms were tightened through a 5 per cent. increase in required minimum down-payments.

In spite of the limitations on private credit, public-sector credit demands imply a continuing heavy burden on the monetary mechanism. In this connection, however, the prospective nationalisation of steel presents no immediate problem for the gilt-edged market, as the financing is not expected to take place for at least a year. More important, from the monetary point of view, will be the extent to which the Exchequer deficit is financed over the coming months by non-monetary means, particularly through sales of longer-term government securities to the public.

United States. Throughout 1964 the primary aim of the monetary authorities was to sustain the growth of demand without inflation. This was deemed to require keeping credit in ample supply at relatively stable long-term borrowing rates. The background was one of a continued high degree of stability in unit labour costs and wholesale prices. Moreover, unemployment was still excessive, Federal Government expenditure was rising only slowly and housing demand was rather weak. Thus, a deliberate policy to restrain domestic credit and raise long-term interest rates was thought to contain the risk of halting the expansion. More recently, however, with demand continuing to show strength, the authorities have moved towards tighter credit conditions.

The essentially easy credit policy, which apart from recent modifications has been adhered to consistently since the recession of 1960, has manifested itself in several ways. In so far as bank credit is concerned, the prime lending rate has remained unchanged at the level of 4½ per cent., to which it was reduced in August 1960. Moreover, while acting to push up short-term interest rates on external grounds, the monetary authorities have sought, principally by means of debt-management and open-market operations, to keep longer-term rates down as an incentive to capital investment. Thus the Treasury has financed the budget deficit largely through the issue of short-term debt, while the Federal Reserve authorities have supplied the reserves needed to support the banks' growing lending activity, partly through the purchase of longer-term government securities.

The balance-of-payments deficit, which in recent years has mainly reflected heavy capital outflows, is itself prima facie evidence that credit policy has in fact been excessively easy. Just how this has worked out in practice, however, is a matter of controversy. The question centres primarily on the corporate and banking sectors, as these have been directly responsible for the bulk of capital outflows. As regards the corporate sector, the data in the table would seem to throw a certain light on what has been happening.

United States: Corporate sources and uses of funds.[1]

Years or yearly averages	Principal external sources				Uses			
	Bonds and shares	Mortgage loans	Bank and other loans	Total credit and equity-market funds	Excess of own investment over own saving	Liquid assets	Net trade and other credit[2]	Foreign and other claims[3]
	in milliards of US dollars							
1952–57	*6.1*	*1.4*	*2.2*	*9.5*	*4.6*	*0.3*	*2.1*	*1.4*
1958	8.0	2.5	0.6	11.0	— 1.3	2.4	3.9	1.5
1959	5.3	2.5	4.4	12.1	— 1.1	2.4	5.3	1.9
1960	5.3	2.2	2.8	10.4	1.8	— 2.4	5.2	3.4
1961	7.3	3.5	1.0	11.7	— 0.7	2.7	4.3	4.6
1962	5.2	5.4	3.6	14.3	0.6	3.6	5.7	2.9
1963	3.4	6.2	3.9	13.6	0.4	1.8	3.4	6.1
1964	5.4	5.7	5.3	16.4	— 0.1	2.3	5.0	6.0
1958–64	*5.7*	*4.0*	*3.1*	*12.8*	*— 0.1*	*1.8*	*4.7*	*3.8*

[1] Non-financial corporations only. [2] Consumer credit and finance paper. [3] These data include corporations' investments abroad and foreign currency holdings but also certain unallocated domestic current assets.
Source: Federal Reserve flow-of-funds accounts.

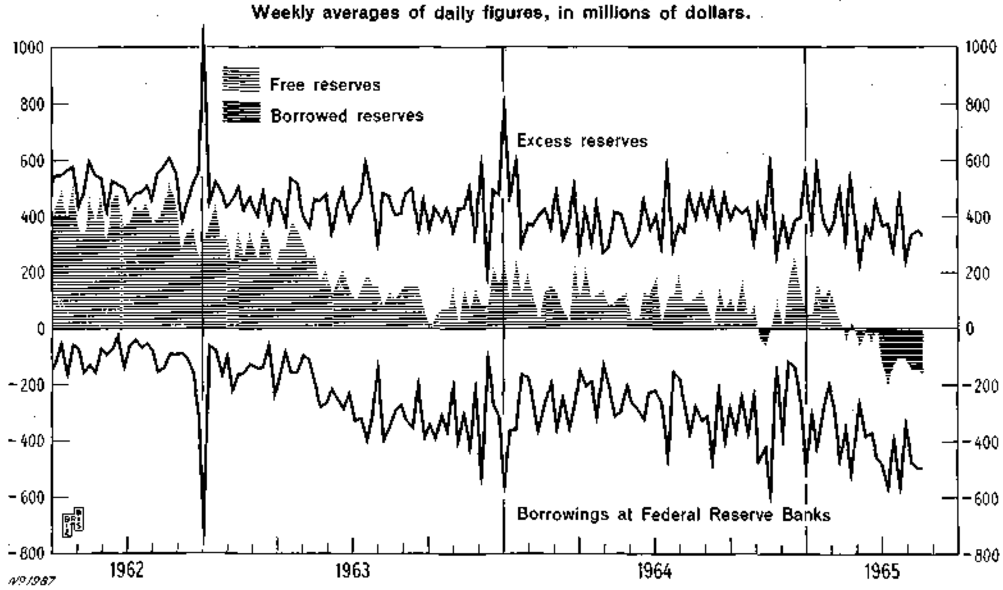
It is striking that, whereas in the years 1952–57 the corporate sector's gross capital investment exceeded its own gross saving by an average of $4.6 milliard a year, in the years 1958–64 its investment was, on this global reckoning, completely covered by its internal funds. Yet, whereas in the earlier period the sector borrowed from the credit and equity markets an average of $9.5 milliard a year, in the years 1958–64 it increased such annual borrowing to $12.8 milliard. Compared with the earlier period, this borrowing found a counterpart in a much higher rate not only of investment overseas but also of credit to domestic customers and of liquid-asset accumulation. While allowance must be made for the growth of the economy, these figures suggest that plentiful credit resulted more in a proliferation of corporate financial claims (including direct investment overseas) than in an acceleration of corporate investment in domestic real assets.

In the banking sector an analogous development occurred. The commercial banks' loans and investments, which in the years 1952–57 had increased by $6.5 milliard a year, rose on the average by $15.0 milliard in the years 1958–64. In part this growth was facilitated by the changeover to higher deposit rates, which, although sanctioned largely on external grounds, enabled the banks to compete more effectively with domestic non-bank financial institutions for deposits. But it also reflected the continuous flow of liquidity into the system associated with the monetary authorities' debt-management and open-market operations. The growth of bank lending tended always to be validated through official actions designed to replenish and augment reserves. Increasingly, as part of their lending activity, the banks sought profitable foreign outlets for funds, culminating in a single year's growth of more than $2.0 milliard in bank loans abroad in 1964. Excessive credit ease is also suggested by the reputed deterioration in the quality of bank loans.

Throughout most of 1964 credit policy continued along the lines laid down in the summer of the previous year. In July 1963, when the interest equalisation tax was also introduced, the discount rate was raised from 3 to 3½ per cent. and the maximum permissible rate payable on time deposits of 90 days or more was increased to 4 per cent. Moreover, the authorities began to supply reserves somewhat more reluctantly, with the result that average free reserves declined to about $100 million. Except for brief periods of greater tightness, free reserves continued to fluctuate around this level in 1964. This was true even after the authorities, impelled by the rise in the UK Bank rate to 7 per cent. on 23rd November, raised the discount rate the next day to 4 per cent. At the same time the maximum rates payable on time and savings deposits under Regulation Q were also raised. On time deposits of less than 90 days the maximum was increased from 1 to 4 per cent., that on time deposits at more than 90 days from 4 to 4½ per cent., and that on savings deposits at under one year from 3½ to 4 per cent. However, the monetary authorities stressed, when increasing the discount rate, that the step was necessary for external reasons only and signified no essential change in the availability of domestic credit. Acceding to official wishes, the banks held their prime rate at 4½ per cent.

However, the deterioration in the balance of payments in the fourth quarter, followed by large gold losses in the early months of 1965, presented the authorities with a serious new challenge. But, rather than risk a rise in longer-term lending rates, the response was recourse to selective measures, including a ceiling on bank loans abroad, the extension and broadening of the interest equalisation tax and a voluntary programme for business firms aimed at improving their external payments position (see pages 8–9). None the less, in support of these measures, the Federal Reserve authorities began

United States: Excess reserves and borrowings of member banks.
Weekly averages of daily figures, in millions of dollars.



to supply reserves less freely, impelling the banks to have greater recourse to central-bank credit and in recent weeks to run a net borrowed reserve position of about $100–150 million. Long-term interest rates have remained at about the same level as a year earlier.

In spite of the administrative measures to limit capital outflows, the question remains whether the necessary results could not better be obtained by higher long-term interest rates. In the United States apprehensiveness regarding higher long-term rates, so long as demand pressures are not excessive, is in one sense understandable. Since investment decisions virtually throughout the industrial and housing sectors are private decisions, higher rates, considered in isolation, would tend to have an adverse effect on investment and a fortiori on aggregate demand. However, last year's tax cut demonstrated rather convincingly that fixed investment responds much more readily to buoyant demand and rising business profits than to liquidity creation at low interest rates. In sustaining the non-inflationary growth of domestic demand, budget taxation and expenditure policies have the advantage over monetary policy that they tend to be more certain in their expenditure effects. Interest rates, on the other hand, are relatively more efficient in influencing the particular channels, domestic and international, through which funds move. Combined with continued flexibility in the application of budget policy, higher longer-term interest rates need not impede domestic growth. Indeed, because of their contribution towards improved external equilibrium, domestic growth would be more soundly based.

France. The primary aim of the stabilisation programme, as further elaborated in 1964, was to halt inflation and safeguard against a current-account deficit. Although external reserves again increased substantially, this was not considered to reflect a conflict between domestic and external policy aims. Rather, it was attributable to the improved position of the overseas franc area and to inflows of long-term capital amenable to policies elsewhere. Domestically, however, wage/price inflation continued to pose a difficult problem. Pending wider acceptance of an incomes policy, which so far has been applied only in the public sector, demand restraint was, apart from direct price controls, the principal means used to combat cost inflation. In consequence, the expansion of demand slowed down in the course of 1964 and investment of private companies tended to stagnate.

The object of budgetary policy has been not only to curb demand but, more positively, to foster national saving as a means of realising the investment objectives of the Fifth Plan. In 1964 notable success was achieved along these lines, largely by keeping public expenditure in check. The overall budget deficit, originally expected to be reduced from nearly Fr.fr. 7.0 milliard in 1963 to Fr.fr. 4.7 milliard in 1964, was in practice almost eliminated, though partly through the shifting of certain expenditure outside the budget. As a consequence, the Treasury, after issuing one public loan of Fr.fr. 1.5 milliard in March 1964, was able to dispense with plans for a second issue in the autumn. The funds available to the Treasury through correspondents' accounts and other usual sources, together with the proceeds of the public loan, substantially exceeded its small borrowing requirements in 1964. Hence, during the year the authorities reduced the minimum Treasury certificate ratio, within the banks' compulsory assets ratio, or "coefficient de trésorerie", in three steps from 15 to 7½ per cent. Concurrently, however, with the sharp decline in their holdings of Treasury certificates, the banks added somewhat to their voluntary holdings of Treasury bills purchased by tender. Altogether, the Treasury reduced its indebtedness to the banking system in 1964 by Fr.fr. 240 million, after having increased it in 1963 by Fr.fr. 3.8 milliard.

Credit policy in 1964 was also aimed at containing demand. The ceiling on the permissible rate of growth of bank credit to the economy, lowered in September 1963 from 12 to 10 per cent., has since remained unchanged. Moreover, this limit was closely observed, credits to the economy in 1964 rising by Fr.fr. 11.0 milliard to reach a total of Fr.fr. 109.3 milliard. A significant part of the increase was ascribable to medium-term credits, which rose by Fr.fr. 2.02 milliard, reflecting a decline in the medium-term claims of the Bank of France by Fr.fr. 640 million and a rise in those of the banks by Fr.fr. 2.66 milliard. This shift, in turn, was facilitated by the reduction of the Treasury certificate ratio within the overall "coefficient de trésorerie". Since their other holdings of compulsory assets consist mainly of medium-term paper otherwise rediscountable at the Bank of France, the banks were thereby induced to carry a larger proportion of medium-term credits in their own portfolio. In addition to the global ceiling of 10 per cent., within which the banks were requested to give priority to credits for exports and productive investments, there is a ceiling on special medium-term rediscountable credits for construction. This ceiling is being used to curtail such credits and to replace them with direct long-term loans.

The banking system's net foreign assets increased in 1964 by Fr.fr. 3.80 milliard, thus making almost the same contribution to domestic liquidity formation as in 1963 (Fr.fr. 4.16 milliard). However, thanks to budgetary and credit restraint, the total increase in the banking system's monetary and quasi-monetary liabilities in 1964 came to only 9 per cent., as against rises of almost 14 per cent. in 1963 and over 18 per cent. in 1962.

Another set of measures last year, partly facilitated by the budgetary improvement, aimed at promoting personal savings and restraining consumption. In January the limit on individual savings deposit accounts was raised from Fr.fr. 10,000 to 15,000. In the same month the Treasury reduced the rates payable on its progressive-interest-rate medium-term bonds, highly liquid because encashable on demand, and in October it ceased altogether to issue this type of paper. In November it also reduced the rates paid on fixed-yield Treasury bonds of three to five years' duration. In consequence of these measures, savings deposits increased sharply, those with the savings banks rising by Fr.fr. 8.6 milliard in 1964, as against only Fr.fr. 5.5 milliard in 1963. This development enabled the Caisse des Dépôts et Consignations, to which a large part of the savings banks' funds are channelled, to expand its long-term lending activity last year. In addition, time deposits with the banks increased by Fr.fr. 2.6 milliard, compared with a rise of Fr.fr. 0.7 milliard in the previous year. Altogether, savings in liquid form, including bank time deposits, went up in 1964 by 14.6 per cent., representing a marked improvement compared with the 11.4 per cent. increase in 1963.

As an aggregate, household saving expanded substantially in 1964. The acquisition of long-term financial instruments, on the other hand, remained at about the same level as in the previous year. This development partly reflects the unfavourable profits outlook and the continued strength of liquidity preference. But it was also a result of the fact that a large proportion of long-term savings last year was invested in housing, which rose by more than 20 per cent. In early 1965 further efforts were made to strengthen interest in capital-market instruments. In January, with a view to creating a market in mortgage paper, credit institutions were given the right to cede such paper to insurance and pension funds. In March, in a bill to reform company taxation, the government proposed as from 1966 to increase, by means of a tax credit to residents on dividends received, the effective yield on equities by 25 per cent.

In the spring of 1964, consequent upon the Treasury's public loan and heavy tax payments, the money and capital markets tightened appreciably. In order to ease the situation, partly with a view to avoiding any inflow of funds from abroad, the authorities temporarily reduced the "coefficient de trésorerie". But at the same time, in order to limit recourse to central-bank credit, they increased the rate on pension "B" ("super-enfer") credits from 6 to 7½ per cent. From June 1964 onwards, in fact, the authorities began to use the "coefficient de trésorerie", which since May 1963 had remained at 36 per cent., as a money-market regulator. It was varied on five occasions between June and December, going as low as 33 per cent., but in January was restored to its original level.

Throughout 1964 and in early 1965 the Bank of France's discount rate was kept at 4 per cent. Together with budgetary restraint, monetary policy was gradually successful in slowing down the rise in prices and wages, though not without some stagnation in private investment. In January 1965 the authorities reduced from 3.75 to 3.60 per cent. the base rate (i.e. the so-called "T" rate, hitherto linked with the discount rate) governing the banks' debtor interest charges. Subsequently, on 8th April, the discount rate itself was brought down to 3½ per cent. and the "super-enfer" rate reduced again to 6 per cent. Also in that month, in anticipation of seasonal money-market strains, the "coefficient de trésorerie" was temporarily reduced once again. Finally, at the end of April the "T" rate was lowered to 3.35 per cent. Although these measures mean lower borrowing costs and fairly stable money-market conditions, the basic aims of policy remain little changed. Thus the budget is expected to be in approximate balance in 1965, and the quantitative ceiling on bank credit continues in force. Moreover, direct controls on prices are still considered necessary, though the authorities have been moving to introduce more flexible control arrangements.

Italy. From about 1962 onwards the authorities were faced with a policy conflict between price stability and external equilibrium on the one hand and economic growth on the other. The conflict arose from the fact that, after many years of broadly parallel development, wage and salary incomes began to increase considerably faster than man-hour productivity. This process, at first regarded as a structural adjustment in labour's share of national income, went to excessive lengths, leading by late 1962 to an external deficit. In the summer of 1963, by which time the deficit had grown to serious proportions, the authorities began to take decisive steps to achieve external balance, turning first to credit restraint and supplementing this later with fiscal measures. Helped by the favourable background of world trade, these measures produced a dramatic turn-round in the external accounts, which moved into sizable surplus from the spring of 1964 onwards. However, in the absence of moderation on the wages front, it was not possible to avoid a marked slowing-down in industrial investment and housing construction.

In the course of 1964, as the external position strengthened, the authorities found themselves with increasing scope for stimulating economic activity. In the monetary field, the credit institutions' liquidity position began to ease concurrently with the shift into external surplus in the spring. The Treasury's operations also made a substantial contribution to bank liquidity in 1964 — on about the same scale, in fact, as in 1963. Although the ordinary budget deficit was considerably smaller in 1964, the financing provided by the Treasury to local authorities and semi-public institutions and enterprises was much larger. Together, the foreign exchange inflow and the Treasury's financing operations supplied the banks with liquid funds of about Lit. 1,100 milliard, which appreciably more than offset the liquidity drain of Lit. 875 milliard associated with the normal growth in reserve requirements and in the public's currency holdings. In addition, however, the authorities took direct steps to increase bank liquidity which were designed at the same time to ease pressures on the capital market and sustain investment. Thus, in the autumn the regulations governing the composition of required reserves were modified in respect of the central organisation of savings banks, permitting it to acquire longer-term bonds issued by the government and semi-public institutions in satisfying this requirement. Moreover, the Bank of Italy purchased an appreciable amount of longer-term securities on the open market over the year as a whole. In these two ways the credit institutions were supplied with about Lit. 400 milliard of additional liquidity in 1964. In the course of the year the banks were thus helped to reduce substantially their net indebtedness abroad, as well as to the Bank of Italy, and also to add to their holdings of Treasury paper in excess of the minimum required.

Although credit conditions became increasingly easy, the economy's demand for bank accommodation remained quite weak. The reason lay largely in the persistence of unfavourable business expectations, ascribable in turn to the progressive squeeze on profit margins in recent years. While the extent of this squeeze cannot be precisely measured, one indication of it lies in the fact that wages and salaries as a share of the national income went up from just over 52 per cent. in 1961 to almost 60 per cent. in 1964. At all events, the credit institutions' total loans increased last year by only 3 per cent., as against a rise of 21 per cent. in 1963 and one of almost 24 per cent. in 1962. Within the total increase in 1964, short-term loans tended to level off, while those at medium and long term continued to expand fairly buoyantly. In addition, the banks' holdings of longer-term bonds of special institutions and others grew last year by about Lit. 460 milliard, or 24 per cent., i.e. at the same rate as in 1963.

In this situation recourse was increasingly had to budgetary measures in 1964 in order to give a more active stimulus to the economy. However, in view of the inroads made by rising incomes on business saving, these measures have generally had the object of restraining consumption and stimulating investment, both private and public. In August the government decided to take over the financing of certain social security benefits, thus relieving the burden on the employers to the extent of Lit. 70 milliard up to the end of the year. In September the budget estimates for 1965 provided that, in accordance with EEC recommendations, overall expenditure would expand by no more than 5 per cent. Within that total, however, the budget calls for a rise of 11 per cent. in "productive and social" investment. On the other hand, in order to revive demand in certain depressed sectors, the government later in the year abolished the special purchase tax on cars, earlier imposed as an emergency measure, and freed certain durable consumer goods from hire-purchase restrictions.

The average yield on longer-term government bonds, which at the end of 1962 had stood at 4.88 per cent., continued to rise until June 1964, when it reached 6.05 per cent. Over the same eighteen months the yield on industrial bonds went up from 6.11 to 8.57 per cent. Liquidity preference played a growing rôle in the latter stages of this development, but the demand for securities revived somewhat from about the middle of the year onwards and rates moved downwards. Over 1964 as a whole capital-market issues were higher than in 1963, reflecting mainly a marked rise in bond issues by semi-public industrial concerns and a recovery in share issues from their low 1963 level.

In the early months of 1965 the demand for credit remained weak, with the credit institutions' loan/deposit ratio falling in February to 74.7 per cent., the lowest level since the beginning of 1963. In March the average yield on longer-term government securities stood at 5.35 per cent. and that on industrial bonds at 7.30 per cent. In these months efforts to stimulate investment were intensified. In January the government approved the establishment of a special fund of Lit. 100 milliard to help small and medium-sized industrial enterprises. It was also decided to prolong the life of the Cassa per il Mezzogiorno, through which Lit. 1,700 milliard for development purposes will be channelled over the next five years. Subsequently, in March, a new series of measures to reactivate the economy was decreed by the government. Among other things these measures provided for the financing of an accelerated programme of public works, social housing and motorways, medium-term

Changes in official discount rates since 1962.

Country and date of change	Official discount rate in %
Austria	
17th March 1960	5
27th June 1963	4½
Belgium	
28th December 1961	4½
18th January 1962	4¼
22nd March 1962	4
9th August 1962	3¾
6th December 1962	3½
18th July 1963	4
31st October 1963	4¼
3rd July 1964	*4¾*
Canada	
24th June 1962[1]	6
7th September 1962	5½
12th October 1962	5
13th November 1962	4
6th May 1963	3½
12th August 1963	4
24th November 1964	*4¼*
Denmark	
23rd May 1961	6½
19th August 1963	6
13th November 1963	5½
11th June 1964	*6½*
Finland[2]	
1st April 1959	6¾
30th March 1962	8
28th April 1962	7
France	
6th October 1960	3½
14th November 1963	4
8th April 1965	*3½*
Germany	
5th May 1961	3
22nd January 1965	*3½*
Greece	
1st November 1960	6
17th January 1963	5½
Iceland	
29th December 1960	9
1st January 1965	*8*
Japan	
29th September 1961	7.30
27th October 1962	6.93
27th November 1962	6.57
20th March 1963	6.21
20th April 1963	5.84
18th March 1964	*6.57*
9th January 1965	*6.205*
3rd April 1965	*5.84*
Netherlands	
16th November 1959	3½
25th April 1962	4
8th January 1963	3½
Netherlands (contd.)	
6th January 1964	*4*
4th June 1964	*4½*
Sweden	
15th January 1960	5
6th April 1962	4½
8th June 1962	4
18th January 1963	3½
14th June 1963	4
31st January 1964	*4½*
6th November 1964	*5*
9th April 1965	*5½*
Switzerland	
26th February 1959	2
3rd July 1964	*2½*
United Kingdom	
2nd November 1961	6
8th March 1962	5½
22nd March 1962	5
26th April 1962	4½
3rd January 1963	4
27th February 1964	*5*
23rd November 1964	*7*
3rd June 1965	*6*
United States	
12th August 1960	3
17th July 1963	3½
24th November 1964	*4*

[1] Prior to this date Bank rate was fixed each Thursday at ¼ per cent. above the latest average tender rate for Treasury bills. [2] Basic rediscount rate.

credit facilities for equipment purchases by relatively small firms and tax concessions for house-building. Moreover, employers' social security contributions were reduced by the equivalent of Lit. 127 milliard for the ensuing twelve months.

Netherlands. Developments and policy last year were strongly influenced by the unusually large wage increases negotiated in the autumn of 1963. Already at that time, in anticipation of the strains that lay ahead, budget policy was tightened, a public loan issued in excess of requirements and new price control regulations introduced. In addition, a ceiling was reimposed on the growth of bank credit and later, in January 1964, the official discount rate was raised from 3½ to 4 per cent. In practice, the average increase in wages in 1964 ultimately worked out at 17 per cent., while prices rose, approximately as foreseen, by some 6 per cent. Much as expected, imports accelerated substantially in early 1964, contributing to a large balance-of-payments deficit in the first half of the year. However, this change appears to have been due less to the growth of consumption, which in real terms came to 6 per cent. last year, than to the large increase — no doubt partly induced — in private fixed investment and inventories. Superimposed on this, and contributing in 1964 to a rise in gross domestic investment in money terms of about 27 per cent., was a major acceleration in investment by both the central government and local authorities.

One element of policy last year was that the public sector should remain monetarily neutral by refraining from net recourse to liquidity creation. The central government followed this principle. Although its net borrowing requirement rose from Fl. 310 million in 1963 to Fl. 730 million in 1964, it raised somewhat more than this amount through borrowing on the capital market. With the local authorities it was a different story. Although their recourse to the capital market increased sharply, rising from Fl. 1,150 million in 1963 to Fl. 1,700 million in 1964, this fell considerably short of their net borrowing requirement, which went up from Fl. 1,440 to 2,210 million. Hence some Fl. 500 million had to be covered by means of short-term financing and a drawing-down of liquid assets.

The ceiling on the permissible growth of bank credit, though adjusted seasonally, was 10 per cent. for the year as a whole. On the assumption of monetary neutrality in the public sector, this ceiling was calculated to keep domestic liquidity creation in line with the expected growth of the real national product. As a further element of restraint, the external deficit was to be allowed to have its impact on bank liquidity, inducing the banks to draw upon their external monetary assets.

In practice, short-term bank credit to the private sector rose last year by some 12 per cent., thus exceeding the prescribed ceiling and compelling the banks to place funds on interest-free deposit with the central bank. In addition, the banks increased their medium-term credits and capital-market claims by over Fl. 900 million, or 23 per cent. On the other hand, the economy's domestic liquid assets, including short-term claims on the public sector, went up by no more than 10 per cent. This increase, which in spite of the external deficit was about the same as in 1963, exceeded the authorities' norm. But given the large wage and price adjustments, together with the local authorities' short-term financing activity, such a monetary expansion could hardly be avoided. Moreover, the increase in the real national product, which came to about 7½ per cent., was itself substantially above original estimates. Furthermore, when viewed against the 15 per cent. rise in national product in money terms, the degree of monetary restraint was quite considerable. Indeed, by the summer of 1964 the external current account was again approaching equilibrium.

Following a steep rise in money-market interest rates in the first half of 1964, the Nederlandsche Bank raised its discount rate in June from 4 to 4½ per cent. Yields on long-term government securities, which had increased markedly in late 1963, also rose sharply around this time, reaching by August a level of about 5.4 per cent., compared with only 4.3 per cent. in the autumn of the previous year. At this level a burst of foreign buying, mainly of public bonds, occurred, tending not only to undermine credit restraint but also to add to official reserves. In the autumn the current account itself shifted back into surplus.

Net funds raised on the capital market amounted in 1964 to Fl. 6.4 milliard, representing a growth of about 25 per cent. compared with 1963. While the rise in public-sector borrowing was quite substantial, that of the private sector, mainly in the form of mortgage and other direct loans, increased even more. Foreign investment on the Netherlands market, although appreciable, accounted for no more than one-eighth of the total increase in long-term funds. In other words, against the background of sharply rising incomes, higher interest rates also proved a big attraction for domestic funds. In the spring of 1965 long-term yields were not far below their level of last summer.

In 1965 the need for policy restraint has persisted. Last year wage costs per unit of output went up by 10 per cent., while in 1965 average wage increases, which are expected to be at least 9 per cent., will again exceed productivity gains. In view of the satisfactory trend of exports, wage increases of this size may be interpreted partly as a structural adjustment to levels prevailing in other countries. None the less, such adjustments tend to have limits and must not be allowed to go to excessive lengths. Another complicating factor is a scheduled cut in income taxes, part of which is to come in the middle of 1965. In these circumstances the authorities are attempting, partly by means of closer surveillance over local-authority financing, to adhere in the public sector to the norm of monetary neutrality. In addition, the ceiling on the growth of bank credit is again to be 10 per cent. in 1965. The broad impression is that monetary policy will continue to bear a heavy burden of restraint.

Belgium. A stronger budget position and a more receptive capital market permitted a marked strengthening of Belgium's public finances last year. The ordinary budget shifted from a B.fr. 3.5 milliard deficit in 1963 to a surplus of B.fr. 2.5 milliard in 1964. Although the deficit in the extraordinary budget increased somewhat — mainly owing to public works projects previously initiated — the Treasury's net financing needs fell from B.fr. 24.5 milliard in 1963 to about B.fr. 13.5 milliard last year. And, whereas in 1963 the Treasury had been able to raise no more than B.fr. 2.9 milliard on the capital market, this figure rose in 1964 to B.fr. 7.9 milliard. Within this total, moreover, net borrowing at long term amounted to as much as B.fr. 15.3 milliard, while medium-term debt was reduced by B.fr. 7.4 milliard. As a result of the greater availability of capital-market funds last year, the Treasury was able largely to dispense with short-term borrowing abroad via the banking system, which in 1963 had served to meet about half of its net financial requirements.

In the aggregate, net capital issues rose from just under B.fr. 28 milliard in 1963 to over B.fr. 35 milliard in 1964, though at this level they were still substantially below the B.fr. 51 milliard figure reached in 1962. The improved receptivity of the market was attributable primarily to the attractiveness of the higher interest yields that prevailed over most of last year. The average yield on 5 to 20-year government bonds, for instance, had increased by March 1964 to about 5.5 per cent. from approximately 4.6 per cent. a year earlier, and during the remainder of 1964 it ranged as high as 5.7 per cent. With respect to bonds issued after December 1962, which at that time were made subject to a 15 per cent. withholding tax, the yield on government issues fluctuated between 6.4 and 6.5 per cent. throughout most of 1964. In this connection, another favourable factor underlying market developments in Belgium last year was the announcement by the German Government in March that foreign holdings of German bonds were also to be made subject to a withholding tax. This led to some repatriation of Belgian funds that had moved to Germany in 1963.

A policy aimed at restraining the growth of bank credit to the private sector had been initiated on a limited scale in July 1963, when the basic discount rate was raised from 3½ to 4 per cent. In October, with bank lending continuing to expand rapidly, the rate was put up further to 4¼ per cent. At the same time the National Bank increased by ¾ per cent. those of its lending rates that usually influence the banks' charges for advances.

As inflationary forces persisted, the authorities found it necessary in early 1964 to turn to more direct measures. In a gentleman's agreement concluded at the initiative of the National Bank, the banks undertook to limit the growth of their lending in 1964 to no more than 10 per cent., or about half the rate of expansion in 1963. Within these limits, preference was to be given to the financing of fixed investment, while hire-purchase and inventory credits were to be kept down. Despite these measures, however, bank lending continued to expand excessively in the first half of 1964, leading the National Bank in July to reinforce its policy. At this time the monetary reserve system, announced in December 1961, was applied for the first time on a modest scale, requiring the banks to place on non-interest-bearing deposit with the National Bank an amount equivalent to 1 per cent. of their monetary and quasi-monetary liabilities. In addition, the National Bank raised its discount rate to 4¾ per cent. and tightened its eligibility requirements for rediscounting commercial paper. Over 1964 as a whole the restraint programme appears to have achieved good results. Bank credit to the private sector rose by about 11 per cent., as against an increase of 21 per cent. in the preceding year. This outcome, together with the central government's reduced recourse to monetary financing, contributed to a more moderate rate of liquid-asset formation. The banking system's monetary and quasi-monetary liabilities, which in 1963 had increased by over 10 per cent., rose last year by about 7 per cent.

Early in 1965 demand conditions eased, though mainly in respect of private investment in particular sectors. With inflationary tensions still rather pervasive, the authorities continued to adhere to a general policy of both budget and credit restraint. An effort is being made to space out public investment and to restrain the growth of public consumption expenditure. In the monetary field the ceiling on the growth of bank lending remains effective on much the same basis as in 1964. In the spring of 1965, in order to give a selective stimulus to the private economy, the monetary authorities allowed private and public credit institutions once again freely to grant investment credits.

Germany. At the beginning of 1964 domestic stability was threatened by a clear-cut case of "imported inflation". Largely because of inflationary developments in neighbouring countries, exports were accelerating sharply. In addition, for a variety of reasons, not least the growing external surplus itself, foreign purchases of German securities were beginning to speed up. The authorities' reactions to this situation, though focused mainly on bringing capital movements under control, were far-reaching in their scope. In March 1964 the government introduced a proposal to put a 25 per cent. withholding tax on interest from German bonds held by non-residents and, in order to encourage foreign issues in Germany, to remove the 2½ per cent. tax on new security issues. At the same time the Bundesbank began once again to supply dollars to the banks on a swap basis below market rates on condition that they were used to acquire US Treasury bills. In addition, the banks' reserve ratios against foreign deposit liabilities, which do not apply in so far as such liabilities are offset by acquisitions of short-term foreign assets, were raised to the legal maximum. As another step, interest payments on foreign time deposits were once again prohibited.

At about the same time that these measures were changing the face of the capital account, the stabilisation efforts in other countries contributed to a marked slowing-down in the growth of German exports. Thus, what had loomed as a disequilibrating surplus of major proportions was successfully averted. Meanwhile, partly under the influence of external demand, domestic investment had developed a strong momentum of its own, leading with the buoyant growth of other demand components to a rising trend in imports. Gradually, in view both of the shift towards an external deficit and of the widespread prevalence of restraint policies elsewhere, the monetary authorities regarded themselves as having greater freedom for domestic action. Hence in July 1964 it was decided to increase (with effect from August) the minimum reserve ratios for residents' deposits by 10 per cent. At the same time, in order further to safeguard against inflows of funds, the authorities decided to reduce the rediscount ceiling of each bank by the amount of its foreign borrowing in excess of the January-June 1964 average. Subsequently, in January 1965 the discount rate, unchanged since May 1961, was raised from 3 to 3½ per cent. Moreover, certain measures taken primarily to modify basic banking regulations also had somewhat restrictive implications.

The credit institutions were brought increasingly under pressure in 1964. In its domestic transactions the Federal Government absorbed funds until late in the year, depositing them with the Bundesbank. Moreover, from about the spring onwards the external deficit began to make inroads on bank liquidity. These developments, together with the increase in reserve requirements and in the currency circulation, resulted over the year as a whole in a large reduction in the banks' liquid assets. However, owing to the official measures taken early in the year, the banks were induced not to draw upon short-term assets held abroad. Instead, the need for funds was met primarily through sales of money-market paper to the Bundesbank to the amount of DM 2.2 milliard and by recourse to central-bank credit facilities to the extent of DM 2.0 milliard.

In the first few months of 1965 liquidity pressures persisted and were reflected in call-money rates well above the discount rate.

Although held in check by the deterioration in their liquidity position, the credit institutions' total lending (excluding purchases of bank bonds) increased in 1964 by DM 30.5 milliard, or about 14 per cent., compared with a rise in 1963 of DM 25.6 milliard, or just over 13 per cent. Short-term bank borrowing by the enterprise sector (excluding housing), the net financial needs of which rose from DM 11.1 milliard in 1963 to DM 16.0 milliard in 1964, substantially accelerated last year. Moreover, long-term bank loans for housing recorded a relatively large increase. Finally, local authorities, together with the Federal Railways, considerably increased their recourse to medium and long-term bank credit last year, partly owing to difficulties in borrowing on the capital market. On the liabilities side, savings deposits rose appreciably in 1964, as did also issues of bank bonds.

For the capital market 1964 was a year of striking change. Foreign net purchases of German fixed-interest-bearing securities, which had earlier been averaging about DM 500 million a quarter, ceased abruptly with the announcement of the proposed 25 per cent. coupon tax in March and were followed by net sales of over DM 500 million in the second quarter. In consequence, yields on domestic bonds rose appreciably, those on public issues increasing from 5.8 per cent. in March to 6.3 per cent. in the summer. Thereafter, foreigners' net transactions in German securities were of insignificant proportions. However, at the higher level of rates German funds began to flow to the market in increasingly large volume, leading to net bond issues in 1964 of DM 14.4 milliard, i.e. 18 per cent. more than in 1963. Including shares, the 1964 increase was larger still. Mortgage and communal bonds issued by banks recorded large gains, but those of the public authorities fell somewhat below the 1963 figure. Foreign issues on the German market, which are not subject to the coupon tax, rose from DM 107 million in 1963 to DM 890 million in 1964, partly reflecting switching operations by foreigners. Late in 1964 and early in 1965, as the liquidity squeeze tended to curb the banks' security purchases, long-term yields moved higher, reaching levels of around 7 per cent. by May.

The less favourable external position since the spring of 1964 has, it is true, provided the authorities with greater scope for domestic monetary restraint. It does not follow from this, however, that the monetary weapon is the most efficient instrument to use for present stabilisation purposes. At their current levels longer-term interest rates could begin, despite the coupon tax, to attract foreign funds. Moreover, business firms appear already in 1964 and early in 1965 to have increased their direct recourse to credits from abroad. Stabilisation efforts last year were helped considerably by the Federal Government, which reduced its cash deficit to less than DM 560 million from DM 3.1 milliard in 1963. This improvement was more than offset, however, by a rise in the deficits of the Länder and local authorities. Furthermore, the problem of fiscal restraint has been aggravated by the DM 2 milliard reduction in income taxes effective as from January 1965. Last year the public sector as a whole increased its total expenditure by about 9 per cent., with the sector's own investment rising by as much as 15 per cent. To bring this total increase into line with the growth of the real national product, as the authorities are seeking to do, would be beneficial on both domestic and external grounds.

Switzerland. In recent years the problem of reconciling domestic and external policy objectives has been a difficult one. Recurrent large inflows of capital, working their way into the monetary system, have contributed to an excessive expansion of credit and demand, as well as to an increasingly large deficit on current account. At first the authorities sought to deal with the problem primarily through the maintenance of low interest rates — partly in order to encourage capital to move elsewhere — and through the import of foreign workers — in order to avert an inflation of domestic wage costs. By about the middle of 1963, however, demand inflation had developed to such an extent that this line of policy was no longer tenable. Interest rates were subsequently allowed to rise and, in view of the capital expenditure attendant upon the use of foreign labour, steps were taken to reduce the intake of workers from abroad.

In March 1964 a broad stabilisation programme was introduced, based partly on proposals involving new legislative powers. In order to curb directly further inflows of foreign capital, it was laid down that the banks would be obliged to place the countervalue of such funds, if not reinvested abroad, on non-interest-bearing deposit with the National Bank. In the domestic sphere, building was made subject to restrictions and the import of foreign labour limited, while capital issues were brought under stricter control and the ceilings on bank lending slightly reduced. Since these measures were designed directly to restrain investment, they helped indirectly to keep the rise in interest rates within limits. This, in turn, helped among other things to minimise the incentive for a repatriation of Swiss capital, over which no controls exist. At all events, the yield on long-term government bonds, which stood at about 3.2 per cent. in the middle of 1963, rose to a level of about 4.0 per cent. by the late spring of 1964.

In practice, the regulations with respect to foreign capital inflows proved immediately effective, thus allowing the external current-account deficit to begin to take a toll on bank liquidity. As could be expected, however, repatriations of Swiss capital held abroad provided an alternative source of bank liquidity and the official reserves continued to rise. In these circumstances the authorities were led to take further measures. In July 1964, in view of the high level of money-market rates, which had remained above the official discount rate since late 1963, the National Bank adjusted its discount rate from 2 to 2½ per cent. In August, in an open-market operation to mop up liquidity, the central bank placed Sw.fr. 225 million's worth of short-term rediscountable Federal "rescriptions" with the banks. In October, in order to reduce the liquidity effect of a maturing loan, the Confederation placed with the banks a five-year certificate issue of Sw.fr. 150 million. Over the year as a whole bank liquidity tightened considerably, leading the banks to borrow fairly large sums from the central bank.

Whereas in 1963 the current-account loans of the sixty-two representative banks had increased by 13 per cent., the rise in 1964 was only 8½ per cent., which was well below the prescribed ceiling. The banks' mortgage loans expanded less rapidly in percentage terms last year, but the change was slight. On the liabilities side, the growth of deposits of all kinds slowed down, but there was a marked acceleration in purchases of medium-term bank bonds, which increased by 9 per cent. after a growth of only 1 per cent. in 1963.

Net capital issues, after rising in 1963 about 27 per cent. above the level in 1962, were somewhat higher still last year. Net foreign issues on the Swiss market, which had reached a peak of Sw.fr. 860 million in 1961, declined further from Sw.fr. 530 million in 1963 to Sw.fr. 280 million in 1964. Thus, the stricter control exercised over these issues, combined with the attractiveness to investors of higher interest rates, facilitated a rise in net domestic bond flotations of over 22 per cent. This increase was ascribable to a sharp rise in the issues of the cantons, communes and electrical power enterprises, while those of banks and industry were somewhat lower than in 1963. Reflecting the weakening equity market, share issues remained unchanged.

In late 1964 and early 1965 demand pressure, though still excessive, eased somewhat, leading to a substantial reduction in the external current-account deficit. The yield on long-term government bonds, after edging upwards in the second half of 1964, has more recently declined to about 3.9 per cent. For 1965 as a whole the permissible expansion of short-term bank credit was fixed at the same rate as in 1964, while that for mortgages was raised by 11 per cent. purely to allow for the consolidation of construction credits. Last January, as a further measure to absorb liquidity, the National Bank swapped foreign exchange with the banks against Sw.fr. 473 million in domestic currency. In February the government decided on a 10 per cent. reduction over two years in the foreign labour force. In the same month a referendum gave public sanction to the legislative proposals introduced the preceding March. As in a number of other countries, public-sector budgets are a negative element in the present situation. The Confederation's budget estimates for 1965 show a much smaller cash surplus and the cantons and communes have been increasing their expenditure at a rapid rate.

Austria. Initiated by a replenishment of stocks, the buoyant expansion from early last year onwards was sustained by increases in exports and investment, particularly in building. Although production did not press against capacity limits, prices rose under the influence of earlier wage adjustments, while the labour market also became increasingly tight. In the spring, therefore, the government decided on a stabilisation programme providing for a further liberalisation of trade, cuts in certain customs tariffs and an increase in foreign labour quotas.

Starting from a comfortable liquidity position at the beginning of the year, *the credit institutions increased their credits to the private sector* in 1964 by 15.8 per cent., as against 7.4 per cent. in 1963. Moreover, as there was a high rate of deposit formation, associated partly with a continuing but smaller overall external surplus, the banks' liquidity position further improved in the course of the year. Hence, although the credit situation remained one of basic ease, the authorities took various steps to limit the growth of bank liquidity. In September 1964 it was decided to raise minimum reserve requirements by one and a half percentage points for deposits of all kinds, thus immobilising Sch. 1.3 milliard. About the same time existing credit ceilings, which are linked to the banks' deposit liabilities, were lowered by two percentage points, thereby reducing unused credit margins by Sch. 1.4 milliard. In addition, an arrangement was reached with a number of banks that Sch. 1.7 milliard of their foreign assets should not be repatriated for a certain period.

In the spring of 1965 industrial investment appeared to be speeding up and, with tighter labour-market conditions, there was some danger of an acceleration also in wages and prices. It is hoped in these circumstances that the budget will be a stabilising factor. Whereas the deficit in 1964 came to Sch. 2.8 milliard, of which Sch. 0.8 milliard was covered by external borrowing, the 1965 budget is intended to be in virtual balance, with no government borrowing abroad envisaged. Monetary policy has continued to aim at controlling the formation of bank liquidity. In February 1965, in order to enable the central bank to pursue a flexible open-market policy, new arrangements were made concerning the National Bank's right to convert its claims on the government into money-market paper. Whereas hitherto only Sch. 780 million could be converted into bills, which had to be sold or repurchased at a fixed yield of 3½ per cent., the National Bank may now exchange an amount of up to Sch. 3 milliard and sell or buy the paper to or from the banks at a nominal interest rate of 2 per cent., but at any price appropriate to policy needs. Finally, in April, on the initiative of the government, the commercial banks lowered their debtor interest rates by ½ per cent., partly as a means of reducing the pull on funds from abroad.

Sweden. Propelled by public investment, housing outlays, exports and inventory accumulation, overall demand accelerated in 1964 and pushed against the limits of supply. In consequence, there was a substantial rise in imports, costs and prices. Budgetary developments accentuated the demand problem. In the second half of 1963 the central government's budget, which had been running a substantial surplus, began to deteriorate, and in 1964 it involved a borrowing requirement of S.kr. 260 million. As a contribution to monetary restraint, however, the authorities made active use of debt management. Long-term government bonds outstanding increased in 1964 by almost S.kr. 590 million and were placed mostly outside the banking system. Shorter-term government debt was reduced by S.kr. 330 million, of which S.kr. 260 million was vis-à-vis the Riksbank. The yield on government bonds rose from 5.22 per cent. in December 1963 to 5.87 per cent. a year later.

As part of the move towards higher interest rates, the Riksbank raised its discount rate in two steps to 5 per cent. by early November 1964. Moreover, in order to restrict access to central-bank credit, the Riksbank in February 1964 introduced a penal borrowing rate of 9 per cent. (i.e. twice the discount rate) on borrowing beyond certain limits. In November this rate was increased to 10 per cent.

The increase in credit of all kinds came in 1964 to S.kr. 9.2 milliard, compared with S.kr. 8.5 milliard in 1963. However, the proportion channelled through the capital market in the broad sense (including loans from capital-market institutions) rose from about 71 per cent. in 1963 to 82 per cent. a year later. This reflects, on the one hand, a substantial increase in borrowing at long term by local authorities and for private housing and, on the other, a decline in the growth of commercial-bank loans to the rest of the economy from S.kr. 2.1 milliard in 1963 to less than S.kr. 1.6 milliard in 1964. The expansion of the banking system's monetary and quasi-monetary liabilities, at 7½ per cent., was much the same as in 1963. But, viewed against the background of the changeover to a budget deficit, the increase in the Riksbank's gold and foreign exchange reserves and the larger nominal rise in the national product, the degree of monetary restraint applied was considerable. Its impact appears to have been diminished to some extent by recourse to trade credits from abroad, but bank access to foreign funds is controlled.

The budget is expected to shift back into surplus in the course of 1965, thanks partly to an increase in the general purchase tax as from the middle of the year. Meanwhile, inflationary demand conditions have continued to prevail, possibly in part because of buying in anticipation of higher indirect taxes. In February the government again floated a long-term loan and in April the Riksbank raised its discount rate to 5½ per cent. and the penalty borrowing rate to 11 per cent.

Denmark. Following a short-lived return towards equilibrium late in 1963, demand surged upwards again in 1964, led by a 22 per cent. rise in fixed investment and a sharp increase in inventory accumulation. In consequence, imports rose more than exports, causing the re-emergence of a large current-account deficit. This deficit did not lead to monetary stringency, since it was more than offset by large capital imports, which contributed to a rise of D.kr. 1.2 milliard in the Nationalbank's gold and foreign exchange reserves.

In 1964 liquidity formation was restrained to a large extent by a rise in the central government's cash surplus, through which D.kr. 1.5 milliard was sterilised at the central bank, as against D.kr. 0.6 milliard in 1963. Moreover, as direct measures, the authorities in March 1964 postponed all public-sector building starts for six months and in the summer prohibited further local-authority borrowing abroad. In June the official discount rate was raised from 5½ to 6½ per cent. In August limits were set for commercial banks' borrowing from the Nationalbank and a 6 per cent. penal interest rate, payable over and above the normal rates, was introduced for borrowing in excess of these limits. Over the year as a whole, however, the commercial banks increased their net borrowing from the Nationalbank by D.kr. 380 million, and the central bank itself eased the liquidity situation somewhat by making net purchases of government securities.

Bank credit to the private sector increased in 1964 by 16 per cent., but the growth of deposits, at 12 per cent., lagged behind. In conjunction with a further rise in capital-market issues, long-term interest rates rose steeply throughout the year, reaching 8–9 per cent. on most mortgage bonds. By early 1965 tighter credit conditions appear to have moderated demand somewhat, but government and local-authority expenditure, as well as private fixed investment and house-building, continued to advance too fast. In February 1965 a voluntary agreement was reached to the effect that commercial and savings banks should deposit with the Nationalbank 20 per cent. of any increase in their domestic deposit liabilities and the full equivalent of any increase in their net foreign liabilities. In the spring of 1965 the government sought by means of various increases in taxes, mostly indirect ones, to offset its rapidly growing expenditure requirements and again to realise a substantial cash surplus. It also decided to space out expenditure on its long-term construction programme and to postpone new building starts until the middle of October.

Norway. By all odds the most dynamic element of demand last year was exports, which continued the upswing that began in the spring of 1963. Although the economy was operating close to capacity limits and imports rose substantially, the growth of exports contributed to a sizable increase in gold and foreign exchange reserves. In controlling aggregate demand main reliance was put on credit restraint. Already in 1963 the central government's budget had become rather more expansionary and in 1964 the overall deficit, including loan transactions, again increased moderately. At the same time, however, the credit control agreement for 1964 provided that the commercial and savings banks should not expand their credits by more than 5–6 per cent., compared with the limit of 6–7 per cent. applied in 1963. Moreover, it was specified that lending in foreign currencies was not to increase by more than N.kr. 100 million above the level of December 1963.

In practice, the banks' loans to the private sector, with an increase in 1964 of 8.6 per cent. as against one of 6.9 per cent. in the previous year, exceeded the prescribed limits. But, as the real gross national product rose by 6.3 per cent., compared with 5.3 per cent. in 1963, the excess had a certain justification. What is more disquieting is the adverse trend in the budget, which in 1965 provides for a 15 per cent. rise in expenditure. Thanks to an increase in the turnover tax rate from 10 to 12 per cent., budget revenue is expected to go up. However, in view of the strength of overall demand and of government plans to stimulate house-building, a greater degree of budget restraint has appeared desirable. Against this background, the credit control agreement for 1965, corresponding in the main to that for 1964, provides that the banks should limit the growth of their loans to 5½-6 per cent. and their foreign currency loans to N.kr. 100 million, while also making larger purchases of government securities.

Finland. Under the influence of rising exports and fixed investment the economy resumed its expansion in 1964. At the same time imports rose steeply, mainly reflecting demand for capital goods and motor-cars, while exports went up only half as fast. Demand developments do not by themselves explain this adverse movement, as the economy had not reached a state of over-full employment. Also pertinent was a rise in labour costs per unit of output of about 9 per cent. and a cost-of-living increase of 10 per cent. Apart from negotiated adjustments, wages were raised twice because of their automatic link with prices, which in turn rose partly because sales taxation was extended to all goods at retail level.

Banking activity accelerated markedly in 1964, the credit institutions' loans to the private sector increasing by 14 per cent. and their deposit liabilities by 12 per cent. After May 1964, when fully index-tied deposits were made tax-free, time deposits grew rapidly. Part of the banks' liquidity needs last year were satisfied through net sales of foreign exchange to the central bank; for, while the external current account deteriorated, this was more than offset by a sharp increase in private borrowing abroad. The banks also had recourse to central-bank credit. In the public sector, various new direct and indirect taxes helped the government to reduce its deficit in 1964. Its financial needs were covered partly by borrowing outside the banking system, although the new tax provisions with respect to indexed deposits reduced the attractiveness of government loans.

The Bank of Finland's basic rediscount rate remained at 7 per cent. last year, and rediscount ceilings were kept at the lower levels to which they had been reduced in 1963. In February 1964 the banks were instructed to discriminate in favour of loans for productivity improvements and against those for consumption and stock accumulation. In order to deter excessive borrowing, it was also recommended that rates on new credits of more than one year's duration should be linked to the wholesale-price index to the extent of 50 per cent. In September the banks were warned not to exceed their rediscount limits and were again requested to use index lending on a broader scale. As a more direct measure to restrict imports, hire-purchase terms on motor-cars were tightened in November and again, together with those on other durable consumer goods, in April 1965. Finally, in May the Bank of Finland ruled that until the end of October 1965 commercial banks' credits may not rise by more than 9 per cent. above the amount outstanding at the beginning of the year. At the same time rediscount limits were raised, but the requirements for import credits were made less favourable. Moreover, banks were allowed to raise their short-term lending rates, in particular in respect of import financing.

Spain. Since the stabilisation programme of 1959 Spain has made notable economic progress, thanks largely to its increasing degree of integration with the international economy. As a consequence of capital inflows, tourist receipts and the remittances of Spanish workers abroad, it has been possible to finance a rapid expansion of imports, especially of capital goods, while at the same time continuously building up the country's external reserves. In its wake, however, progress has brought some problems. The external surplus has gone hand in hand with domestic inflationary pressures, which have tended to concentrate mainly on foodstuffs and the building sector. In 1964, following a period of relative stability in 1963, prices began to rise substantially again.

Last year, however, the external surplus was not the only factor tending to increase bank liquidity, as there was also considerably greater recourse by public institutions to credit from the Bank of Spain. Thus the banks were enabled not only to reduce their own indebtedness to the central bank, which dropped by over Pesetas 11 milliard, but also to accelerate their lending operations. Credits granted to the private sector by the banking system (including the central bank) rose last year by 21 per cent., or much the same as in the previous year. The acceleration was rather in credits to the public sector, which rose by 17 per cent., as against increases of 7 per cent. in 1963 and 4 per cent. in 1962. These developments were associated with a growth in the banking system's monetary and quasi-monetary liabilities in 1964 of 21 per cent., compared with a rise of 17 per cent. in the previous year.

Net capital issues, which had already risen sharply from Pesetas 30.9 milliard in 1962 to Pesetas 53.6 milliard in 1963, expanded further to Pesetas 63.4 milliard in 1964. The increase over the preceding year was ascribable almost entirely to larger public-sector issues, which were taken up mainly by the commercial and savings banks. Another public-sector issue, amounting to Pesetas 10 milliard, was placed in February 1965.

The increase in borrowing by the public authorities has been occasioned principally by the four-year development plan, which was launched at the beginning of 1964. While the development plan will in the long run help to eliminate structural distortions, themselves a current source of inflationary pressure, it should be paced so as not to intensify unduly the short-term demand pressures on the economy. Along other lines certain steps towards the containment of inflationary pressures were taken towards the end of 1964. Customs duties were reduced, imports further liberalised and efforts initiated to keep wage increases in line with productivity gains.

Canada. In 1964 the economy advanced vigorously, a continued rapid growth in housing construction, automobile output and local-authority expenditure being reinforced by a major rise in plant and equipment expenditure. Against this background, the demand for credit on the part of business firms and households increased sharply. Concurrently, however, a buoyant rise in tax revenues contributed to an improvement in the central government's budget position, which changed over, on a national accounts basis, from a deficit of Can.$280 million in 1963 to a surplus of Can.$330 million in 1964. Thus, thanks to the budgetary improvement, the monetary authorities were able to permit growing private demand for credit to be satisfied without a change in credit conditions.

The chartered banks' total Canadian dollar loans increased in 1964 by 14 per cent., as against 6.8 per cent. in 1963. But, whereas in 1963 the banks increased their holdings of government bonds and Treasury bills by almost Can. $650 million, in 1964 they reduced such holdings by nearly Can. $280 million. The contraction in the government's financial needs also facilitated private capital-market activity in 1964.

Up to the autumn of 1964 the yield on three-month Treasury bills fluctuated within a range of 3.5 to 3.9 per cent. and that on long-term government securities between 5.15 and 5.25 per cent. Afterwards, however, long-term yields began to edge downwards and, not long after Bank rate was raised from 4 to 4¼ per cent. in November, Treasury bill yields also tended to decline. These changes, which involved a narrowing of the gap between Canadian and US interest rates, were broadly consistent with external policy aims. At the beginning of May 1965 the yield on three-month Treasury bills stood at 3.77 per cent. and that on government bonds at about 5.10 per cent.

In the spring, with expansion expected to advance more slowly, the government announced that the Federal income tax is to be reduced as from 1st July by 10 per cent., up to a limit of Can. $600 for each taxpayer.

Japan. In 1963, as on several earlier occasions, rapid domestic expansion led to a marked deterioration in the external balance. And, as in the past, the authorities did not hesitate to apply brakes to the domestic economy, relying as usual mainly upon monetary restraint. The new restraint phase began in December 1963 with a modest increase in the banks' reserve requirements against demand deposits. A more decisive step was taken in January 1964, when the banks were requested to keep the increase in their lending below that for the corresponding period of the preceding year — 10 per cent. below for the first quarter, 12 per cent. for the second quarter and 22 per cent. for the third and fourth quarters. Subsequently, in March, the official discount rate was raised from 5.84 to 6.57 per cent.

These measures, although immediately effective in slowing down the growth of bank credit and the money supply, did not have the same quick impact on spending. Because the corporate sector had substantial liquid assets upon which to draw, and because government investment outlays were rising appreciably, economic activity continued to gain momentum, leading to a further deterioration in the external balance in the first half of 1964. After the middle of the year, however, side by side with a further deceleration of credit expansion, investment and consumption slowed down perceptibly. The squeeze on the banks' and corporate sector's liquidity showed itself clearly in the sharp increase in the call-money rate and in the selling of securities by firms. The already stagnant stock market would have been still more depressed by these sales but for the buying operations of the Joint Securities Company, a government-supervised company organised at the beginning of 1964 for the purpose of lending support to the stock market. Such action occurred particularly during the last quarter of 1964, the necessary finance being supplied largely by the central bank. Meanwhile, however, the progressive improvement of the visible trade balance was such that external reserves rose rapidly and for the year as a whole showed only a moderate net decline.

Thus, by the end of 1964 the policy that had been in force for one year had succeeded in restoring external equilibrium. It is true that the money supply rose by about 14 per cent., but this was a relatively small increase compared with that of 34 per cent. in 1963 and the 9 per cent. growth in 1964 in the real gross national product. The commercial banks' credit to the private sector went up in 1964 by almost Yen 2,500 milliard, showing an increase of about 15 per cent., as against one of more than 25 per cent. in 1963. Around the turn of the year, as the favourable trend of exports was expected to continue — in fact it has since strengthened — and as symptoms of recession were tending to spread, the authorities moved gradually back to an easier policy. In December reserve requirements were reduced and the credit guide-lines were relaxed. In early January the Bank of Japan lowered its discount rate from 6.57 to 6.205 per cent. and in early April restored it to the level — 5.84 per cent. — at which it had stood before the restraint programme was initiated.

II. WORLD TRADE AND PAYMENTS.

The expansion of world trade continued in 1964, with a rise of 11.5 per cent. in current values, against one of 8.5 per cent. in the previous year. The rate of increase slackened, however, in the course of the year, and in the first quarter of 1965, as far as can be seen from incomplete data, it seems to have declined in regard to both the preceding quarter and the first quarter of 1964. This was mainly due, however, to the prolonged strike in US ports at the beginning of the year, which led to a sharp contraction in US exports.

In 1964 developed areas' exports and imports increased by 13 and 12.5 per cent. respectively. In absolute figures, exports rose from $104.5 to 118.1 milliard and imports from $111.0 to 125.0 milliard.

The group of four countries comprising Australia, Japan, New Zealand and South Africa registered the fastest advance, its imports rising by 18 per cent. and its exports by 16 per cent. The expansion of imports reflects, inter alia, a steep rise in Australian purchases following high export earnings the previous year, when large wheat deliveries were made to the USSR and wool and sugar prices were high. The rise in exports was mainly due to a sharp increase in sales by Japan, which accounts for over one-half of the group's

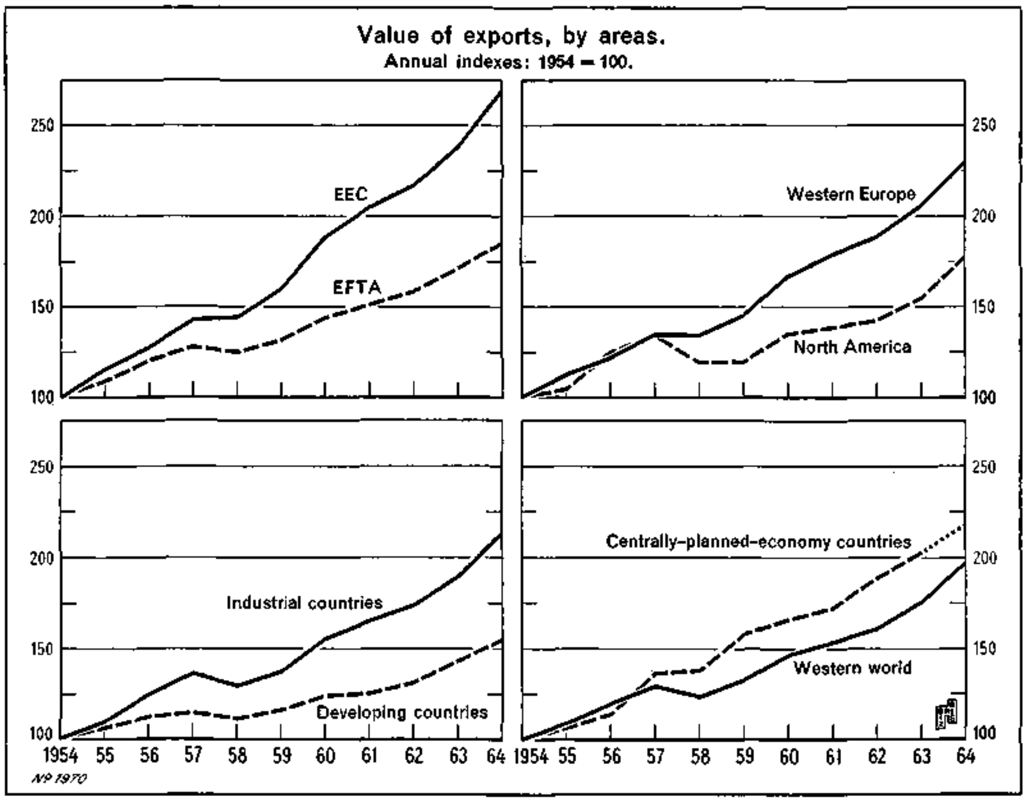
International trade.

Areas	Exports			Imports			Changes in volume of	
	1954	1959	1964	1954	1959	1964	exports 1954–64	imports 1954–64
	in milliards of US dollars						in percentages	
Developed areas								
Western Europe								
EEC	15.8	25.2	42.6	16.6	24.3	44.9	*+ 147*	*+ 171*
EFTA	12.9	17.1	24.0	15.7	20.0	30.1	*+ 68*	*+ 88*
Other countries	2.3	2.8	4.5	3.0	4.0	7.6	*+ 99*	*+ 185*
Total for western Europe	31.0	45.1	71.1	35.3	48.3	82.6	*+ 112*	*+ 135*
United States and Canada	19.5	23.3	34.7	15.6	23.3	27.8	*+ 63*	*+ 76*
Other areas[1]	4.9	7.5	12.3	6.3	7.9	14.6	*+ 206*	*+ 153*
Total for developed areas	55.4	75.9	118.1	57.2	79.5	125.0	*+ 96*	*+ 118*
Developing areas								
Latin America	7.3	7.7	9.9	6.8	7.2	8.5	*+ 57*	*+ 21*
Other areas	14.4	17.6	23.9	15.3	19.6	25.7	*+ 71*	*+ 63*
Total for developing areas	21.7	25.3	33.8	22.1	26.8	34.2	*+ 67*	*+ 49*
Grand total[2]	77.1	101.2	151.9	79.3	106.3	159.2	*+ 89*	*+ 96*

[1] Australia, Japan, New Zealand and South Africa. [2] Represents roughly 90 per cent. of world trade, as the trade of centrally-planned economies is not included except in so far as it is reflected in the imports and exports of their partners in the western world.

exports. Exports from the United States and Canada went up by 15 per cent., while their imports lagged behind, rising by 10.5 per cent. In western Europe, by contrast, imports rose somewhat more rapidly than exports, by 12.5 against 11.5 per cent. The EEC countries' exports expanded nearly twice as fast as those of the EFTA countries, whose combined results were kept down by the sluggishness of UK sales. On the other hand, the upsurge of UK imports caused those of the EFTA group to rise, exceptionally, at a faster rate than EEC imports.

Looking back over the period 1954–64, world exports increased at an annual compound rate of 7 per cent. Their growth rate in the first half of the decade amounted to 5.5 per cent. and accelerated to 8.5 per cent. in the second half. Developed countries' exports increased by 6.5 per cent. in the period 1954–59 and by 9 per cent. in the following five years, which have witnessed the establishment of both the EEC and the EFTA.

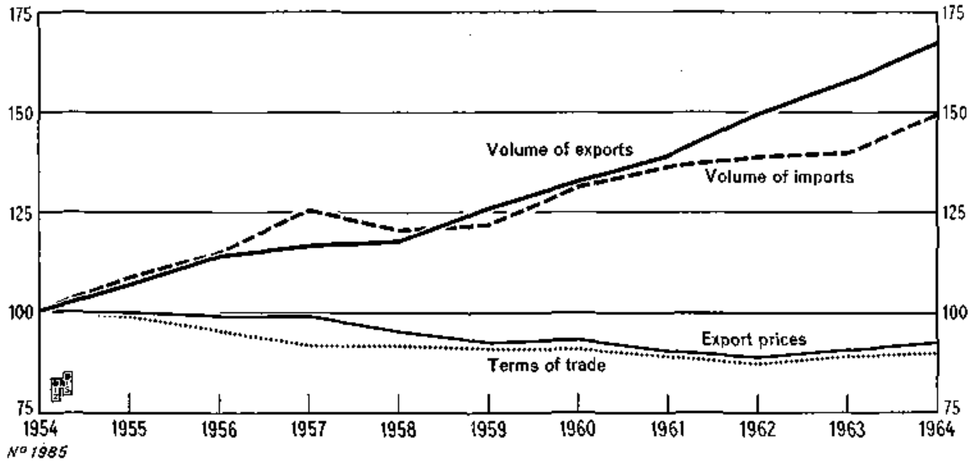


Note: Industrial countries include western Europe, North America, Australia, Japan, New Zealand and South Africa. Industrial and developing countries together are termed the western world. Centrally-planned-economy countries comprise the USSR, eastern Europe, mainland China and Cuba.

The centrally-planned economies' exports, which started from a low level in 1954, rose by 8.5 per cent annually in the following nine years (complete data for 1964 are not available at the time of writing); this is a somewhat faster rate than that of industrial countries' exports, but if the comparison is limited to the period 1959–63 the rate of increase was slower.

Developing countries' exports lagged markedly behind those of all other countries, with rates of 3 and 6 per cent. respectively in the first and second halves of the decade. Their share in world trade consequently diminished from 28 per cent. in 1954 to 22 per cent. in 1964. As Latin America's exports expanded only about half as much as those of other developing countries, its share of total exports declined from 9.5 to 6.5 per cent.

Developing countries: Volume of trade, export prices and terms of trade.
Annual indexes: 1954 = 100.



The rise in the value of developing countries' exports was due first and foremost to an expansion in the volume of sales, which accelerated in the period 1959–64. The terms of trade, which had fallen from 1954 to 1957 owing to a rise in import prices, then remained fairly stable until 1962, and from that year onwards showed a slight upturn following an increase in export prices. The value of imports rose in line with that of exports in the ten-year period, viz. at an annual rate of 4.5 per cent., but whereas in the first half of the decade their rate of increase, at 4 per cent., was higher than that of exports, in the second half, at 5 per cent., it was lower.

The next table shows changes in the world balance-of-payments situation during the last three years. Looking at developments in 1964, the current surplus of the United States increased by $2.5 milliard, two-thirds of the change being outside western Europe. At the same time, US capital exports increased by $1.7 milliard, all but $300 million of which went to western Europe.

So far as western Europe is concerned, reserves went up as much in 1964 as they had done the year before, since the $1 milliard deterioration on current account was offset by larger capital inflows.

In the rest of the world reserves, including sales of monetary gold, had gone up by $1.7 milliard in 1963; they rose by $0.4 milliard in 1964. The current deficit, excluding sales of monetary gold, rose by $1.5 milliard, World balance of payments.

	Balance of United States	Balance of Western Europe	Balance of Rest of the world
	in milliards of US dollars		
1962			
Current account with United States	—	− 0.9	− 1.5
western Europe	+ 0.9	—	− 0.7
rest of the world	+ 1.5	+ 0.7	—
Total current account	+ 2.4	− 0.2	− 2.2
Capital account, errors and omissions	− 4.6	+ 2.4	+ 2.6
Overall balance, corresponding to change in official gold and foreign exchange holdings and net IMF position	− 2.2	+ 2.2	+ 0.4
Monetary gold sales	—	—	+ 0.3
1963			
Current account with United States	—	− 1.2	− 1.8
western Europe	+ 1.2	—	− 0.3
rest of the world	+ 1.8	+ 0.3	—
Total current account	+ 3.0	− 0.9	− 2.1
Capital account, errors and omissions	− 5.0	+ 2.6	+ 3.0
Overall balance, corresponding to change in official gold and foreign exchange holdings and net IMF position	− 2.0	+ 1.7	+ 0.9
Monetary gold sales	—	—	+ 0.8
1964			
Current account with United States	—	− 1.9	− 3.6
western Europe	+ 1.9	—	0
rest of the world	+ 3.6	0	—
Total current account	+ 5.5	− 1.9	− 3.6
Capital account, errors and omissions	− 6.7	+ 3.5	+ 3.3
Overall balance, corresponding to change in official gold and foreign exchange holdings and net IMF and GAB position	− 1.2	+ 1.6	− 0.3
Monetary gold sales	—	—	+ 0.7

Note: The overall balances for the different areas correspond to the changes in countries' official gold and exchange holdings and in their net IMF positions. They are affected by differences in statistical presentation and by movements of official dollar reserves into or out of the Euro-dollar market. Reserves of the USSR, other eastern European countries, mainland China and North Korea are excluded. US reserves are net of short-term dollar liabilities to official foreigners and of foreign official holdings of non-marketable US Government bonds and notes. UK reserves are net of sterling liabilities to overseas monetary authorities. If the overall balance figures are added across, a positive net result is obtained. In the absence of inconsistencies in the statistics of exchange holdings, this figure would equal the rise in monetary gold stocks for the year in question.

entirely against the United States, and only $0.3 milliard of this change was offset by larger capital inflows. This group of countries can be usefully divided into five developed countries on the one hand — Australia, Canada, Japan, New Zealand and South Africa — and the less-developed world on the other hand. One-quarter of the 1964 deterioration in the group's current balance of payments is attributable to the five developed countries, whose capital receipts also declined slightly. So far as the less-developed countries are concerned, the current balance deteriorated between 1963 and 1964 from equilibrium to a deficit of $1.2 milliard. As their capital receipts rose from $1.2 to 1.6 milliard, however, they continued to add to their reserves, though only by $0.4 milliard, compared with $1.1 milliard in 1963.

The world pattern of capital movements in 1964 continued to consist of very large outflows from the United States to both western Europe and the rest of the world. As in previous years, however, the net capital imports of the less-developed countries in 1964 were less than their gross capital receipts. It would, however, appear that a smaller part than in 1963 of the capital inflow to Europe came from these poorer countries.

Balances of payments.

United States. On regular transactions the US deficit amounted to $3.1 milliard in 1964 — somewhat less than in the previous year. The surplus on commercial transactions rose from $3.8 to 6.0 milliard and net expenditure

United States: Balance on regular transactions.

Items	1963	1964	1964 quarters, seasonally adjusted 1st	2nd	3rd	4th	1965 1st
	in millions of dollars						
Commercial transactions							
Exports	19,270	22,380	5,470	5,345	5,615	5,950	n.a.
Imports	16,995	18,635	4,415	4,605	4,715	4,900	4,665
Trade balance	+ 2,275	+ 3,745	+ 1,055	+ 740	+ 900	+ 1,050	n.a.
Investment income	+ 3,275	+ 3,860	+ 1,030	+ 1,000	+ 1,020	+ 810	+ 1,180
Remittances	− 825	− 830	− 195	− 205	− 215	− 215	− 220
Other services	− 945	− 760	− 170	− 220	− 200	− 170	n.a.
Balance of trade and services	+ 3,780	+ 6,015	+ 1,720	+ 1,315	+ 1,505	+ 1,475	n.a.
Government transactions							
Exports	+ 2,720	+ 2,840	+ 640	+ 710	+ 755	+ 735	n.a.
Services	+ 600	+ 580	+ 135	+ 145	+ 150	+ 150	n.a.
Military expenditure less receipts	−2,240	−2,050	− 505	− 580	− 510	− 455	− 465
Grants and loans	−3,785	−3,660	− 780	− 910	− 935	−1,035	− 785
Miscellaneous non-liquid liabilities*	+ 0	+ 205	+ 0	− 0	+ 205	− 0	n.a.
Total	−2,705	−2,085	− 510	− 635	− 335	− 605	n.a.
Private capital movements	−3,995	−6,090	−1,335	−1,275	−1,580	−1,900	−1,155
Errors and omissions	− 340	− 895	− 140	− 30	− 250	− 475	− 95
Balance on regular transactions	−3,260	−3,055	− 265	− 625	− 660	−1,505	− 730
less: seasonal adjustment items	—	—	− 335	− 35	+ 350	+ 20	− 515
Balance on regular transactions before seasonal adjustment	−3,260	−3,055	+ 70	− 590	−1,010	−1,525	− 215

* Non-marketable US Government securities worth $204 million invested by Canada as counterpart of the US participation of $254 million under the Columbia River Treaty, which is included in private capital movements.

on government transactions was reduced by $600 million, but this combined improvement was almost completely offset by an increase in the net outflow of private capital — including unrecorded transactions — from $4.3 to 7 milliard. Roughly one-half of the deficit on regular transactions occurred in the last quarter of the year.

Commercial exports rose in 1964 by $3.1 milliard, or 17 per cent., and government-financed exports by some $100 million, or 4 per cent. Whereas in the first half of 1964 total exports, on a seasonally adjusted basis, were only slightly above the high level reached in the last quarter of 1963, in the second half they were $900 million up on the first half. About $200 million of this gain, however, represented accelerated shipments in anticipation of the dock strike.

Exports of non-agricultural products expanded by $2.5 milliard last year, against $860 million in 1963, those of industrial materials increasing by $950 million and those of capital equipment, chiefly machinery, by $900 million. More than half of the increase in sales of non-agricultural products was accounted for by western Europe ($750 million) and Canada ($620 million). In the first case the rise in demand covered mainly industrial supplies and materials and in the second capital goods, which may reflect pressures on Canadian manufacturing capacity. Exports to Japan rose by $200 million, or less than in the previous year, and seem to have been affected by Japan's restrictive policies. Higher foreign exchange earnings in Latin America, Australia and South Africa greatly stimulated exports to these areas. Exports of agricultural products went up by $650 million last year, commercial sales accounting for 85 per cent. of the increase. Two-thirds of the rise occurred in the first six months, when $160 million's worth of grain was sold to the USSR and eastern Europe.

Imports increased by $1.6 milliard, or 10 per cent., in 1964 and, like exports, reached a peak in the fourth quarter. Industrial supplies and materials accounted for $750 million of the annual increase and finished goods for most of the remainder. The moderate rise in food and beverages reflected mainly a sharp advance in coffee prices.

Net private investment income, by far the most important invisible item, reached nearly $3.9 milliard last year, an increase of $600 million over 1963, in which year it had fallen off somewhat. On the whole, investment income has risen steadily since the end of the war, and in 1964 it was four and a half times as large as in 1947. Income from private direct investment, which accounts for some 70 per cent. of total investment income, went up from $3.1 to 3.6 milliard last year. Part of the gain reflected income from African oil fields which came into production in 1964. There was also a rise of nearly $200 million in income from other private investment. US payments on private investment went up by $60 million.

Net military expenditure was gradually brought down from its peak of $3.1 milliard in 1958 to $2.1 milliard in 1964, the latter year accounting for a fifth of the decline. This result primarily reflects streamlining of the overseas forces and increased cash sales of military equipment, which went up from \$300 million in 1958 to \$700 million in 1964. Over the same period net government grants and capital assistance increased from \$2.6 to 3.7 milliard, but the greater part of this item represents transactions involving no direct dollar outflow, since most of the aid is now tied to US deliveries of goods and services.

The net outflow of US private capital increased from \$4.3 to 6.4 milliard in 1964, two-thirds of the increase being accounted for by short-term capital.

United States: Private capital movements.

Items	1963	1964	1964 quarters, seasonally adjusted 1st	2nd	3rd	4th
	in millions of dollars					
US capital						
Long-term						
Direct investment	— 1,885	— 2,300	— 515	— 570	— 575	— 640
Portfolio	— 1,105	— 675	+ 40	— 125	— 85	— 505
Other						
Banks	— 740	— 940	— 265	— 100	— 245	— 330
Non-banks	+ 160	— 335	— 10	— 55	— 265	— 5
Total	— 3,570	— 4,250	— 750	— 850	— 1,170	— 1,480
Short-term						
Banks	— 745	— 1,530	— 450	— 460	— 175	— 445
Non-banks	+ 10	— 580	— 160	— 95	— 230	— 95
Total	— 735	— 2,110	— 610	— 555	— 405	— 540
Total US capital outflow	— 4,305	— 6,360	— 1,360	— 1,405	— 1,575	— 2,020
Foreign capital						
Long-term	+ 330	+ 155	+ 15	+ 115	— 65	+ 90
Short-term	— 20	+ 115	+ 10	+ 15	+ 60	+ 30
Total foreign capital inflow	+ 310	+ 270	+ 25	+ 130	— 5	+ 120
Total private capital outflow	— 3,995	— 6,090	— 1,335	— 1,275	— 1,580	— 1,900

Despite a drop of \$430 million in net portfolio investment, the net outflow of US long-term capital expanded by \$680 million owing to rises of over \$400 million in direct investment and nearly \$700 million in other investment by banks and non-banks.

Direct investment, which amounted to \$2.3 milliard in 1964 (more than half of it going to Europe), maintained a steady rate in the first three quarters but accelerated in the last. Portfolio investment was also concentrated in the last quarter of the year, mainly owing to a bunching of Canadian issues, which had previously been held back pending the adoption of the interest equalisation tax. Thus portfolio investment amounted to \$505 million in the last quarter, compared with \$675 million for the year as a whole.

Increasing pressure on foreign capital markets, together with the US brake on security transactions, led to a substantial increase in long-term US lending other than through direct and portfolio investment. Such lending went up from \$580 to 1,280 million. While bank lending increased by \$200 million, non-financial institutions shifted, by \$500 million, from net borrowing to net lending. Half of the shift reflected the \$254 million payment to Canada in connection with the Columbia River Treaty. In return Canada invested \$204 million of the amount received in non-marketable US Government securities. (These are shown under "miscellaneous non-liquid liabilities" in the balance on regular transactions.)

On short-term US account the net outflow rose from \$735 million in 1963 to \$2,110 million last year, banks accounting for \$785 million of the increase and non-banks for \$590 million. The rise in short-term bank lending, which began in the last quarter of 1963, continued at a very high rate during 1964, except in the third quarter. Japan, which has been the main short-term borrower in the last two years, saw its share fall roughly from 65 to 25 per cent. of the total, as Latin America and other countries, except Canada, greatly increased their bank borrowing. Canadian enterprises, on the other hand, had recourse mainly to direct credit granted by US commercial firms. Short-term claims of such enterprises went up by \$590 million in 1964, of which \$285 million concerned Canadian firms.

In order to stem the outflow of capital, the President sent a message to Congress in February 1965, the details of which are given in Part I, page 8. Actual measures, as well as expectations, seem to have influenced developments favourably in the first quarter. According to preliminary figures, the deficit on regular transactions amounted to \$730 million, about half the size of the fourth-quarter deficit.

Canada. The overall surplus on the balance of payments increased from \$135 million in 1963 to \$335 million last year, roughly one-half of the rise being attributable to a reduction in the current deficit and the rest to a larger net inflow of long-term capital.

Foreign trade expanded more rapidly in 1964 than in the previous year, exports going up by 16 per cent. and imports by nearly as much. Sales of grain to the USSR, eastern European countries and Cuba rose from \$180 to 280 million and exports of most other staple products and of manufactured goods also registered substantial increases. The import rise largely reflected the expansion of business investment. Bigger purchases of industrial machinery and of motor-vehicles each accounted for about one-fifth of the total increase.

Increased travel expenditure by Canadians, together with higher interest and dividend payments to non-residents, raised the deficit on invisible items by \$85 million last year. The net improvement on current account therefore came to \$95 million. While Canada's current deficit vis-à-vis the United States widened by \$440 million, its surplus in relation to other countries grew by \$535 million.

The inflow of long-term capital, which had practically stopped in mid-1963 following the announcement of the proposed US interest equalisation

Canada: Balance of payments.

Items	1963	1964	1964 1st quarter	2nd quarter	3rd quarter	4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	6,550	7,620	1,600	2,035	2,015	1,970
Imports	6,085	6,975	1,570	1,895	1,690	1,820
Trade balance	+ 465	+ 645	+ 30	+ 140	+ 325	+ 150
Services						
Interest and dividends	— 600	— 625	— 160	— 145	— 145	— 175
Travel	+ 20	— 45	— 85	— 45	+ 110	— 25
Other	— 400	— 395	— 100	— 95	— 95	— 105
Total	— 980	—1,065	— 345	— 285	— 130	— 305
Current balance	— 515	— 420	— 315	— 145	+ 195	— 155
Long-term capital						
Canadian securities						
New issues	+ 895	+ 975	+ 130	+ 290	+ 95	+ 460
Other transactions	— 430	— 350	— 140	— 80	— 25	— 105
Foreign securities	+ 20	— 0*	— 5	— 30	+ 45	— 10
Direct investment	+ 120	+ 70	+ 10	— 35	+ 30	+ 65
Other	— 40	— 20	— 30	— 35	+ 15	+ 30
Total	+ 565	+ 675	— 35	+ 110	+ 160	+ 440
Balance on current and long-term capital account	+ 50	+ 255	— 350	— 35	+ 355	+ 285
Short-term capital	+ 85	+ 80	+ 310	+ 100	— 210	— 120
Total balance (= changes in monetary items)	+ 135	+ 335	— 40	+ 65	+ 145	+ 165

* Including net receipts of $50 million under the Columbia River Treaty. (Under this treaty Canada received from the United States a payment of $254 million, of which it reinvested $204 million in medium-term non-marketable US Government securities.)

tax, began again in the second quarter of 1964. After the US tax bill was signed, exempting Canada, in early September, new issues on the New York market increased sharply. The net long-term capital inflow, which had totalled $540 million in the first half of 1963 and $25 million in the second half, amounted to $75 million in the first half of 1964 and $600 million in the second. Whereas for the year as a whole net sales of Canadian securities to non-residents increased by $160 million, net direct investment in Canada declined by a further $50 million. At $70 million, it was lower than in any year since the war and down to some 12 per cent. of its 1960 record of $555 million.

European OECD countries. The current account of the European OECD countries, which had been more or less in equilibrium in 1962, showed a deficit of nearly $800 million in 1963 and one of $1.7 milliard last year. In both cases the deficit was due to an increase in the import surplus.

Whereas in 1963 it was the EEC countries that were responsible for the deterioration, in 1964 it was the EFTA countries. In fact, in each year the growth of the European trade deficit primarily reflected the expansion of imports in one country, viz. Italy in 1963 and the United Kingdom in 1964.

The EEC trade balance, which had shown a deficit of $510 million in 1963, moved close to equilibrium last year. This improvement was due essentially to a contraction of the Italian import surplus by $1 milliard. The Dutch trade deficit, on the other hand, increased by $400 million and the French balance deteriorated by $290 million. The German export surplus rose by $170 million. The EEC countries' net receipts from services, which have tended to decline in recent years, amounted to not quite $450 million. In all, the EEC countries earned a current surplus of $420 million in 1964, against one of only $25 million the previous year.

The combined current deficit of the EFTA countries rose from $265 million in 1963 to $1.6 milliard last year. The deterioration occurred entirely in the trade sector, chiefly as a result of the upsurge in imports in the United Kingdom, whose trade deficit expanded by $1.3 milliard. Austria, Denmark, Portugal and Switzerland also recorded increases in their import surpluses totalling $365 million, of which a third was accounted for by Denmark. Norway and Sweden, on the other hand, together improved their trade balance by $60 million. Net receipts from invisible items increased by $300 million, reflecting mainly a rise in income from tourism in Austria and Portugal and in net shipping receipts in Denmark and Norway.

As regards the five remaining OECD countries, the current-account positions of Spain and Turkey improved in 1964, while that of Iceland showed practically no change and those of Greece and Ireland worsened. In Spain higher receipts from invisible items, in particular tourist trade and workers' remittances, more than offset the rise in imports, so that the current balance moved from a deficit of $130 million to a surplus of $60 million. In Turkey the large deficit on current account contracted somewhat owing to a reduction in imports.

The deterioration in the Greek balance on current account resulted from a sharp rise in imports. In addition, there was a fall in net receipts from services owing to a decline in emigrants' remittances and tourist receipts. Thus, the current deficit expanded from $50 to 205 million.

A 7 per cent. increase in Ireland's export prices did not compensate the rise in the import bill, so that the trade deficit was $40 million greater in 1964 than in the previous year. This rise was only partly offset by higher net receipts from invisible items. In Iceland there was also a widening of the trade deficit, which was due to large purchases of ships and aircraft. As, however, these are financed by foreign credits, the overall balance actually showed a surplus.

For the OECD countries as a whole, the net inflow of capital (calculated as the difference between the change in reserves and the balance on current account) rose from $2.8 milliard in 1963 to $3.2 milliard last year. Two-fifths of the increase was attributable to recorded long-term capital

European OECD countries: Balances of payments.

Countries	Years	Trade balance (f.o.b.)	Services[1]	Current balance	Net capital movements (inflow+)[2] Long-term	Net capital movements (inflow+)[2] Short-term	Overall balance[3]
		in millions of US dollars					
Belgium-Luxemburg. . .	1963	— 170	+ 85	— 85	+ 305		+ 220
	1964	— 175	+ 180	+ 5	+ 245		+ 250
France	1963	+ 175	+ 335	+ 510	+ 85	+ 265[4]	+ 860
	1964	— 115	+ 200	+ 85	+ 465	+ 265[4]	+ 815
Germany	1963	+ 2,345	— 2,125	+ 220	+ 490	+ 10	+ 720
	1964	+ 2,515	— 2,415	+ 100	— 270	+ 395	+ 225
Italy	1963	— 2,495[5]	+ 1,605	— 890	— 355	+ 835	— 410
	1964	— 1,485[5]	+ 1,820	+ 335	+ 440	— 410	+ 365
Netherlands	1963	— 365	+ 635	+ 270	— 120	+ 20	+ 170
	1964	— 765	+ 660	— 105	+ 85	+ 270	+ 250
Total for EEC . . .	1963	— 510	+ 535	+ 25	+ 1,535		+ 1,560
	1964	— 25	+ 445	+ 420	+ 1,485		+ 1,905
Austria.	1963	— 340[5]	+ 360	+ 20	+ 100	+ 25	+ 145
	1964	— 415[5]	+ 475	+ 60	+ 20	— 0	+ 80
Denmark	1963	— 65	+ 115	+ 50	+ 170		+ 220
	1964	— 215	+ 160	— 55	+ 225		+ 170
Norway.	1963	— 750[5]	+ 555	— 195	+ 245		+ 50
	1964	— 700[5]	+ 620	— 80	+ 120		+ 40
Portugal	1963	— 160	+ 140	— 20	+ 90	— 35	+ 35
	1964	— 175	+ 190	+ 15	+ 120	— 30	+ 105
Sweden	1963	— 190[5]	+ 160	— 30	— 15		— 45
	1964	— 180[5]	+ 155	— 25	+ 225		+ 200
Switzerland.	1963	— 820[5]	+ 460	— 360	+ 560		+ 200
	1964	— 945[5]	+ 485	— 460	+ 505		+ 45
United Kingdom	1963	— 225	+ 495	+ 270	— 485	+ 55	— 160
	1964	— 1,545	+ 500	— 1,045	— 1,040	+ 740	— 1,345
Total for EFTA . . .	1963	— 2,550	+ 2,285	— 265	+ 710		+ 445
	1964	— 4,175	+ 2,585	— 1,590	+ 885		— 705
Greece	1963	— 450[5]	+ 400	— 50	+ 100	— 40	+ 10
	1964	— 575[5]	+ 370	— 205	+ 190	+ 5	— 10
Iceland	1963	— 5	+ 0	— 5	+ 5		— 0
	1964	— 10	+ 5	— 5	+ 10		+ 5
Ireland	1963	— 310[5]	+ 250	— 60	+ 70		+ 10
	1964	— 350[5]	+ 265	— 85	+ 100		+ 15
Spain	1963	— 935	+ 805	— 130	+ 210	+ 20	+ 100
	1964	— 995	+ 1,055	+ 60	+ 265	+ 40	+ 365
Turkey	1963	— 320[5]	+ 40	— 280	+ 215		— 65
	1964	— 255[5]	+ 5	— 250	+ 260		+ 10
Grand total	1963	— 5,080	+ 4,315	— 765	+ 2,825		+ 2,060
	1964	— 6,385	+ 4,730	— 1,655	+ 3,240		+ 1,585

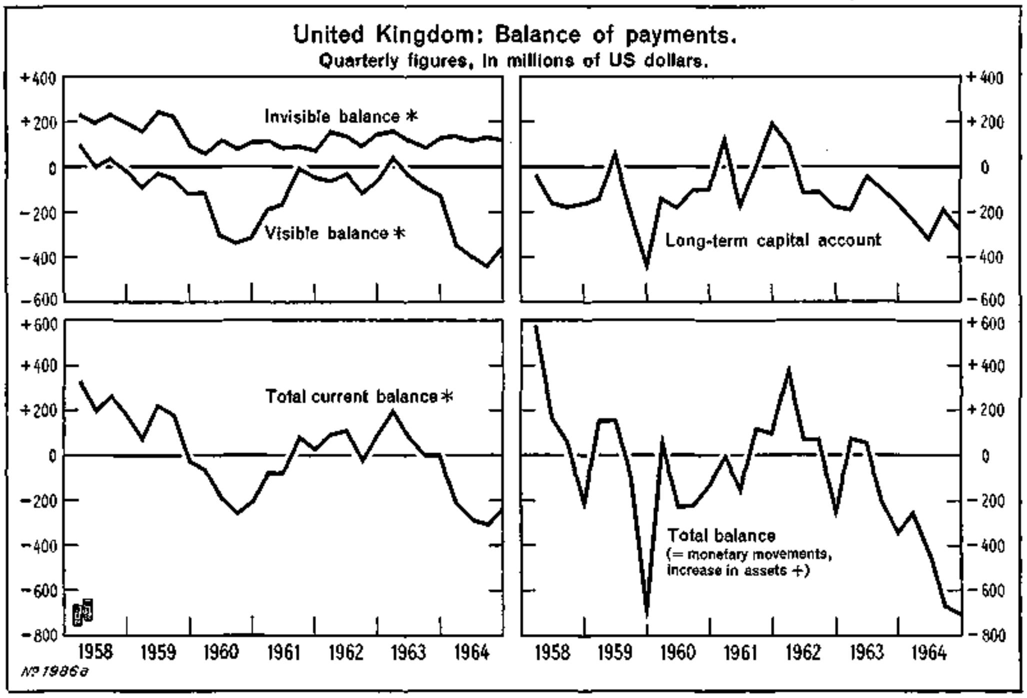
[1] Including unilateral transfers. [2] Calculated as the difference between the current account on the one hand and the overall balance on the other. Long-term capital movements are shown separately where possible. Overall figures or figures for short-term capital movements include errors and omissions and non-reserve monetary items. [3] Equal to changes in official reserves and the net IMF position, including the General Arrangements to Borrow. [4] Including the balance of French overseas territories vis-à-vis the non-franc area. [5] Imports c.i.f.

transactions and the rest to short-term capital transactions, non-reserve monetary items and errors and omissions. The ascertained net inflow of long-term capital went up from $115 to 275 million. This rise conceals three major shifts which occurred in Germany, Italy and the United Kingdom. In Germany there was a turn-round of $760 million from a net inflow to a net outflow, while in Italy an even larger shift occurred in the opposite direction. In the United Kingdom the net outflow of long-term capital, after amounting to close on $500 million in 1963, soared to over $1 milliard last year. Within the EEC the movements recorded in Germany and Italy practically cancelled each other out. As, however, the outflow of French official capital was greatly reduced, while foreign investment in the Netherlands rose substantially last year, the net inflow of long-term capital into the EEC, excluding Belgium–Luxemburg, for which data are not available, went up from $100 million to over $700 million.

United Kingdom. The balance-of-payments situation was the outstanding feature of economic developments in the United Kingdom during 1964. For the whole year a deficit of $2.1 milliard was recorded, about equally divided between the current and long-term capital accounts. The deficit began in the second half of 1963. By the first quarter of 1964 it was running at an annual rate of $1.8 milliard and in the following two quarters the figure was even higher. Most of the deficit in the first three quarters of the year was covered by a substantial inflow of funds to London. During the last quarter of the year, by which time the deficit was past its peak, though still substantial, there was a very large outflow of money from London superimposed on it, and a major crisis resulted. Measures were then taken, aimed principally at the external trade balance. This was in any case showing signs of improvement on both the import and export side and the overall deficit for the first quarter of 1965 is almost certain to have been much lower than in any quarter of 1964. Subsequently, in the April 1965 budget a number of steps designed to effect a permanent and substantial reduction in the net capital outflow were proposed.

Before describing what happened in 1964, it is relevant to look at some of the salient features of the UK balance of payments during recent years. Taking the seven years from 1958 to 1964, which were respectively the best and the worst post-war years for the balance of payments, the first thing that stands out is the cyclical movement of the trade — and therefore also the current — account. The high points in 1958 and 1962 are widely separated from the low points of 1960 and 1964. Secondly, both the trade balance and the current account have been on a gradually worsening trend throughout the period, since the recovery from the 1960 low point did not restore the 1958 position and the 1963–64 downswing took the current deficit to a considerably larger figure than was recorded in 1960.

The deterioration in the current account in 1958–60 and 1963–64 may be explained by the emergence in both cases of situations of over-full employment of domestic resources. And in 1963–64 rising prices of food and



* Seasonally adjusted.

raw-material imports played a part. The unfavourable trend over the whole period covered by the graphs is another matter. That there has been some weakening of the United Kingdom's international competitiveness is suggested by the decline from 18 per cent. in 1958 to 14 per cent. in 1964 in the country's share of world exports of manufactured goods. Of recent years the fastest-growing market for British goods has been western Europe; it might have grown faster still had the separation into EEC and EFTA not occurred. In addition, it may be mentioned that the share of finished goods in total UK imports went up during this period from 8 to 15 per cent.

Looking at the two main periods of weakness on the current account, the first covered seven quarters from the end of 1959 to mid-1961, while the second began in the third quarter of 1963 and lasted until the end of 1964. Given the size of the UK reserves, such substantial current-account deficits in a country which is a regular exporter of long-term capital were only possible because they coincided with periods during which money was flowing to London. 1960 saw a very large increase in the London balances of countries outside the sterling area, particularly Europe, while in 1963–64 the outer sterling area was in balance-of-payments surplus and local authorities in the United Kingdom were borrowing through the Euro-dollar market.

Taking the seven years together, the quarterly average of the identified items on current account works out at practically zero. The average quarterly long-term capital outflow was $125 million. Even allowing that a good part of the favourable "balancing item" of $25 million per quarter represents unidentified current receipts, during these seven years the long-term capital outflow from the United Kingdom was mainly financed by a change in the external monetary position of $2.6 milliard, $2 milliard of which occurred in 1964. As official reserves were about the same at the end as they had been at the beginning of the period, virtually the whole of the financing took place through an increase in external liabilities. Official borrowing, from foreign monetary authorities and the IMF, rose by $0.8 milliard; sterling balances held by non-residents in London (excluding the counterpart to official assistance) increased by about the same amount, of which holders in the outer sterling area accounted for two-thirds; and the remaining $1 milliard came from inflows of funds that did not show up in the form of additions to foreign sterling balances.

United Kingdom: Balance of payments.*

Items	1963	1964	1964 1st quarter	1964 2nd quarter	1964 3rd quarter	1964 4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Imports	12,230	14,065	3,505	3,530	3,415	3,615
Exports and re-exports	12,005	12,520	3,155	3,225	2,885	3,255
Trade balance	− 225	−1,545	− 350	− 305	− 530	− 360
Services	+ 495	+ 500	+ 200	+ 135	+ 25	+ 140
Current balance	+ 270	−1,045	− 150	− 170	− 505	− 220
Long-term capital						
Official	− 295	− 335	− 80	− 55	− 80	− 120
Private						
UK	− 945	−1,185	− 290	− 315	− 280	− 300
Foreign	+ 755	+ 480	+ 130	+ 50	+ 165	+ 135
Total	− 485	−1,040	− 240	− 320	− 195	− 285
Balance on current and long-term capital account	− 215	−2,085	− 390	− 490	− 700	− 505
Errors and omissions	− 205	+ 5	+ 125	+ 50	+ 30	− 200
Total balance (= changes in monetary items)	− 420	−2,080	− 265	− 440	− 670	− 705
of which changes in reserves and IMF position	*− 160*	*−1,345*	*+ 5*	*+ 45*	*− 165*	*−1,230*

* On a transactions basis.

Turning to the year 1964 alone, the trade account on the basis of customs figures deteriorated by $1,470 million. Imports rose by $1,960 million, or 15 per cent., and exports by $490 million, or 4 per cent. One-quarter of the increase in import payments, and half of the increased receipts from exports, resulted from higher prices.

On the import side, $1,080 million of the increase came from purchases of industrial materials (including semi-manufactured goods), which were 20 per cent. higher than in 1963. A quarter of this rise was in prices, and increased stock-building probably accounted for an even greater proportion. The next biggest rise (and in fact relatively speaking the greatest, since the percentage increase was 29) was that of \$515 million in imports of finished goods. Purchases of capital goods were \$380 million higher; this was equivalent to over 40 per cent. of the increase in the private sector's fixed capital investment, excluding houses. Imports of finished consumer goods rose by 23 per cent. in 1964, for the second consecutive year. Food and fuel imports went up by \$365 million, or about 6½ per cent.

On the export side, sales of engineering goods, which account for nearly half of the total, rose by only \$90 million, or 2 per cent. The whole of this rise consisted of higher sales of motor vehicles. Most of the increase in exports came from other categories of manufactured goods, sales of which expanded by \$420 million. Chemicals were up by \$125 million, metals by \$110 million, miscellaneous manufactured goods by \$100 million and textiles by \$60 million. Exports of non-manufactured goods, which accounted for 16 per cent. of the total, were in the aggregate unchanged. Exports of food and beverages, particularly whisky, were higher, while fuel exports, which had been boosted in 1963 by exceptionally large sales of coal to France and the Netherlands, declined.

The decrease in exports during the middle quarters of the year, which accounted for their relatively modest rise during the year as a whole, was mainly the result of lower shipments to EEC countries. For the whole year, sales to the Common Market were up by \$45 million, compared with a rise of \$295 million in 1963. Two-thirds of the difference between these two figures can be accounted for by the Italian market, sales to which declined by 21 per cent. in 1964. Sales to France and Germany were hardly higher than in 1963, while exports to the Benelux countries rose considerably. With sales to EFTA countries up by \$175 million, western Europe took close to half of the 1964 increase in British exports. Sales to the sterling area rose by \$175 million and to North America by \$85 million.

On 26th October 1964 a temporary surcharge of 15 per cent. was imposed on all imports into the United Kingdom except food and raw materials. This roughly doubled the tariff on manufactured goods. At the same time, it was announced that exporters would benefit from a rebate of various indirect taxes that affect the cost of producing exports. The rates of rebate range from 1 to 3 per cent. of the value of the goods. The import surcharge was reduced in April 1965 to 10 per cent.

For the first quarter of 1965 the seasonally adjusted trade deficit on a f.o.b. basis was \$106 million. Imports were 4 per cent. lower than in the previous quarter. Some of the decline may have been due to dock strikes in the United States. Exports, after rising 4 per cent. in the last quarter of 1964, went up by a further 1½ per cent. in the first three months of 1965. Most of the export recovery has been in the engineering sector.

On a balance-of-payments basis the trade deficit for 1964 was \$1,545 million, after \$225 million in 1963. Despite the deferment of \$90 million of interest payments due on the post-war loans from the United States and Canada, there was virtually no change in the net balance of invisible transactions, which yielded \$500 million. The surplus would have been higher had it not been for special payments made under an agreement to rephase tax payments to one of the large oil-producing countries. Government expenditure overseas rose by \$125 million and the identified current-account balance showed a deficit of \$1,045 million.

The net outflow of long-term capital in 1964, at \$1,040 million, was exceptionally high. Official capital exports went up slightly, from \$295 to 335 million. In the private sector, however, there was a rise of over \$500 million, from \$190 to 705 million. A large part of this was attributable to increased net investment overseas by the oil industry, including the \$170 million investment by the Royal Dutch/Shell Group in Montecatini. Net portfolio investment transactions, which had produced an inflow during 1963, resulted in an outflow of \$160 million in 1964. A part of this probably reflected the loss of confidence in sterling during the course of the year; in addition, however, nearly one-third of the net portfolio outflow in 1964 was attributable to the acquisition of the overseas interests in one UK company.

The deficit on current and long-term capital account therefore amounted to \$2,085 million. The "balancing item", representing errors and omissions, was virtually nil. As this item contains some net surplus on account of unidentified current transactions, the capital outflow must have been somewhat larger than the statistics indicate.

In his budget speech on 6th April 1965, the Chancellor of the Exchequer announced measures designed to effect a substantial reduction in the net outflow of long-term capital from the United Kingdom. Firstly, overseas investment income transferred to the United Kingdom is to be taxed more heavily than before, by restricting UK tax relief on such income. Secondly, the supply of currency available for making foreign investments that are not allowed at the official rate of exchange is to be reduced. Thirdly, more stringent rules are being introduced as regards the use of the official exchange market for direct investments outside the sterling area.

Italy. The overall balance of payments, which had been in deficit throughout 1963 and the first quarter of 1964, took a sharp turn for the better in the second quarter, when both the current and the capital account moved into surplus. The 1963 deficit of over \$1.2 milliard was thus followed last year by a surplus of \$775 million. This turn-about was ascribable to a concurrent decrease in imports and increase in exports, which cut down the trade deficit by \$1 milliard, combined with a substantial net inflow of capital.

Compared with the previous year's level, import expenditure (c.i.f.) fell by 3 per cent. in 1964 (after rising by 18 per cent. in the first quarter, it declined by 9 per cent. in the following nine months). Export receipts rose by 17 per cent. over the year as a whole (11 per cent. in the first quarter and 19 per cent. in the last three quarters). Consequently, the trade gap was reduced from $680 million in January–March 1964 to an average of $270 million a quarter from April to December. In the first quarter of 1965 it amounted to $195 million owing to a further contraction of imports.

The policy of credit restraint applied as from the middle of 1963, together with more specific measures introduced in February and April 1964, contributed to this result. Thus the introduction of a purchase tax of 7–15 per cent. on new cars (subsequently abolished in November) and the tightening of payment terms for imports of certain durable goods affected purchases of motor-cars, which declined from $325 to 200 million, accounting for one-third of the total reduction in imports as registered by customs statistics. Imports of iron and steel and of engineering products fell by about $140 million each last year, reflecting the slowing-down in economic activity. Exports rose in absolute values by $900 million, of which about one-third each was attributable to consumer goods and capital goods. The latter benefited from strong demand abroad and a contraction of home demand — the reverse of the situation in 1963.

The net balance of services improved by over $200 million in 1964, mainly because of larger net receipts from tourism — which must be attributed

Italy: Balance of payments.*

Items	1963	1964	1964 1st quarter	1964 2nd quarter	1964 3rd quarter	1964 4th quarter	1965 1st quarter
	in millions of US dollars						
Merchandise trade							
Imports (c.i.f.)	7,260	7,065	1,935	1,725	1,635	1,770	1,710
Exports (f.o.b.)	4,765	5,580	1,255	1,330	1,475	1,520	1,515
Trade balance	— 2,495	— 1,485	— 680	— 395	— 160	— 250	— 195
Services							
Travel	+ 750	+ 825	+ 90	+ 185	+ 350	+ 200	+ 115
Emigrants' remittances	+ 520	+ 550	+ 100	+ 135	+ 160	+ 155	+ 115
Transport	+ 305	+ 330	+ 80	+ 85	+ 90	+ 75	+ 80
Other	+ 30	+ 115	— 15	+ 45	+ 35	+ 50	+ 0
Total	+ 1,605	+ 1,820	+ 255	+ 450	+ 635	+ 480	+ 310
Current balance	— 890	+ 335	— 425	+ 55	+ 475	+ 230	+ 115
Capital movements							
Repatriated bank-notes	— 1,470	— 575	— 260	— 140	— 115	— 60	— 135
Investment by non-residents	+ 1,240	+ 1,085	+ 245	+ 430	+ 200	+ 210	+ 90
Investment by residents	— 115	— 110	— 30	— 15	— 45	— 20	
Other	— 10	+ 40	+ 35	— 105	— 15	+ 125	
Total	— 355	+ 440	— 10	+ 170	+ 25	+ 255	— 45
Total balance (= changes in monetary items)	— 1,245	+ 775	— 435	+ 225	+ 500	+ 485	+ 70
of which changes in reserves and IMF position	*— 410*	*+ 365*	*— 645*	+ 80	+ 430	+ 500	0

* On a cash basis.

to higher Italian prices, as hotel occupancy was actually somewhat below that in 1963. The other important service items also showed better results than in the previous year. In the first quarter of 1965 net receipts from services were $55 million higher than in the corresponding quarter of 1964.

The reversal in the capital account from a net outflow of $355 million in 1963 to a net inflow of $440 million was due primarily to a sharp contraction of illegal capital exports in the form of bank-notes, which was connected with the tightening of liquidity and, more specifically, with a change in the taxation of dividends. In February the 15 per cent. withholding tax was replaced by an option to pay either a 5 per cent. withholding tax as an advance on income tax or a flat 30 per cent. on dividends received. Bank-note exports, as measured by the amount of notes repatriated and credited to non-residents' capital lira accounts, declined from $1,470 million in 1963 to $575 million last year. In the fourth quarter they had shrunk to $60 million, compared with $280 million a year earlier and the peak of $525 million attained in the first quarter of 1963. Net investment in Italy by non-residents decreased by $155 million to $1,085 million and tended to shift from portfolio investment to direct investment and lending: net foreign purchases of Italian securities declined by $600 million, while net direct investment rose by $190 million and net loans taken up abroad by $255 million.

Germany. The balance on the combined current and long-term capital account shifted from a surplus of $710 million in 1963 to a deficit of $165 million last year. The main cause of the swing was a turn-round in the balance of German security transactions; in addition, there was some rise in net expenditure on services.

For the year as a whole the trade surplus, at over $1.5 milliard, was practically the same as in 1963, but owing to the rapid expansion of imports it was much smaller in the second half of the year than in the first. Compared with the corresponding period of 1963, imports rose by 8 per cent. in the first half of 1964 and 17 per cent. in the second, while exports followed the reverse pattern, rising by 17 and 7 per cent. in the first and second halves respectively. Imports continued to rise faster than exports in the first quarter of 1965, so that the export surplus was reduced to $275 million, as compared with a surplus of $595 million in the corresponding quarter of 1964.

Except for armament imports, which continued to decline in 1964, all major categories of goods had a share in the increase. Imports of food and of finished products rose by some 10 per cent. in each case, while those of industrial raw materials and semi-finished goods went up about twice as much.

For the first time since the creation of the European Economic Community, exports to member countries grew less than total exports, namely by 8 per cent., as against 11 per cent. The export surplus vis-à-vis Italy, which had amounted to $440 million in 1963, was reduced to $30 million last year.

The trade surplus vis-à-vis the EFTA countries, on the other hand, rose substantially in 1964, mainly because of an improvement in the trade balance vis-à-vis Denmark, the United Kingdom and Austria.

Germany: Balance of payments.[1]

Items	1963	1964	1964 1st quarter	1964 2nd quarter	1964 3rd quarter	1964 4th quarter	1965 1st quarter
	in millions of US dollars						
Merchandise trade							
Exports (f.o.b.)	14,580	16,230	3,890	4,055	3,870	4,415	4,340
Imports (c.i.f.)	13,070	14,710	3,295	3,560	3,700	4,155	4,065
Trade balance	+1,510	+1,520	+ 595	+ 495	+ 170	+ 260	+ 275
Services	— 50	— 215	— 20	— 20	— 140	— 35	— 15
Unilateral transfers	—1,240	—1,205	— 280	— 355	— 290	— 280	— 305
Current balance	+ 220	+ 100	+ 295	+ 120	— 260	— 55	— 45
Long-term capital							
Private							
Security transactions	+ 595	— 110	+ 80	— 245	+ 45	+ 10	— 140
Other	+ 190	+ 155	+ 35	+ 40	— 5	+ 85	+ 220
Total private	+ 785	+ 45	+ 115	— 205	+ 40	+ 95	+ 80
Official	— 295	— 310	— 65	— 60	— 65	— 120	— 45
Total	+ 490	— 265	+ 50	— 265	— 25	— 25	+ 35
Balance on current and long-term capital account	+ 710	— 165	+ 345	— 145	— 285	— 80	— 10
Short-term capital							
Private[2]	+ 5	+ 40	+ 165	+ 15	— 75	— 65	+ 45
Official[3]	— 80	— 175	— 95	+ 5	+ 20	— 105	+ 20
Total	— 75	— 135	+ 70	+ 20	— 55	— 170	+ 65
Balance on capital account	+ 415	— 400	+ 120	— 245	— 80	— 195	+ 100
Errors and omissions	— 130	+ 470	+ 235	+ 105	+ 190	— 60	+ 300
Total balance (= changes in monetary items)	+ 505	+ 170	+ 650	— 20	— 150	— 310	+ 355
of which changes in reserves and IMF position	*+ 720*	*+ 225*[4]	*+ 100*	*+ 90*	*— 80*	*+ 115*[4]	*— 160*

[1] On a transactions basis. [2] Excluding changes in the net foreign position of the commercial banks. [3] Excluding transactions with the IMF. [4] Including credit of $180 million to the IMF under the General Arrangements to Borrow.

The tendency towards large deficits on services account was accentuated last year. But whereas in previous years growing deficits on travel account had been the main cause of the deterioration, in 1964 the worsening was attributable to nearly all items, but first and foremost to higher payments in respect of investment income. The increase came to $100 million — as compared with an overall deterioration on services account of $165 million — and reflected a rise in dividends paid by German companies to their foreign shareholders.

At $1.2 milliard, unilateral transfers were somewhat smaller than in 1963. Indemnification payments continued to fall, while workers' remittances remained stable. As both the number of foreign workers and the general level of wages increased last year, it must be assumed that many immigrants have now brought their families to Germany.

The net inflow of long-term private capital, which had been a regular feature of the balance of payments since 1960 and had amounted to nearly $800 million in 1963, fell below $50 million last year. This was due primarily to a sharp decline in foreign investment in Germany but also to an increase in German investment abroad.

As regards foreign private capital, the net inflow declined from over $1 milliard to less than $500 million last year, nearly nine-tenths of the decrease being accounted for by a drop in net purchases of German bonds. This was the direct result of the government's announcement in March 1964 of its intention to introduce a 25 per cent. capital yield tax on foreign-held German fixed-interest securities. The tax was actually voted at the beginning of 1965. While there had been net purchases of $110 million in the first quarter of 1964, in the second quarter there were net sales of $130 million. Although during the rest of the year non-residents bought rather more German securities than they sold, for the year as a whole foreign transactions in German bonds were completely balanced. Net foreign purchases of German shares fell from $220 million in 1963 to $100 million last year, the reduction having occurred, as in the case of bonds, in the second quarter. Unlike investment in securities, foreign direct investment increased last year.

As regards German long-term private capital, there was a net outflow of $445 million last year (against $280 million in 1963), of which $120 million represented net purchases of foreign bonds. During 1964 twelve foreign loans denominated in Deutsche Mark, totalling $225 million, were offered on the German market, of which residents took up about $90 million. Credits and loans to foreigners more than doubled and purchases of foreign shares also increased substantially. In the first quarter of 1965 large-scale purchases of foreign bonds by German residents, together with substantial sales of German securities by non-residents, brought about a net outflow of $140 million. This was more than compensated, however, by a rise in the net inflow of other long-term capital, so that total private long-term capital showed a net inflow of $80 million.

On short-term capital account the total outflow expanded from $75 million in 1963 to $135 million last year. The net official capital outflow rose from $80 to 175 million owing to German prepayments for armaments. In the private sector, on the other hand, the net inflow of capital was larger than in 1963, as German enterprises borrowed more abroad.

The reversal of the overall capital-account balance from a net inflow of $415 million in 1963 to a net outflow of the same magnitude last year was to a large extent compensated by a change of $600 million in the balance of unrecorded items, as the terms of payment moved in favour of Germany.

Given the deterioration in the current balance, however, the overall surplus was reduced from $505 to 170 million last year. In the first quarter of 1965 there was an overall surplus of $355 million, due almost entirely to a very large surplus on unrecorded items.

France. Last year, for the first time since 1958, France's balance of trade showed a deficit. As receipts from services declined, the surplus on current account, which between 1959 and 1963 had averaged some $730 million, was reduced to $85 million. However, the absence of advance debt repayments, which had amounted to $280 million in 1963, the somewhat larger net inflow of foreign private capital and better results in the rest of the franc area brought the overall balance, as measured by the increase in official reserves, to $815 million, nearly as much as in 1963.

Foreign trade with countries outside the franc area continued to expand rapidly. As measured by customs statistics, exports, which had increased by

France: Balance of payments.[1]

Items	1963	1964[2]	1964 1st quarter	1964 2nd quarter	1964 3rd quarter	1964 4th quarter
	in millions of US dollars					
France						
Merchandise trade (f.o.b.)						
Exports	6,745	7,585	1,825	1,835	1,830	1,935
Imports	6,570	7,700	1,950	1,890	1,750	2,010
Trade balance	+ 175	− 115	− 125	− 55	+ 80	− 75
Services						
Travel	+ 120	+ 30	+ 30	+ 60	− 90	+ 20
Workers' remittances	− 205	− 230	− 50	− 55	− 65	− 65
Other	+ 420	+ 400	+ 50	+ 90	+ 105	+ 120
Total	+ 335	+ 200	+ 30	+ 95	− 50	+ 75
Current balance	+ 510	+ 85	− 95	+ 40	+ 30	+ 0
Long-term capital						
Official	− 430[3]	− 80	− 15	− 10	− 40	− 15
Private	+ 515	+ 545	+ 110	+ 140	+ 130	+ 145
Total	+ 85	+ 465	+ 95	+ 130	+ 90	+ 130
Balance on current and long-term capital account	+ 595	+ 550	+ 0	+ 170	+ 120	+ 130
Short-term capital	− 70	− 100	− 25	− 20	− 25	− 20
Rest of French franc area	+ 130	+ 260	+ 65	+ 50	+ 55	+ 75
Errors and omissions	− 5	+ 65	+ 60	+ 70	+ 25	+ 45
Total balance (= changes in monetary items)	+ 650	+ 775	+ 100	+ 270	+ 175	+ 230
of which changes in reserves and IMF position	+ *860*	+ *815*	+ 70	+ 305	+ *95*	+ *345*

[1] On a cash basis. [2] The sum of the quarters does not tally with the annual figure, as revisions are included in the yearly total but not in the quarterly figures. [3] *Including debt prepayments of $161 million to the United States and $119 million to the IBRD.*

11 per cent. in 1963, rose by 12 per cent. last year; the growth rate of imports decreased somewhat — from 22 to 17 per cent. In the course of 1964 and in the early months of 1965, however, exports rose faster than imports, so that the trade deficit narrowed from \$340 million in the first quarter of 1964 to \$180 million in the first quarter of 1965.

Over the last five years some noticeable shifts have occurred in the composition of trade. As regards imports — which in absolute values rose from \$4,860 million in 1960 to \$8,430 million in 1964 — the share of consumer goods has increased from 7 to 14 per cent. and that of foodstuffs from 9 to 12 per cent. In 1964, however, meat imports were 80 per cent. higher than in the previous year as a result of a shortage on the French market. Imports of raw materials, on the other hand, declined from 24 per cent. of the total to 16 per cent. and fuel imports from 19 to 14 per cent. — the latter because of larger purchases from the franc area.

Exports increased from \$4,810 million in 1960 to \$7,410 million in 1964, i.e. by 55 per cent. Exports of foodstuffs rose by as much as 115 per cent. and their share of the total went up from 11 to 16 per cent., owing particularly to an increase in sales of grain. Exports of manufactured products, on the other hand, rose by 48 per cent. and their share fell from 75 to 71 per cent. This mainly reflects a decline — from 34 to 30 per cent. — in the share of semi-finished products, but exports of consumer goods also lost some ground.

As regards trade with the franc area, imports have grown by only 15 per cent. since 1960, while exports have actually declined by some 25 per cent. In imports the share of foodstuffs has gradually fallen from 57 to 47 per cent., while that of fuel has increased from 11 to 23 per cent. Algeria's share in France's total exports went down to 31 per cent. last year, compared with 53 per cent. in 1960.

Net receipts from services, which had reached a peak of \$540 million in 1960, subsequently declined to \$335 million in 1963 and \$200 million last year. Because of keen competition in other Mediterranean countries and limited capacity, French tourist expenditure abroad has grown much faster than receipts from foreign tourists in France. The traditional surplus, which amounted to \$240 million in 1960, thus nearly disappeared last year. Continuous economic expansion has augmented the number of foreign workers, while wage rates have gone up, so that net remittances by foreign labour rose from \$100 million in 1960 to \$205 and 230 million in 1963 and 1964 respectively. In the latter year the foreign labour force, excluding Algerians, was estimated at 1,370,000 persons.

Net private foreign investment in France, which has averaged \$450 million in recent years, rose to \$545 million in 1964. Of this, direct investment accounted for \$310 million, the highest figure ever attained, reflecting primarily additional capital for the expansion of existing enterprises. Although subject to authorisation, direct investment has been treated liberally. But, according to a statement made by the Minister of Finance at the end of March 1965, it may in future be restricted to projects creating new industries or applying new techniques. Portfolio investment by non-residents amounted to $140 million, or slightly more than in 1963. On the other hand, loans taken up abroad, which are strictly controlled, declined from $115 to 105 million. French private investment abroad was balanced by disinvestment. While loans to foreign countries and French enterprises' direct investment increased, French residents continued to sell foreign securities at the rate of $100 million a year — a development which is attributable to the strong position of the franc and the financing needs of the economy.

Net receipts from the rest of the franc area rose from $130 to 260 million last year, reflecting larger sales and higher prices of raw materials and foodstuffs.

Netherlands. Under the impact of the investment and wage explosion imports rose last year by $900 million, or 17 per cent. Exports went up by 10 per cent. and the trade deficit accordingly increased from $365 to 765 million, which was, however, only about half the deficit expected as a result of the upsurge of demand. This relatively favourable outcome was due essentially to large crops, which enabled the country to reduce imports and expand exports of agricultural produce.

Netherlands: Balance of payments.[1]

Items	1963	1964	1964 1st quarter	1964 2nd quarter	1964 3rd quarter	1964 4th quarter	1965 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Imports	5,215	6,115	1,440	1,565	1,530	1,580	1,545
Exports	4,850	5,350	1,220	1,320	1,340	1,470	1,375
Trade balance	— 365	— 765	— 220	— 245	— 190	— 110	— 170
Services							
Investment income	+ 180	+ 200	+ 55	— 40	+ 80	+ 105	+ 60
Other	+ 455	+ 460	+ 85	+ 120	+ 135	+ 120	+ 115
Total	+ 635	+ 660	+ 140	+ 80	+ 215	+ 225	+ 175
Current balance	+ 270	— 105	— 80	— 165	+ 25	+ 115	+ 5
Capital movements							
Official	— 105[2]	— 30	— 0	— 10	— 10	— 10	— 5
Private							
Long-term	— 15	+ 115	— 30	+ 30	+ 50	+ 65	+ 30
Short-term	— 10	+ 80	— 20	— 20	+ 90	+ 30	— 35
Total	— 130	+ 165	— 50	— 0	+ 130	+ 85	— 10
Total balance (= changes in monetary items)	+ 140	+ 60	— 130	— 165	+ 155	+ 200	— 5
of which changes in reserves and IMF position	*+ 170*	*+ 250*	*— 60*	*— 30*	*+ 175*	*+ 165*	*— 5*

[1] On a cash basis. [2] Including debt prepayments amounting to $70 million.

As net receipts from invisible items increased somewhat, the current balance moved from a surplus of $270 million in 1963 to a deficit of $105 million. The whole of the deterioration took place in the first half of the year, when the deficit amounted to $245 million. In the third quarter of 1964 the current account was in equilibrium and in the last quarter it yielded a surplus of $115 million. In the first quarter of 1965 the current account was once more virtually in equilibrium; it thus showed an improvement on the corresponding quarter of 1964 but a deterioration compared with the last quarter of that year.

Whereas in 1963 the current surplus was partly offset by a net outflow of capital, in 1964 the current deficit of $105 million was more than compensated by a net capital inflow of $165 million.

The net outflow of official capital fell from $105 million in 1963 to $30 million last year, as no advance debt repayments were made. The main changes, however, took place in the private sector, where the small deficit of $15 million on long-term capital account recorded in 1963 was replaced by a surplus of $115 million. The outflow of Dutch capital was reduced to less than half its 1963 level, for, although direct investment abroad increased slightly, purchases of foreign securities ceased and credit-granting abroad was also halted. The inflow of foreign capital was practically the same as in the previous year, a decline in purchases of Dutch securities having been offset by a rise in loans and direct investment. There was also a shift from a net outflow to a net inflow in the movement of short-term funds.

Belgium. In recent years movements in the current-account balance have mainly reflected changes in service items, for the trade balance has not fluctuated very widely. Total net invisible receipts, which had fallen to $85 million in 1963, increased to $180 million last year, owing essentially to higher receipts from processing and merchanting trade. The increase occurred mainly in the last quarter of the year, when exports also expanded, and the trade deficit of $205 million registered in the first nine months was followed by a surplus of $30 million. Owing to these favourable developments, the current account shifted from a deficit of $115 million in the first three quarters of 1964 to a surplus of $120 million in the last quarter. For the year as a whole, therefore, it was in equilibrium, whereas in 1963 there had been a deficit of $85 million.

The capital account also improved last year, owing to an increase in the net inflow of private capital from $20 to 130 million. This improvement resulted from a reduction from $85 to 20 million in the outflow on account of security transactions, while net receipts from direct investment and other private transactions went up. Net borrowing abroad by public enterprises and state credit institutions increased but borrowing by the state and public authorities declined somewhat. In all, the net inflow of capital rose from $75 million in 1963 to $200 million last year. As, however, the capital inflow due to changes in the net position of the banks was much smaller last year than in 1963, the overall surplus, as measured by changes in official reserves, amounted to $250 million, or only $30 million more than in 1963.

Austria. The overall balance-of-payments surplus declined from $145 million in 1963 to $80 million last year. Net receipts on current account were $40 million higher, but the net capital inflow, including errors and omissions, was about $100 million lower.

Imports rose by 11 per cent. in response to sustained domestic demand and to tariff reductions and trade liberalisation measures. Exports went up by 9 per cent. in 1964, against 5 per cent. in the previous year, owing to the revival of foreign demand for basic materials and semi-manufactures. Exports of manufactured goods also continued to rise sharply. The trade deficit — almost all of which was incurred with EEC countries — consequently expanded from $340 to 415 million. Austrian exporters are finding increasing difficulty in maintaining their position on these markets.

Net receipts from services — over 90 per cent. of which came from the tourist trade — rose from $345 to 420 million and those from unilateral transfers from $15 to 55 million. This latter increase mainly reflects a large special payment made by the German Government and the termination in 1963 of deliveries to the USSR under the State Treaty.

The net long-term capital inflow declined from $100 to 20 million last year as, following the liberalisation measures taken in 1963, Austrian lending abroad increased substantially, while net foreign investment in Austria declined.

Switzerland. For the fourth year in succession Switzerland recorded an increase in the deficit on current account, as the growth of the import surplus exceeded that of receipts from services.

Owing to strong demand, both domestic and foreign trade expanded at an accelerated rate in 1964. Imports rose by 11 per cent. and exports by 10 per cent. — as against 8 and 9 per cent. respectively in 1963 — and the trade deficit widened from $820 to 945 million. In the first quarter of 1965 the import surplus fell in annual terms to $865 million. Net receipts from services are estimated to have been about the same in the last two years, viz. $460 and 485 million respectively, as rising receipts from the tourist trade and investment in 1964 were more or less cancelled out by increased remittances by foreign workers.

The net inflow of capital, measured as the difference between changes in official reserves and the balance on current account, amounted to roughly $500 million last year, against $560 million in 1963. It was concentrated in the second and fourth quarters of the year. Whereas in early summer the tightness of the money market had induced the banks to repatriate assets from abroad in order to increase their liquidity, at the end of the year the capital inflow was mainly due to the sterling crisis and to the normal year-end operations of the banks.

Scandinavian countries. The combined current deficit of the three Scandinavian countries was roughly the same in 1964 as in 1963, since an improvement in Norway's current account last year offset the jump in Denmark's imports.

Denmark's current-account balance of payments has fluctuated widely in recent years. In 1962 a sharp rise in domestic demand pushed the deficit up to $190 million. In 1963 a surplus of $50 million was achieved as a result of restrictive policy measures. Last year, owing to a renewed expansion of demand, the balance swung back to a deficit of $55 million. Exports showed a further substantial rise (of 10 per cent., against 14 per cent. in 1963), but imports, which had remained stable in 1963, grew by 17 per cent., so that the trade deficit went up from $65 to 215 million. Nearly one-third of the increase in imports was accounted for by machinery and transport equipment and roughly another third by manufactured goods for production purposes. Purchases from the EFTA and the EEC countries expanded at roughly the same rate, viz. by 30 per cent. Of the rise from $115 to 160 million in net receipts from services, about half was accounted for by the increase in shipping income.

The net inflow of capital, most of which was at long term, increased from $170 million in 1963 to $225 million last year. Public authorities and the telephone and electricity companies borrowed heavily abroad in the early months of 1964, attracted by the lower rates and encouraged by the government, which wished to strengthen the foreign exchange position. This aim having been achieved in the course of the spring and bank liquidity having eased, the government stopped all borrowing by public authorities and concessionary companies as from the beginning of June. In all, the net inflow on account of such loans amounted to $145 million in 1964 — slightly more than in the previous year.

In 1964 Norway's overall balance-of-payments surplus worked out at $40 million, against $50 million in the previous year. The deficit on current account was reduced from $195 to 80 million, mainly as a result of more favourable terms of trade, a decrease in imports of ships and a rise in shipping receipts.

Exports of goods, excluding ships, rose by 19 per cent. and imports by 13 per cent., or twice as fast as in the previous year. The demand for Norwegian goods reflects the building-up of inventories abroad, particularly in the United Kingdom. For the first time for many years export prices increased, by 3 per cent., compared with a rise in import prices of 1 per cent. The trade deficit was about the same in both 1963 and 1964, viz. $500 million. Net imports of ships having declined from $250 million in 1963 to $190 million, the total trade deficit was consequently reduced from $750 to 700 million.

Loans and credits connected with the building and import of ships, which had amounted to $155 million in 1963, fell to $50 million last year. As net borrowing by the public authorities and other loans and credits expanded somewhat, net capital imports were reduced from $225 to 135 million.

Sweden's balance on current account during the last two years has shown a small annual deficit of about $30 million. In 1964 exports rose by 15 per cent., or slightly more than imports, and the trade gap was reduced from $190 to 180 million. There was a small decline in net invisible receipts, however, which partly offset the improvement in the balance of trade.

The tightness prevailing on the domestic credit market last year was countered by extensive borrowing abroad and also by more favourable terms of payment. Whereas in 1963 there had been net lending abroad by the private sector to the amount of $50 million, net borrowing to the extent of $90 million took place in 1964. In all, the net capital outflow of $60 million in 1963 was followed by a net inflow of about the same magnitude last year. In addition, the inflow of funds from unrecorded transactions went up from $45 to 160 million. The overall balance consequently moved from a deficit of $45 million to a surplus of $200 million.

Japan. After a severe deterioration in 1963 the balance on current account improved last year, owing to a favourable outcome on trade account. As, however, the net inflow of capital diminished and the deficit on unrecorded transactions widened, the overall balance swung from a surplus of $35 million to a deficit of $80 million.

Japan: Balance of payments.[1]

Items	1963	1964	1964 1st half	1964 2nd half
	in millions of US dollars			
Merchandise trade				
Imports	5,565	6,480	3,280	3,200
Exports	5,355	6,580	2,885	3,695
Balance	− 210	+ 100	+ 395	+ 495
Services				
Transportation	− 235	− 230	− 110	− 120
Fees, royalties, investment income	− 285	− 330	− 155	− 175
Other[2]	+ 155	+ 100	+ 50	+ 50
Total	− 365	− 460	− 215	− 245
Current balance	− 575	− 360	− 610	+ 250
Long-term capital account	+ 470	+ 380	+ 195	+ 185
Balance on current and long-term capital account	− 105	+ 20	− 415	+ 435
Short-term capital account	+ 185	+ 95	+ 425	− 330
Errors and omissions	− 45	− 195	− 130	− 65
Total balance (= changes in monetary items)	+ 35	− 80	− 120	+ 40

[1] On a cash basis. [2] Including receipts from foreign military expenditure in Japan.

As regards the trade balance, whereas in 1963, in response to vigorous growth in the domestic economy, imports had risen almost twice as fast as exports, in 1964 it was the other way round. Monetary restrictions in force throughout the year slowed down the import growth from 22 to 16 per cent., whereas buoyant demand from abroad pushed up the rate of expansion of exports from 12 to 23 per cent. As the gap between the growth rates widened in the second half of the year, the trade balance shifted from a deficit of almost $400 million in the first half-year to a surplus of close on $500 million in the second.

For the whole year the $300 million improvement in the trade balance was partly cancelled out by a rise of $100 million in net expenditure on invisible items. The deficit on current account was consequently reduced from $575 to 360 million.

Net long and short-term borrowing from abroad was reduced in each case by about $90 million in 1964. The decline in the net inflow of long-term capital was due to larger repayments and increased new investment abroad by Japan, while the fall in the inflow of short-term capital, mostly trade credits, was connected with the slowing-down of imports.

Commercial policy.

A further step towards closer economic integration of EEC countries was taken on 15th December 1964, when the Council of Ministers fixed uniform cereal prices which are to come into effect on 1st July 1967. As from that date a common price policy will prevail over national policies in agriculture. Two further advances in this sector were the coming into force of market regulations for rice in September 1964 and for dairy produce and beef in November. However, the very important question of the financing of agricultural policy through the European Orientation and Guarantee Fund has not yet been finally settled.

The Community's internal tariff barriers were reduced by a further 10 per cent. on 1st January 1965, bringing tariffs on industrial products down to 30 per cent. of their original level. It should be recalled that associated countries have the benefit of these reductions without having to provide any counterpart.

As regards the common external tariff, duties on mineral oil and oil products, which figure on the G list of the Treaty of Rome and were to be fixed by negotiation, were agreed upon by the Council in May 1964, so that no further tariff items remain to be fixed.

On 1st October 1964 the Commission addressed to the Council and to the governments of member countries a memorandum called "Initiative 1964", which draws up a programme of commercial, monetary and social policies that, according to the Commission, should hasten the achievement of political union. Thus the common external tariff should come into being on 1st January

1966 and all internal barriers should be abolished by the end of that year. In addition, all indirect obstacles to the movement of goods within the Community, in particular controls at the internal frontiers, should be removed by 1st January 1970.

As regards relations with the outside world, the EEC's agreements of association with the Netherlands Antilles and Turkey entered into force on 1st October and 1st December 1964 respectively, and trade agreements were concluded with Israel in June 1964 and with Lebanon in May 1965.

Finally, it should be mentioned that in March 1965 the Council agreed to the merger, with effect from 1st January 1966, of the three executive bodies of the EEC, Euratom and the European Coal and Steel Community.

The cohesion of EFTA has been under a severe test since last October, when the United Kingdom introduced a 15 per cent. temporary surcharge on imports in order to redress its balance of payments. This measure was subjected to close scrutiny by the EFTA Council and, at its meeting in February 1965, the UK representative announced a lowering of the surcharge to 10 per cent. as from 26th April. Notwithstanding this temporary setback, the EFTA countries further reduced their tariffs on industrial products vis-à-vis each other by 10 per cent. on 31st December 1964, thus keeping in line with the EEC. Another 10 per cent. reduction is to take place at the end of 1965, leaving the remaining 20 per cent. barrier to be eliminated at the end of 1966.

Within the framework of the General Agreement on Tariffs and Trade the Kennedy negotiations, which started in May 1964, have continued. They aim principally at a 50 per cent. linear reduction of import duties. However, the developing countries are not expected to offer reciprocity to the developed countries. As regards the latter, it has been agreed that, in view of the disparities existing in the structure and level of certain tariffs, a limited number of exceptions may be made to the 50 per cent. rule if justified by overriding national interests. The European Economic Community, Finland, Japan, the United Kingdom and the United States duly deposited their lists of exceptions by the agreed date of 16th November 1964 and the confrontation of these lists began in December.

In May 1965 the principal partners in the agricultural discussions, i.e. the main producing countries, the EEC, Japan and the United Kingdom, made known their proposals on the organisation of the world cereal market, thus opening the way for negotiations.

In May 1963 the contracting parties adopted a programme of action to further developing countries' exports and since then a certain number of countries have reduced or abolished import duties on tropical products, in particular tea.

In order to help the developing countries more effectively, the contracting parties to GATT (which at present consist of sixty-six countries, plus six which have acceded provisionally) adopted last November the text of a new chapter added to the General Agreement, i.e. Part IV on trade and development. This Part IV legally binds the developed contracting parties to take certain measures, either individually or jointly, to promote the developing countries' exports. Pending ratification, it entered provisionally into force on 8th February 1965.

Another body that has concerned itself with the problems of the developing countries is the United Nations Conference on Trade and Development, which lasted from March to June 1964. It agreed to set up a permanent Trade and Development Board, which was formally approved by the General Assembly of the United Nations on 30th December 1964. The Board is a body of the United Nations and comprises representatives of fifty-five states, of which thirty-two are developing countries, sixteen industrial countries and seven centrally-planned-economy countries. At its first session in April–May 1965 it decided to set up its secretariat in Geneva.

III. GOLD, RESERVES AND FOREIGN EXCHANGE.

There was a further substantial increase in international liquidity during 1964. With total fresh gold supplies of \$1.9 milliard available, world gold reserves rose by \$0.7 milliard to \$43 milliard. The outstanding feature of the year, however, was the very large rise in official and private holdings of foreign exchange. Foreign holdings of dollars increased by \$2.5 milliard to \$31.2 milliard and sterling balances by \$1.4 milliard to a total of \$14.4 milliard. Most of the increase in dollar holdings was in the hands of commercial banks and other private holders, while the whole of the rise in sterling balances was accounted for by the International Monetary Fund and central-bank credits to the United Kingdom.

Excluding international institutions, the 1964 increase in international liquidity was \$3.5 milliard — about the same as in 1963. \$3 milliard accrued to continental European countries, of which \$1.2 milliard in gold, \$1 milliard in dollars and \$0.7 milliard in IMF and GAB positions. The United Kingdom's international liquid assets declined by \$0.9 milliard and those of the United States by only \$0.2 milliard. Other countries' international liquidity went up during 1964 by \$1.6 milliard, about half of which accrued to the developing countries.

Gross drawings on the IMF in 1964 totalled \$2 milliard, a figure second only to that of \$2.4 milliard recorded in 1961. The United Kingdom and the United States were the biggest drawers, with \$1 and 0.5 milliard respectively. In May 1965 the United Kingdom drew a further \$1.4 milliard. A general increase in quotas, subsequently fixed at 25 per cent., was agreed on at the 1964 annual meeting of the Fund and is now in the process of being implemented.

During the first half of 1964 conditions in the gold and exchange markets were rather quiet. In the last quarter, however, the sterling crisis, coupled with renewed weakness of the dollar, brought increasing pressure on the London gold market, while substantial official intervention, both spot and forward, was needed to defend sterling. The anxieties caused by the crisis, reinforced by suggestions for a return to the gold standard, brought even greater market demand for gold during much of the first quarter of 1965.

So far as international liquidity is concerned, the picture changed completely in the first quarter of 1965. Countries' official gold reserves probably have shown some decline. Their short-term dollar holdings fell by \$0.6 milliard and their sterling holdings by \$0.1 milliard. It would appear, therefore, that their international liquidity may have decreased by almost \$1 milliard. Part of this resulted from the level of non-monetary demand for gold; the biggest factor, however, was conversions of dollars into gold at the US Treasury.

Gold production and markets.

World gold production in 1964 (excluding the USSR, other eastern European countries, mainland China and North Korea) is estimated to have amounted to just over 40 million ounces, worth $1.4 milliard at the official dollar parity. The rise in output was about 1.5 million ounces, practically the same as in 1963. On a percentage basis the 1964 increase was 3.9, compared with 4.3 in 1963 and 6.6 in 1962.

With production in the rest of the world continuing gradually to decline, last year's gains once more resulted entirely from a further expansion in South African output — by 1.7 million ounces, or 6.2 per cent. For the second year in succession the increase in South Africa's gold production, too, both in absolute and relative terms, was less than in the preceding year; the 1963 increase was 1.9 million ounces, or 7.6 per cent. and the corresponding figures for 1962 were 2.6 million ounces and 11.2 per cent.

World gold production.

Countries	1929	1940	1946	1953	1961	1962	1963	1964
	weight, in thousands of fine ounces							
South Africa	10,412	14,046	11,927	11,941	22,946	25,506	27,432	29,137
Canada	1,928	5,333	2,849	4,056	4,474	4,158	3,972	3,799
United States	2,059	4,870	1,575	1,958	1,548	1,543	1,427	1,410
Australia	427	1,644	824	1,075	1,076	1,069	1,024	966
Ghana	208	886	586	731	834	888	921	863
Southern Rhodesia	561	826	545	501	570	555	566	575
Japan	335	867	40	258	379	421	433	460
Philippines	163	1,121	1	481	424	423	376	425
Colombia	137	632	437	437	401	397	325	350
Mexico	655	883	421	474	269	237	238	212
Total listed	16,885	31,108	19,205	21,912	32,921	35,197	36,714	38,197
Other countries[1]	1,715	5,892	2,495	2,188	1,779	1,803	1,886	1,903
Estimated world total[1]	18,600	37,000	21,700	24,100	34,700	37,000	38,600	40,100
	in millions of US dollars							
Value of estimated world total at $35 per fine ounce	650[2]	1,295	760	845	1,215	1,295	1,350	1,400

[1] Excluding the USSR, eastern Europe, mainland China and North Korea. [2] At the official price of $20.67 per fine ounce then in effect, $385 million.

The amount of ore milled in South Africa was 1½ per cent. higher than in 1963, with a slightly smaller labour force, and the yield of gold per ton milled rose by 4¾ per cent., so that total profits were 6¼ per cent. higher. Wage increases approximately offset the better gold yields obtained, so that average profits per ounce of gold produced were virtually unchanged at $16.30. In both the old mines and the new mines average profits declined — by 3½ and 1 per cent. respectively. But the share of the new mines in total profits continued to rise.

From the point of view of total fresh gold supplies, the 1964 increase in gold production was more than offset by the decline of Russian sales from their 1963 level. Total Russian offerings during 1964 may be put at some $450 million's worth. Altogether the value of fresh gold supplies in 1964 is estimated at about $1,850 million, rather less than the 1963 figure. As private demand for gold was somewhat higher than it had been in 1963, the amount of gold available for adding to official gold reserves declined from $840 to 725 million, the latter figure representing just on 40 per cent. of estimated supplies.

Estimated sources and uses of gold.

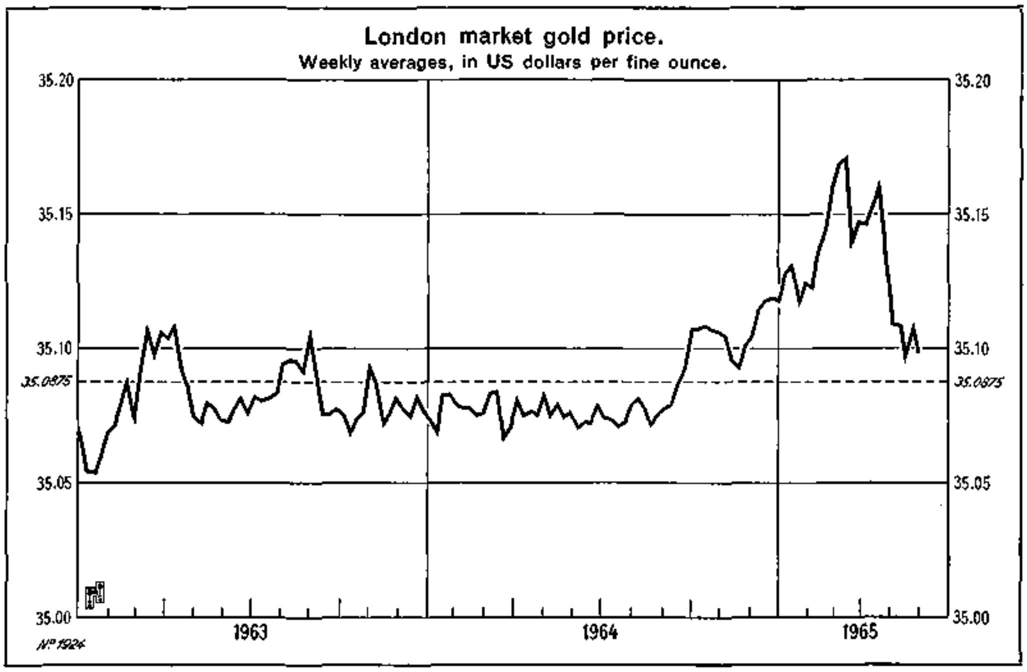
Items	1960	1961	1962	1963	1964
	in millions of US dollars				
Gold production[1]	1,175	1,215	1,295	1,350	1,400
Sales by the USSR	200	300	200	550	450
Total	1,375	1,515	1,495	1,900	1,850
Increase in official gold stocks[1]	345	600	330	840	725
Other uses[2]	1,030	915	1,165	1,060	1,125

[1] Excluding the USSR, eastern Europe, mainland China and North Korea. [2] Residual figures.

The balance between demand and supply in the gold market varied considerably during the period under review. In the first eight months of 1964 market conditions were generally quiet, with quotations at the London "fixing" ranging between $35.06 and $35.09½ per fine ounce. Virtually the whole of the year's increase in official gold reserves occurred during these months; indeed during the second quarter of 1964 alone gold reserves went up by $520 million, Russian sales being concentrated in the period from mid-March to the end of April.

The substantial additions to gold reserves during the first eight months of 1964 were accompanied by a well-maintained level of private demand for gold. Subsequently, the approach of the British and American elections, as well as political events in Russia, added to demand for gold and in October the London "fixing" price went above $35.11. Though conditions eased somewhat in November, private demand continued to absorb virtually the whole of fresh supplies. In December prices became firmer again and were above $35.12 at the very end of the year, by which time the gold market was feeling the effects of the sterling crisis and of the simultaneous weakness of the dollar. In these circumstances private demand for gold began, for the first time since the Cuban crisis of October 1962, to exceed fresh gold supplies.

The first quarter of 1965 saw continued pressure in the gold market. While the sterling crisis had by then passed its peak, the anxieties it aroused were not easily allayed. Moreover, two further occurrences had the effect of maintaining demand for gold at an exceptionally high level. The first was the announcement, early in January 1965, that the French authorities had decided to convert some dollars arising out of past payments surpluses into gold. This set off a wave of buying on 8th January, when the "fixing" price rose to nearly $35.15. The US Treasury at once reaffirmed its determination to



maintain the existing gold price, backing up its statement with action to abolish the gold cover for the Federal Reserve System's deposit liabilities. The market price then came down to about $35.12. The second occurrence was criticism of the gold exchange standard and suggestions for a return to the gold standard. By the middle of February the "fixing" price had again reached $35.15 and early in March, by which time US gold losses since the turn of the year had reached $500 million, it went as high as $35.17½. A month later quotations were still above $35.15 but by end-April they had eased to $35.10 and they remained at that level during May.

Gold and exchange holdings.

The next table shows countries' official gold holdings, their official and private exchange holdings and their net IMF and GAB positions. Measured in this way, their internationally liquid assets increased in 1964 by $3.4 milliard, of which dollars accounted for $2.5 milliard and gold reserves for nearly all of the rest. International institutions, which are not shown in the table, had practically no change in their gold and dollar holdings; their sterling balances, however, rose by almost $1 milliard.

Gold. The estimated increase of $725 million in official gold holdings of countries (excluding the USSR, other eastern European countries, mainland China and North Korea) and international institutions during 1964 brought the total to a figure of $43 milliard at the end of the year. As in other recent years there was a considerable rise, of $1,144 million, in continental European gold reserves; and in addition Canada's gold reserves went up by $209 million.

On the other hand, and in contrast to the pattern of recent years, there was very little change in the US gold stock, which fell by only $125 million. The United Kingdom's gold reserve declined by $348 million and that of the IMF, which had to be called upon to the extent of $250 million in connection with the UK drawing in December 1964, went down by $133 million.

International liquidity of countries.

Holders	Years and end of years	Gold	US dollars[1]	£ sterling	Other currencies[2]	Total	Net IMF position plus GAB	Grand total	Memorandum item[3]
		in milliards of US dollars							
United States	1963, change	− 0.5		—	+ 0.1	− 0.4	− 0.0	− 0.4	
	1964, change	− 0.1		+ 0.2[4]	− 0.1	+ 0.0	− 0.3	− 0.3	
	End-1964, total	*15.5*		*0.4*[4]	*0.1*	*16.0*	*0.8*[5]	*16.8*	
United Kingdom	1963, change	− 0.1	− 0.1			− 0.2	− 0.0	− 0.2	
	1964, change	− 0.3	+ 0.5			+ 0.2	− 1.0	− 0.9	
	End-1964, total	*2.1*	*2.3*			*4.4*	− *0.5*	*3.9*	
Continental western Europe	1963, change	+ 1.0	+ 0.6	− 0.0		+ 1.8	+ 0.1	+ 1.9	+ 0.6
	1964, change	+ 1.1	+ 1.0	+ 0.1		+ 2.2	+ 0.7	+ 2.9	+ 0.4
	End-1964, total	*18.3*	*10.6*	*1.9*		*30.8*	*2.4*	*33.3*	*1.0*
Total	1963, change	+ 0.5	+ 0.7	− 0.0	+ 0.1	+ 1.2	+ 0.0	+ 1.3	+ 0.6
	1964, change	+ 0.7	+ 1.5	+ 0.3	− 0.1	+ 2.4	− 0.5	+ 1.8	+ 0.4
	End-1964, total	*36.0*	*12.9*	*2.3*	*0.1*	*51.3*	*2.7*	*54.0*	*1.0*
Other countries	1963, change	+ 0.3	+ 1.1	+ 0.7	+ 0.0	+ 2.1	+ 0.0	+ 2.2	+ 0.1
	1964, change	+ 0.2	+ 1.0	+ 0.1	− 0.1[4]	+ 1.2	+ 0.4	+ 1.6	—
	End-1964, total	*4.9*	*12.4*	*9.4*	*0.4*[4]	*27.1*	*0.0*	*27.1*	*0.1*
Grand total	1963, change	+ 0.7	+ 1.8	+ 0.7	+ 0.1	+ 3.4	+ 0.1	+ 3.4	+ 0.7
	1964, change	+ 0.9	+ 2.5	+ 0.4	− 0.2	+ 3.6	− 0.2	+ 3.4	+ 0.4
	End-1964, total	*40.8*	*25.4*	*11.7*	*0.5*	*78.4*	*2.7*	*81.1*	*1.1*
Grand total, official holders	1963, change	+ 0.7	n.a.	+ 0.3	+ 0.1	n.a.	+ 0.1	n.a.	+ 0.7
	1964, change	+ 0.9	+ 0.7[6]	+ 0.3	− 0.2	+ 1.7	− 0.2	+ 1.5	+ 0.4
	End-1964, total	*40.8*	*14.3*[6]	*6.9*	*0.5*	*62.6*	*2.7*	*65.3*	*1.1*

[1] Foreign holdings of short-term dollars and marketable US Government securities with an original maturity of more than one year. [2] US official holdings of convertible currencies, excluding sterling, and official franc balances of the French franc area. [3] US Government non-marketable medium-term convertible securities, except those issued to the Government of Canada in connection with transactions under the Columbia River Treaty. [4] Estimate. [5] Excludes a negative entry of $800 million representing the Fund's sales of gold for the acquisition of income-earning US securities. [6] These figures are reported by US sources. As some officially-owned foreign dollar balances are held with commercial banks outside the United States, they will be reported as belonging to those banks.

The rise in gold reserves on the continent of Europe (which here includes the BIS and the European Fund) brought them to a total of $18.3 milliard at the end of 1964. Continental European countries added $920 million to their gold reserves: they purchased a net amount of $706 million from the US Treasury and a further $192 million from the IMF. Of the countries included in the table on page 120, eight increased their gold reserves in 1964. France, with $554 million, and Germany, with $404 million, were the largest gainers.

On the other hand, Italy's gold reserve declined by $236 million and Switzerland's by $95 million. The Italian gold loss was due to a sale of

$200 million's worth to the US Treasury in March 1964 and a gold subscription payment of $58 million to the IMF in August 1964. The fall in Switzerland's gold reserves essentially reflected the fact that gold held by the Swiss National Bank under swaps with the BIS was very much less at the end of 1964 than it had been a year earlier. Comparing January 1965 with January 1964, there was actually a rise of $153 million in the National Bank's gold holdings.

The difference between the rise of $1,144 million in continental European gold reserves and that of $920 million in the gold holdings of continental countries was almost entirely the result of a reduction of $229 million in the negative spot gold position of the BIS. In large part this reflected the smaller gold swaps, already referred to, with the Swiss National Bank at the end of 1964; in addition, however, the BIS spot gold position at the end of 1963 had been affected by outstanding contracts in connection with Russian gold sales.

Starting the year at a figure of $15,596 million, the US gold stock on balance showed virtually no change during the first ten months of 1964. After some decline in January and February, it increased by $209 million during March and April 1964, when the gold pool was in substantial surplus, to a total of $15,727 million. The rest of the year saw a decline of $256 million, most of which occurred during the last quarter, and the end-year figure was $15,471 million.

As domestic users bought $89 million, US net gold sales to foreigners during 1964 were only $36 million. Gross sales totalled $921 million, of which France accounted for $405 million and Germany for $225 million. Gross purchases totalled $885 million, of which $618 million came from the United Kingdom and $200 million from Italy. Gold purchased from the United Kingdom included amounts distributed by the gold pool.

The United Kingdom's official gold reserve went down during 1964 by $348 million. There was a moderate decline of $45 million in the first half of the year, when reserves on balance were still going up. The rest was sold to help meet the pressures of the sterling crisis in the last four months of the year.

The International Monetary Fund's gold reserve declined by $133 million to $2,179 million at the end of 1964. The Fund received new gold subscriptions amounting to $84 million and a further $20 million from repayments in gold of earlier drawings. These receipts, plus some interest payments from member countries, were more than offset by the sales of $250 million in December 1964 to ten member countries.

Though full data are not yet available, it seems certain that total official gold reserves declined in the first quarter of 1965. The principal changes were a drop of $832 million in the US gold stock and an increase of $660 million in continental European gold reserves, of which France accounted for $468 million. In addition, South African gold reserves went down by $76 million.

Exchange. Countries' official and private holdings of dollars and sterling rose by $2.9 milliard during 1964. Of this amount, $2.5 milliard represented additions to dollar balances. Countries' sterling balances, which had continued their 1963 rise during the first three quarters of 1964, were sharply reduced towards the end of the year, so that the increase for the year as a whole was only $0.4 milliard. Nearly all of this was accounted for by central-bank assistance to the United Kingdom in the form of swaps against sterling.

There were two particular features of the 1964 increase in foreign holdings of dollars. One was that private holdings accounted for about three-quarters of the total rise and the other that there was a further substantial improvement in the position of the developing countries. The following table shows the 1964 changes in foreign countries' dollar balances by areas of the world and by types of holder.

Changes in countries' dollar balances, 1964.

Country or area	Official	Private	Total
	in millions of US dollars		
Western Europe *	+ 403	+ 1,057	+ 1,460
Canada	— 181	+ 191	+ 10
Latin American republics	+ 180	+ 147	+ 327
Asia	+ 289	+ 350	+ 639
Africa	+ 6	+ 7	+ 13
Other countries	+ 2	+ 57	+ 59
Total	+ 699	+ 1,809	+ 2,508

* Including the BIS and the European Fund.

The greater part of the increase in private dollar holdings took place in western Europe. This was mainly due to the renewed expansion of the Euro-dollar market. Connected with this expansion, though not its only cause, was the increase in short-term capital outflows from the United States to the record figure of $2.2 milliard. In particular, short-term claims on foreigners reported by banks in the United States went up from $6 to 7.7 milliard. Claims on Asian countries alone rose by $0.8 milliard, of which Japan accounted for 80 per cent.

The increase in the total dollar balances of Latin America, Asia, Africa and the group of "other countries" during 1964 was $1 milliard. Excluding Japan and Australia, which are the only two developed countries in these areas with substantial dollar holdings, it can be said that the balances of the developing countries rose by $0.8 milliard in 1964.

So far as foreign countries' holdings of sterling are concerned, there was a sharp contrast between the first nine months and the rest of the year. During the first nine months of 1964 sterling-area countries' balances went up by $0.6 milliard and those of non-sterling-area countries by $0.3 milliard. In the final quarter sterling-area balances were reduced by $400 million, while non-sterling-area balances went down by $150 million. The fall in sterling-area balances came partly from a deterioration in these countries' balance-of-payments situations and partly from loss of confidence in sterling. Central banks outside the sterling area acquired $310 million of sterling during the last four months of the year under official support arrangements with the Bank of England. There was therefore, during the fourth quarter, a sharp fall in other sterling balances held outside the sterling area.

Taking the year 1964 as a whole, almost all of the increase in sterling balances was due to the effect of official support arrangements for the pound. As there was also a moderate increase over the year in the sterling balances of the developed countries in the sterling area (Australia, New Zealand and South Africa), it can be said that developing countries did not add to their holdings of sterling during 1964.

There was practically no change during 1964 in the dollar holdings of international institutions. The IMF's dollar balances went up by $266 million as a result of the change in the US net position at the Fund, while other institutions' balances were reduced by nearly the same amount. The rise of $1,019 million in international institutions' sterling balances reflected the UK drawing on the IMF in December.

International Monetary Fund.

Balance-of-payments developments during 1964 illustrate the important rôle played by the Fund as an international source of credit. At the same time they emphasise the limitations of the Fund's ordinary resources in the face of requests for drawings by both key-currency countries. Total gross drawings amounted to $1,950 million, a figure second only to that of $2,478 million recorded in 1961. Out of total net drawings of $1,130 million, only $475 million came from members' subscriptions and the remainder was found by Fund gold sales and by activating the General Arrangements to Borrow.

Drawings by three member countries dominated the Fund's activities in 1964. The United Kingdom drew $1 milliard in December 1964, with which it paid off short-term assistance granted by central banks during the

Fund exchange transactions, 1964.

Country or area	Drawings	Repurchases	Net drawings
	in millions of US dollars		
United States	525	277	248
Canada	—	197	— 197
United Kingdom	1,000	—	1,000
Italy	225	66	159
Other European countries	19	47	— 28
Latin America	63	150	— 87
Other countries	118	83	35
Total	1,950	820	1,130

previous months. The United States drew a total of $525 million, in five instalments, which was used to sell currencies to other Fund members wishing to repay earlier drawings, in order to avoid strain on the US gold reserve. Net drawings by the United States on the IMF were only $248 million, since a total of $277 million's worth of dollars was "repurchased" through other countries' drawings of dollars from the Fund.

Italy drew $225 million in March 1964. Only $68 million of this was repayable to the Fund, the rest corresponding to the net amounts of lire previously drawn by other members. Repayment was completed by September 1964, partly through the increase in Italy's quota.

Canada completed repayment of its $300 million 1962 drawing, while elsewhere in the world repurchases exceeded drawings by $80 million.

Easily the most-used currency for Fund transactions in 1964 was the Deutsche Mark, with gross drawings of $718 million and net drawings of $454 million. Next came the US dollar and the French franc, with net drawings of $277 and 232 million respectively. There were also net drawings of between $50 and 100 million in Canadian dollars, Dutch florins, Belgian francs, Spanish pesetas and Japanese yen.

The development of the Fund's holdings of leading member currencies since 1958 is shown in the next table. Excluding the United Kingdom and the United States, the amounts available at the end of March 1965 in these members' currencies totalled $1.7 milliard. At that date the total of unused stand-by arrangements with the Fund was $0.5 milliard.

With both the United Kingdom and the United States in debt to the Fund, the counterpart of all the drawings on the Fund at present outstanding is to be found in the net creditor positions of the continental European countries, Canada and Japan. During the course of 1964 the scope for further increases in creditor positions of these countries, taken as a group, became

Fund holdings of selected member currencies.

Currencies of	1958	1960	1962	1963	1964	Amounts outstanding March 1965
	end-year figures as a percentage of member's quota					in millions of US dollars
Austria	75	75	65	50	3	3
Belgium	75	75	61	59	49	161
Canada	70	72	125	111	67	325
France	150	74	44	43	34	245
Germany	55	61	34	30	7	87
Italy	—	75	25	16	72	326
Japan	75	75	64	64	60	297
Netherlands	75	71	51	51	45	184
Spain	—	118	75	64	29	39
Sweden	75	75	68	65	52	78
United Kingdom	124	75	74	75	126	2,449
United States	29	62	74	75	81	3,424

rather limited and in order to provide currency for the $1 milliard British drawing in December the Fund considered it opportune to supplement its holdings of these members' currencies by selling $250 million of gold to them and by activating the General Arrangements to Borrow for the first time, to the extent of $405 million. Indeed, the whole of the amounts drawn by the United Kingdom in Deutsche Mark, French francs and Dutch florins was obtained by the Fund through gold sales and the GAB.

During the first quarter of 1965, net drawings on the Fund totalled $100 million. In May the United Kingdom drew a further $1.4 milliard. $400 million of the currencies needed to meet this drawing came from Fund gold sales to member countries and $525 million from a second activation of the GAB.

Following what was said on the subject in the Group of Ten report in August 1964, it was agreed at the 1964 annual meeting of the IMF that there should be a general increase in Fund members' quotas. The size of the increase was subsequently fixed by the Fund's Board of Executive Directors at 25 per cent., with larger increases being approved for sixteen member countries. The effect will be to increase the total of all quotas from $16 to 21 milliard. The Fund's holdings of the currencies of which net use was made for drawings in 1964 (all those in the preceding table, except US dollars and sterling) will be increased by rather over $1 milliard.

In accordance with the Fund's Articles of Agreement, each member pays 25 per cent. of its quota increase in gold. In order to mitigate the effects of the gold payment requirement on members with low reserves, provision has been made for them, if they so wish, to subscribe their quota increases in annual instalments over a period of up to five years. Alternatively, any member with very low reserves that wishes to have the full increase in its quota take immediate effect may draw from the Fund an amount up to the equivalent of the increase in its gold subscription. The Fund has also made certain arrangements the effect of which will be to alleviate the impact on the two reserve currency countries of other Fund members' gold purchases from them in connection with gold subscription payments.

The US international liquidity position.

In 1964 the US balance-of-payments deficit, as conventionally measured, was almost as large as it had been the year before — $3.1 milliard against $3.3 milliard. The offsets to it in monetary movements were, however, quite different. In particular, official financing requirements were much less, because foreign private dollar balances increased substantially.

Private foreign holdings of dollars went up during 1964 by $1.5 milliard. The rise occurred mostly in the second half of the year and mostly in the dollar holdings of foreign commercial banks. Altogether it covered half of the deficit on regular transactions. Partly, this must have resulted from the movement out of sterling that took place during the last four months of 1964.

Financing of the US balance-of-payments deficit.

Items	1963	1964 Total	1964 1st half	1964 3rd quarter	1964 4th quarter
	in millions of US dollars				
Balance on regular transactions . .	— 3,260	— 3,055	— 520	— 1,010	— 1,525
less					
Prepayments on US military sales .	335	205	85	— 30	150
Change in liquid liabilities to non-official foreigners	595	1,520	345	555	620
Balance on official settlements basis	— 2,330	— 1,330	— 90	— 485	— 755
financed by					
1. Special government transactions	985	460	145	230	85
of which					
(a) Non-scheduled receipts on government loans	*325*	*120*	*85*	*30*	*5*
(b) Sales of non-marketable government securities . .	*660*	*340*	*60*	*200*	*80*
2. Change in liquid liabilities to official foreigners	970	700	— 305	185	820
3. Change in monetary reserve assets (increase —)	380	170	250	70	— 150
of which					
(a) IMF gold tranche	*30*	*265*	*250*	*135*	*— 120*
(b) Convertible currency holdings	*— 110*	*— 220*	*30*	*— 45*	*— 205*
(c) Gold	*460*	*125*	*— 30*	*— 20*	*175*

For a large part, however, it was connected with the increase in private capital outflows from the United States. In addition, it would seem that a part of the renewed expansion of the Euro-dollar market from the spring of 1964 onwards was due to placements of funds in this market by US corporations.

If the increase in privately-owned dollar balances, together with foreign prepayments in respect of US military sales, is deducted from the deficit on regular transactions, the deficit to be financed in 1964 through changes in official assets and liabilities was $1.3 milliard, compared with $2.3 milliard in 1963 and $2.9 milliard in 1962.

The official financing items can conveniently be divided into three categories. The first consists of special government transactions. In 1964 these amounted to $460 million, of which non-scheduled receipts on government loans were $120 million and net sales of US Government non-marketable securities came to $340 million. This was a drop of over $500 million from the 1963 figure and represents the biggest change between the two years in the official financing items.

The second category is foreign official dollar balances. The 1964 increase of $700 million was nearly $300 million less than that recorded for the previous year. In 1963, however, foreign monetary authorities had added $175 million to their dollar balances held under swap arrangements with the Federal Reserve System, while during 1964 their swap dollars declined by $110 million. Outright holdings of dollars by foreign monetary authorities therefore went up by almost exactly the same amount in both years — $795 million in 1963 and $810 million in 1964.

The third category of official financing items is the monetary reserve assets, in which is now included the gold tranche position at the IMF. However measured, and whether compared with the deficit on regular transactions of \$3.1 milliard or with the \$1.3 milliard deficit on an official transactions basis, the decline in reserve assets was very moderate indeed. Taking the gold reserve alone, the fall was only \$125 million; if gold, convertible currencies and IMF gold tranche are taken together, it was \$170 million; and, if the first-line reserve assets only — gold and convertible currencies — are considered, there was actually an increase of \$95 million in 1964.

Looking at the course of events during the year 1964, the deficit on regular transactions in the first six months was only \$520 million and the increase in private dollar holdings covered \$345 million of that amount. As in addition there were some foreign prepayments for military exports, hardly any official financing was needed. What was needed was more than provided by special government transactions. Since, however, the increase in private dollar balances was accompanied by a comparable decline in official holdings, US reserve assets fell by \$250 million.

In the third quarter the deficit to be financed was \$1,010 million. After taking account of a substantial further rise in private dollar balances, something like half of the deficit remained to be financed from official sources. Special government transactions, nearly all sales of non-marketable securities, produced \$230 million and there was an increase of \$185 million in official dollar balances. The decline in reserve assets, therefore, was only \$70 million.

The final quarter saw the deficit on regular transactions rise to \$1,525 million — the largest figure since the quarter immediately following the outbreak of the Korean war. It was almost covered by an increase of \$1,440 million in foreign holdings of dollars. The statistics show less than half of this as having accrued in the hands of private owners; this is partly because in December there is a seasonal transfer of dollars from certain banking systems to their central banks.

The large deficit in this quarter was accompanied by an increase of \$150 million in the monetary reserve assets. The gold stock, it is true, declined by \$175 million; but the gold tranche position at the IMF improved by \$120 million and the convertible currency holdings went up by \$205 million. All three types of monetary reserve asset were affected during the last quarter by the sterling crisis. Firstly, there were net UK gold sales of \$125 million to the US Treasury; secondly, the United States lent \$200 million to the United Kingdom through the IMF; and thirdly, US official holdings of convertible currencies rose by \$165 million through the Bank of England drawings on its swap facility with the Federal Reserve System.

During the first quarter of 1965 there were very large monetary movements arising out of foreign purchases of gold from the US Treasury. The gold stock declined by \$832 million and official foreign holdings of dollars (excluding those of the IMF) went down by $951 million. Non-official short-term dollar balances, on the other hand, rose by $349 million. In March, the first full month after the announcement of the new controls on US capital exports, foreign countries' short-term dollar balances reported by US banks declined by $680 million. This compared with a fall of $354 million in the gold stock during that month.

During 1964 the Federal Reserve System's swap network was no longer primarily used on the initiative of the United States. Indeed, total drawings on the United States amounted to $870 million, whereas total drawings by the United States were $450 million. The reduction of the US payments deficit during the first half of the year allowed the United States to move from a net debtor position of $342 million in December 1963 to a net creditor position of $65 million by the end of June 1964. However, the deterioration of the US balance of payments during the second half of the year resulted in a renewed US net debtor position under the swap arrangements, of $130 million, at the end of December 1964. At that date US drawings on swap facilities were $330 million — $135 million on the Netherlands, $100 million on the BIS, $50 million on Germany and $45 million on Belgium. On the other hand, the United Kingdom had drawn $200 million on its swap facility with the United States.

In the course of 1964 the Federal Reserve System's swap arrangement with the Bank of England was increased from $500 to 750 million and its arrangement with the National Bank of Belgium from $50 to 100 million. During the first quarter of 1965 the arrangement with the Bank of Italy was increased from $250 to 450 million and that with the Bank of Japan from $150 to 250 million. These increases brought the total of reciprocal currency arrangements to $2,650 million at the end of March 1965.

European monetary reserves.

During 1964 western European countries' first and second-line monetary reserves rose by $1.6 milliard to a total of $33.1 milliard at the end of the year. Official gold and exchange holdings went up by $1.9 milliard, from $29.2 to 31.1 milliard, while IMF and GAB positions declined from $2.3 to 2 milliard. If central-bank assistance received by the United Kingdom and the increase in official sterling liabilities (including British Government securities held by non-official foreigners) are taken into account, the net increase in European official monetary assets is reduced from $1.6 to 1 milliard.

European gold reserves rose by $0.6 milliard in 1964. This was half the increase recorded in 1963, and it was also much lower than the rise in any other recent year. As gross official exchange reserves went up a little more in 1964 than they had done the year before, the gold percentage in western European reserves was reduced from 66.5 to 64.7, or, if non-marketable US Government bonds included by the holders in their first-line reserves are left out of account, from 67.8 to 66.3.

Taking the four years 1961–64, the official gold reserves and gross exchange assets of western European countries went up by \$7 milliard, from \$24.5 to 31.5 milliard. Gold reserves rose by \$4.4 milliard, from \$16 to 20.4 milliard, and exchange reserves by \$2.6 milliard, from \$8.5 to 11.1 milliard. For western European countries which are members of the Group of Ten (including Switzerland) the gold percentage in reserves was slightly higher at the end of the period than it had been at the beginning, despite the 1964 decline. In the other group of countries, where gold holdings traditionally are a much smaller proportion of reserves, the gold percentage also fell in 1964, in this case bringing it noticeably below the end-1960 level. If non-marketable US Government securities are left out of account, then the increase in European exchange reserves during 1961–64 is reduced to \$1.8 milliard. This leaves the gold percentage for the European Group of Ten countries at the end of 1964 above the end-1960 figure.

Taking western Europe as a whole (and excluding Switzerland, for which no data on the foreign position of the banks are available), total official and private monetary movements were more favourable in 1964 than they had been the year before. It is true that the increase in net official assets was \$0.7 milliard less than in 1963; but, on the other hand, there was no change in the overall foreign position of the banks in 1964, whereas during the previous year their net foreign liabilities had gone up by as much as \$1.3 milliard. Total monetary movements, therefore, except for Switzerland, were positive in 1964 to the extent of \$1 milliard, compared with \$0.4 milliard in 1963.

There were two countries, Italy and the United Kingdom, in which the contrast between monetary movements in 1963 and 1964 was very sharp. The Italian position improved by \$2 milliard between the two years, whilst that of the United Kingdom deteriorated by \$1.5 milliard. In the rest of Europe, again excluding Switzerland, the surplus on monetary movements was much the same in the two years. In 1963 official assets rose by \$2.5 milliard and bank liabilities by \$0.5 milliard; the corresponding rises for 1964 were \$2.6 and 0.4 milliard respectively, so that these countries raised their surplus a little, from \$2 to 2.2 milliard.

Complete data on western European countries' monetary movements during the first quarter of 1965 are not yet available. Official gold and exchange reserves, excluding those of Finland and Portugal, showed a small decline of about \$130 million, while net IMF positions increased by some \$50 million. The United Kingdom's short-term indebtedness to foreign central banks increased considerably, but sterling balances declined. Data on changes in European commercial banks' foreign positions are as yet very incomplete, but it would seem that the seasonal improvement in the banks' positions was larger than the decline in official gold and exchange reserves. German banks alone added some \$500 million to their net foreign assets, and in seven other European countries for which figures are available there was a net improvement of approximately \$180 million in the banks' positions.

European countries: Reserve positions.

Countries	End of year	Net reserves: Gold	Net reserves: Foreign exchange	Net reserves: Total	Net IMF and GAB position	Net reserves, plus or minus net IMF and GAB position
		in millions of US dollars				
Austria.	1962	454	597	1,051	26	1,077
	1963	536	650	1,186	37	1,223
	1964	600	632	1,232	72	1,304
Belgium-Luxemburg. . .	1962	1,365	237	1,602	133	1,735
	1963	1,371	445	1,816	141	1,957
	1964	1,452	552	2,004	204	2,208
Denmark	1962	92	118	210	33	243
	1963	92	336	428	33	461
	1964	92	504	596	33	629
Finland	1962	61	206	267	14	281
	1963	61	239	300	14	314
	1964	85	261	346	14	360
France	1962	2,587	1,023	3,610	439	4,049
	1963	3,175	1,282	4,457	450	4,907
	1964	3,729	1,376	5,105	619	5,724
Germany	1962	3,679	2,686	6,365	517	6,882
	1963	3,844	3,207	7,051	552	7,603
	1964	4,248	2,665	6,913	913	7,826
Greece	1962	77	193	270	15	285
	1963	77	201	278	15	293
	1964	77	189	266	15	281
Italy	1962	2,243	1,358	3,601	203	3,804
	1963	2,343	826	3,169	226	3,395
	1964	2,107	1,503	3,610	146	3,756
Netherlands	1962	1,574	128	1,702	203	1,905
	1963	1,594	277	1,871	203	2,074
	1964	1,679	379	2,058	265	2,323
Norway.	1962	29	237	266	25	291
	1963	29	289	318	25	343
	1964	29	327	356	25	381
Portugal	1962	471	321	792	15	807
	1963	497	330	827	15	842
	1964	497	442	939	15	954
Spain	1962	446	561	1,007	38	1,045
	1963	573	520	1,093	54	1,147
	1964	616	791	1,407	107	1,514
Sweden	1962	181	567	748	48	796
	1963	182	518	700	53	753
	1964	189	676	865	88	953
Switzerland.	1962	2,667	201	2,868	—	2,868
	1963	2,820	250	3,070	—	3,070
	1964	2,725	388	3,113	—	3,113
Turkey	1962	140	— 52	88	— 27	61
	1963	115	— 89	26	— 31	— 5
	1964	104	— 64	40	— 34	6
United Kingdom	1962	2,582	224	2,806	502	3,308
	1963	2,484	173	2,657	489	3,146
	1964	2,136	180	2,316	— 516	1,800
Total	1962	18,648	8,605	27,253	2,184	29,437
	1963	19,793	9,454	29,247	2,276	31,523
	1964	20,365	10,801	31,166	1,966	33,132

Note: 1. Net reserves consist of central-bank and/or other official holdings of gold and foreign exchange, excluding IMF and GAB positions and claims or debts arising out of the liquidation of the EPU. The figures are also net of any other foreign exchange liabilities shown in the central-bank returns or other official sources, except for the UK sterling liabilities. For France, Spain, Switzerland and the United Kingdom the net reserves consist of gold and convertible currencies only. For Germany they exclude non-freely-usable balances, which (ignoring claims arising out of the liquidation of the EPU) amounted at the end of 1962, 1963 and 1964 to $351, 345 and 340 million respectively. 2. Net IMF position is gold subscription, plus repurchases of currency subscription, minus the member's net drawings or plus the Fund's net sales of its currency, plus or minus the Fund's administrative and operational expenditure or receipts in its currency. GAB position consists of loans made under the General Arrangements to Borrow of October 1962.

United Kingdom. The financing of the payments deficit presented few problems during the first half of 1964, when official gold and exchange reserves actually showed a small increase of $50 million. About half of the deficit during these months was covered by a rise of $345 million in the sterling area's London balances and a further $250 million by a rise in the net foreign currency liabilities of UK banks.

In the third quarter the sterling area's surplus dwindled away and there was increasing nervousness about the balance of payments and the approaching general election. At first a good part of the deficit was offset by a further inflow of funds from outside the sterling area, but by the end of August the Bank of England began to draw on its $500 million swap facility with the Federal Reserve System. In September a further $500 million of short-term credit facilities was arranged with seven other central banks and by the end of that month assistance totalling $200 million had been taken under these various arrangements. As official reserves at the end of September were $165 million lower than they had been three months earlier, more than half of the third-quarter deficit required official financing.

In the fourth quarter the reserves declined by a further $225 million and, in addition, there was $1,405 million of fresh official borrowing from abroad. Total official financing for the quarter therefore came to $1,630 million, more than twice the overall deficit recorded and more than three times the identified deficit on current and long-term capital account. Most of the difference between the deficit and the size of the official financing is explained by a reduction of $1,030 million in sterling balances. Some of this reduction resulted from a payments deficit in the rest of the sterling area, but the larger part represented a flight from the pound.

United Kingdom: Monetary movements.

Items	1964			
	1st half	3rd quarter	4th quarter	Year
	in millions of US dollars			
Official reserves (increase +)	+ 50	− 165	− 225	− 340
Official assistance (increase −)	− 15	− 185	− 1,405	− 1,605
of which				
IMF drawing	*—*	*—*	*− 1,000*	*− 1,000*
Other	*− 15*	*− 185*	*− 405*	*− 605*
Total official financing	+ 35	− 350	− 1,630	− 1,945
Sterling liabilities (increase −)				
to overseas sterling area	− 345	− 20	+ 490	+ 125
to non-sterling area*	− 30	− 210	+ 540	+ 300
to international institutions*	+ 15	+ 5	− 40	− 20
Non-sterling liabilities (increase −)	− 250	− 100	− 35	− 385
Other monetary movements (increase in liabilities −)	− 130	+ 5	− 30	− 155
Monetary movements other than official financing (increase in liabilities −)	− 740	− 320	+ 925	− 135
Total (= balance-of-payments surplus/deficit)	− 705	− 670	− 705	− 2,080

* Excluding the sterling counterpart of official assistance in the form of swaps and of the IMF drawing.

During October further drawings on official credit facilities amounted to \$215 million and in November \$785 million of assistance was taken. The remaining \$585 million of existing central-bank facilities was used up and a new \$3 milliard support operation involving eleven central banks, the BIS and the Export-Import Bank was announced on 25th November, \$200 million of which was used before the end of that month. In December the short-term indebtedness incurred before 25th November was repaid by drawing \$1 milliard on the International Monetary Fund. In addition, a further \$325 million of assistance was taken under the arrangements of 25th November, \$80 million of Swiss francs was borrowed from the Swiss National Bank in connection with the activation of the GAB (\$50 million of which was used to repay a loan received from the Swiss Confederation in 1961) and \$174 million of principal and interest payments due on the post-war loans from the US and Canadian Governments was deferred.

Despite the large outflow during the fourth quarter, it can be seen from the table that during the year as a whole there was a small inflow of funds, since the balance-of-payments deficit was slightly bigger than the total of official financing. This inflow was more than accounted for by a rise in banks' net external liabilities in foreign currencies. At the end of the year the official gold and exchange reserves stood at \$2,316 million.

Full details of developments in the first quarter of 1965 are not yet available. The balance-of-payments deficit declined considerably and there was a slight increase in official reserves. Gold and exchange holdings rose by \$15 million and the net debt to the IMF was reduced by \$5 million through other countries' sterling drawings. On the other hand, further use was made of the credit facilities arranged in November 1964. Foreign countries' sterling balances declined during the quarter by \$65 million. The sterling area's balances were drawn down by \$235 million, while non-sterling-area balances, including central-bank assistance, rose by \$170 million.

In May 1965 the British reserves rose by \$505 million to a total of \$2.9 milliard. During the month \$1,400 million was borrowed from the IMF and Switzerland, and some \$1,100 million of central-bank assistance was repaid.

France. For the fourth consecutive year France had by far the biggest increase in reserves of any European country in 1964. Official monetary assets rose by \$817 million, almost as much as in 1963. Within this total rise, however, the share of the net IMF and GAB position went up by \$11 and 169 million, while the increase in official gold and exchange reserves came down from \$847 to 648 million, of which \$554 million was in gold.

The rise in official monetary assets reflected rather closely the 1964 balance-of-payments surplus. There were no prepayments of external government debt and the net foreign liabilities of the French banking system, which had gone up by \$200 million in 1963, grew during 1964 by only \$39 million. Non-residents' franc balances continued to rise, by \$98 million; but the net foreign exchange holdings of French residents, which had been drawn down by $150 million in 1963, went up by $60 million.

France's official monetary assets rose by a further $234 million during the first quarter of 1965. Nearly the whole of this increase was in the official reserves, which went up from $5,105 to 5,316 million. There was a marked shift during the quarter between exchange and gold reserves. The gold reserve rose by $468 million and the exchange reserve declined by $257 million. This reflected the French Government's decision in January 1965 to take the whole of any future surpluses in gold, as well as to convert into gold a part of official exchange holdings derived from past surpluses. Although the official reserves showed a further rise of $51 million in April 1965, the inflow of foreign exchange has diminished since the end of the first quarter.

Italy. Despite the balance-of-payments deficit in the early months of the year, Italy's net official reserves rose by $445 million during 1964. The convertible exchange reserves alone went up by $735 million, while the gold reserve declined by $235 million, official holdings of non-marketable US Government bonds fell by $200 million, and official foreign liabilities by $145 million. Net lending to the IMF declined by $80 million and there was also a moderate fall in other official monetary assets. As, however, the foreign position of the banks improved by $440 million, the overall surplus came to $775 million.

Italy: Monetary movements.

Items	1963	1964	1964 January–March	1964 April–December	1965 January–March
	in millions of US dollars				
Net official reserves	− 435	+ 445	− 420	+ 865	− 35
of which					
Gold	*+ 100*	*− 235*	*− 200*	*− 35*	*− 15*
Convertible foreign exchange	*− 535*	*+ 735*	*− 35*	*+ 770*	*+ 20*
US Government non-marketable lira bonds	*+ 150*	*− 200*	*− 50*	*− 150*	*—*
Short-term foreign liabilities	*− 150*	*+ 145*	*− 135*	*+ 280*	*− 40*
Net IMF and GAB position	+ 25	− 80	− 225	+ 145	+ 35
Other official monetary assets	− 185	− 30	+ 10	− 40	+ 15
Commercial banks' foreign position	− 650	+ 440	+ 200	+ 240	+ 55
Total (= balance-of-payments surplus / deficit)	−1,245	+ 775	− 435	+1,210	+ 70

In the first quarter of 1964 the deficit was $435 million. As the banks reduced their foreign liabilities by $200 million, official financing amounted to $635 million. There was a gold sale of $200 million to the US Treasury; $225 million was drawn on the IMF; and short-term official liabilities rose by $135 million, reflecting an increase in US official lira balances at the Bank of Italy. This increase resulted partly from drawings by Italy on its swap facility with the Federal Reserve System and partly from US official purchases of lire.

During the second quarter the balance of payments turned sharply into surplus and has since remained positive. The overall surplus for the last nine months of 1964 was $1,210 million. The banks reduced their net foreign liabilities by a further $240 million, while net official monetary assets rose by $970 million, of which $770 million was in convertible foreign exchange. There was some further slight reduction in the gold reserve caused by the increase in Italy's IMF quota. On the other hand, the net IMF and GAB position improved by $145 million and official short-term liabilities were reduced by $280 million. The counterparts of this latter movement were the extinction of swap debts vis-à-vis the Federal Reserve System and the repurchase by the United States of non-marketable lira securities.

Total monetary movements were positive to the extent of $70 million in the first quarter of 1965. There was a further decline of $55 million in the banks' net foreign liabilities.

Benelux. In both Belgium and the Netherlands official monetary assets rose during 1964 by $250 million and in both cases the first-line reserves accounted for 75 per cent. and the net IMF position for the remainder of the increase. Most of the 1964 increase in Belgium's reserves occurred in the last quarter of the year and there was little further rise during the first quarter of 1965.

The increase of $187 million in the reserves of the Nederlandsche Bank during 1964 was exactly matched by a decline in the net foreign assets of the Dutch commercial banks. Following their substantial rise in the second half of 1964, the Nederlandsche Bank's monetary reserves declined by $11 million in the first quarter of this year, while the net foreign assets of the banks increased by $53 million.

Germany. The German balance of payments, which had been heavily in surplus early in 1964, went into deficit later in the year. Nevertheless, for the year as a whole the total of monetary movements was positive to the extent of $170 million. Germany's net IMF and GAB position improved by $360 million, while first-line official reserves declined by $135 million and other official monetary assets by $40 million — the latter because of further repayments of debt arising out of the liquidation of the EPU.

The composition of the first-line official reserves changed considerably during 1964. The gold reserve went up by $405 million and holdings of non-marketable US Government bonds by $400 million. On the other hand, the foreign exchange reserve declined by $940 million.

For the year as a whole there was virtually no change in the foreign position of the German banking system. This contrasted with a reduction of $170 million in their net foreign position during 1963; and it occurred despite the fact that bank liquidity decreased during the course of the year.

In March 1964 the Bundesbank began to offer special swap facilities to the banks for the purchase of US Treasury bills, and in April it raised the reserve requirements for banks in respect of foreign liabilities not covered by foreign assets. These measures were successful in so far as the banks increased their foreign assets by $175 million during 1964. But the effect of this was offset by a rise of $90 million in foreign DM working balances and by an increase of about the same size in credits taken up abroad by the German banks.

During the first quarter of 1965 the balance of payments returned to a substantial surplus of $355 million. The banks, reversing their end-year operations, added $515 million to their net foreign assets. The Bundesbank's gold and exchange reserves declined by $125 million and there was a reduction of $35 million in Germany's net IMF position.

Switzerland. Measured in the conventional way, by the change in the gold and exchange holdings, the Swiss National Bank's reserves went up during 1964 by $43 million. However, the end-year operations of the Swiss banks in December 1963 were on an exceptionally large scale, so that if November 1963 is compared with November 1964 the rise in the reserves was $215 million, while if January 1964 is compared with January 1965 it was $240 million.

Even if this factor is ignored, however, $43 million is not the true measure of the increase in the National Bank's external monetary assets in 1964. Its holdings of US Government non-marketable securities denominated in Swiss francs went up by roughly $50 million and in addition the National Bank acquired $100 million of sterling through swaps with the Bank of England in December 1964. Including these items, the reserves in the broad sense went up by $195 million in 1964. This compares with an increase of $202 million in 1963. Allowing for the scale of the end-1963 operations of the Swiss banks, it can be said that the official monetary assets rose more in 1964 than they had done the year before.

In January 1965 the reserves fell seasonally by just over $100 million. In March and April there was a further decline of $111 million, a good part of which reflected the stronger position of the dollar on the Swiss market following the introduction of measures to limit capital outflow from the United States. In addition, the National Bank transferred during this period to Swiss commercial banks $60 million's worth of the sterling it had been holding under swaps with the Bank of England.

Other European countries. Elsewhere in western Europe, there were some substantial increases in monetary reserves during 1964. Spain's reserves, including the net IMF position, went up by $367 million, while Portugal's official gold and exchange holdings rose by $112 million. In Scandinavia, Sweden's reserves rose by $200 million, of which the IMF and GAB positions accounted for $35 million, and those of Denmark by $168 million. In the Danish case, the increase in official assets went with a rise of $57 million in the banks' net foreign liabilities. There were also increases, of $46 and 38 million, in the official reserves of Finland and Norway.

Foreign exchange.

There were no unusual developments in the exchange markets during most of the first nine months of 1964. In the last part of the year, however, the markets came to be dominated by the sterling crisis and the deterioration in the US balance of payments. By mid-September the pound had fallen virtually to its lower limit against the dollar in the spot market and from then on until February 1965 it required frequent and substantial official support. After a further period of weakness in March and early April the spot rate recovered almost to parity, then weakened again in May.

Towards the end of 1964 the important continental European currencies (except the lira, which has been held very close to par since March 1964) and the Canadian dollar were at, or fairly close to, their upper limits against the US dollar in the spot markets. When the new US balance-of-payments measures were introduced in February 1965 the currencies most affected were the pound, the Canadian dollar and the Swiss franc.

A highlight of the period under review was the decision of the British authorities towards the end of November 1964 to intervene also in the forward exchange market. This decision in effect provided the authorities with a new instrument for defending the exchange rate. It appears that most of the unusual volume of forward operations with which the market had to cope at that time was related to commercial transactions. The forward cover provided by the authorities was therefore in the main a way of ensuring that traders could execute at the existing rate of exchange payments that would in any case have fallen due within a few months.

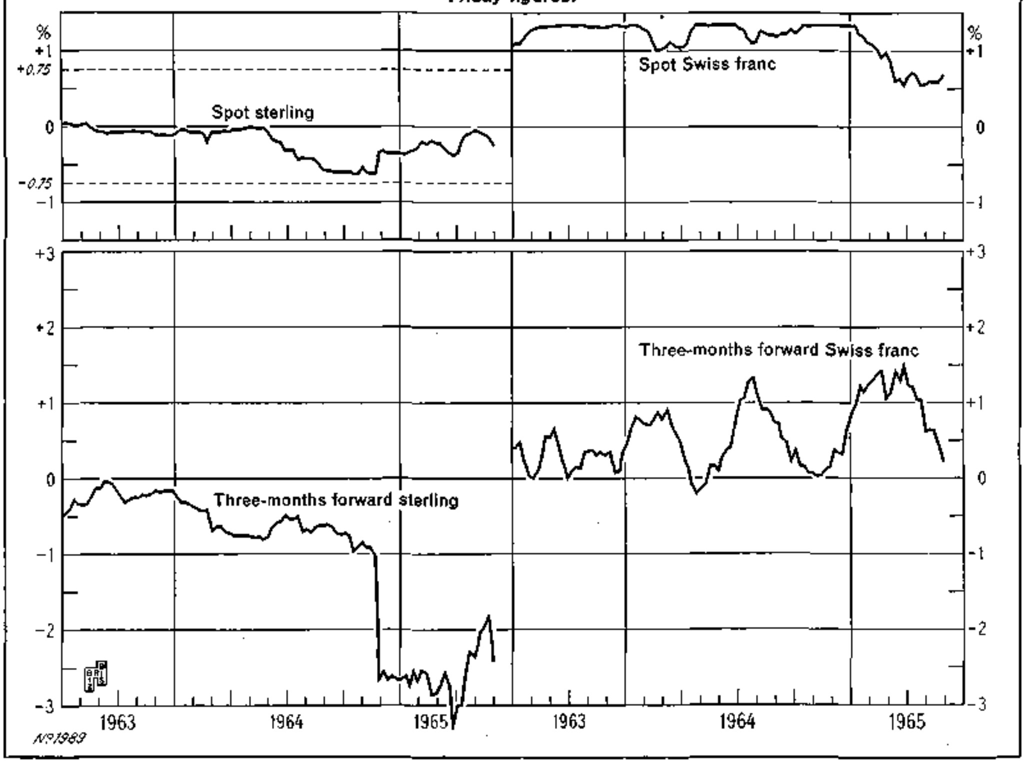
The greater firmness of a number of continental European currencies against the dollar in the spot market during the second half of 1964 was accompanied, until November, by an opposite movement in the forward market. In November, however, European forward rates began to strengthen, partly because of the rise in US and Euro-dollar interest rates. This firmer tendency was reinforced in February 1965 by the drying-up of the US capital outflow, which will have reduced the demand for forward dollars in the market.

Sterling. The year 1964 opened quietly with the pound at about \$2.79¾ in the spot market. Sterling eased somewhat in the third week of February, partly because of rumours of a possible revaluation of the Deutsche Mark and partly because of signs that balance-of-payments difficulties might lie ahead. Bank rate was raised at the end of the month and from then on, till the last week in May, sterling was fairly firm.

Towards the end of May the spot rate began to decline and by the third week of July it had gone just below \$2.78¾. After nearly a month at that level it fell by the end of August to \$2.78⅜, practically the lower support point. Sterling was not, however, under any speculative pressure at this time and the three-months forward discount on the dollar actually narrowed from ¾ to ½ per cent. between end-May and mid-July. By the latter date UK Treasury bills, the interest rates on which had been moving upwards, were yielding nearly ½ per cent. more than US Treasury bills on a covered basis. In order to prevent this differential from attracting US funds to London, the US authorities sold over $50 million of sterling forward, with corresponding spot purchases, in July and August 1964.

With the spot rate virtually at the lower support point, the increased pressure on sterling from September onwards was reflected mostly in the loss of reserves and in the amount of assistance taken from foreign central banks. Although forward sterling was not strong at that time, and the covered interest margin in favour of London gradually disappeared, it was only after the 2 per cent. increase in Bank rate on 23rd November that conditions in the forward market really changed. Sales of forward sterling then assumed substantial proportions, the three-months forward discount on the dollar widened from 1 to 3 per cent. per annum and the interest rate differential shifted in favour of New York. The British authorities then began to intervene in the forward market in order not only to maintain the forward discount of the pound at the level appropriate to interest rate conditions but also to avoid having to use the official reserves to provide the banks with spot dollars in cover of forward sales. Throughout December 1964 and January 1965 the three-months forward discount of the pound was rather over 2½ per cent. per annum.

Sterling and Swiss franc quotations for the US dollar.*
Friday figures.



* Spot rates showing the pound and the franc above (+) or below (—) par on the US dollar. Forward rates showing the premium (+) or discount (—) on the spot rates expressed as an annual rate of interest.

Contrary to what happened in the forward market, the spot rate improved to over \$2.79 following the announcement on 25th November of the \$3 milliard support operation for sterling. The improvement was short-lived, however, and the rate had to be supported throughout December, during which month it was not allowed to fall below \$2.79. In January less official intervention was needed and in February the spot rate began to go markedly above \$2.79. But this firmer trend was soon overlaid by the effects of the measures taken to improve the US balance of payments, as well as by renewed uncertainty about the stability of the international financial system, this time arising more out of criticisms of the gold exchange standard as such than from any change in the actual situation. The spot rate began to sag again and by 26th March it was down to just below \$2.79.

During April both spot and forward rates improved considerably, particularly after the Prime Minister's reaffirmation that the exchange rate would be maintained, and in mid-May the spot rate was just below parity, whilst the three-months forward discount had come down below 2 per cent. per annum for the first time since November 1964. By the end of May, however, the spot rate had weakened to about \$2.79¼ and the three-months forward discount on the dollar had widened to over 2½ per cent.

Swiss franc. Under the influence of repatriation of Swiss funds from abroad, the spot rate for the franc against the dollar, after an unusually short period of seasonal weakness at the beginning of the year, had by the end of April 1964 reached the Swiss National Bank's upper intervention point of Sw.fr. 4.31½, where it stayed until after the middle of the year. During the third quarter the franc eased a little bit against the dollar, but by the middle of October the rate had gone back again to Sw.fr. 4.31½. The renewed tightening of Swiss money-market conditions, seasonal factors and the effects of the sterling crisis kept the Swiss franc very firm against the dollar for the rest of the year.

The fluctuations of the Swiss franc against the dollar in the forward market were quite pronounced during 1964 and also tended to reflect changes in the flow of funds into Switzerland. In April, when there was a substantial repatriation of funds from abroad, the forward premium ran off altogether and was for a time replaced by a slight discount; the premium was at its highest, on the other hand, in July, when the spot rate eased as a result of a reversal of mid-year operations by the banks. The forward premium of the Swiss franc was again reduced to zero in November 1964, when the spot rate was at the upper limit. From there it rose to an average level of 1¼ per cent. per annum during the first three months of 1965 before falling again to less than ¼ per cent. at the end of May.

The situation in the spot dollar market changed considerably during the first months of 1965. The usual seasonal weakening of the franc at the very beginning of the year was followed by a much sharper fall in the rate, which took it by late March to nearly Sw.fr. 4.35, its lowest level for thirteen years. This change was undoubtedly connected with the US balance-of-payments measures and with the rise in Euro-dollar rates. In addition, the commercial demand for dollars in Switzerland was strong and there was some reversal of leads and lags in favour of the United Kingdom.

Deutsche Mark. During the period under review the spot DM rate for the dollar, though remaining well above parity, gradually eased. In the first months of 1964 large payments surpluses, containing an element of speculative capital inflow, kept the Deutsche Mark very close to its ceiling against the dollar. The deterioration of the basic balance of payments, partly caused by the announcement of measures designed to discourage capital inflow, gradually took the pressure out of the market. Somewhat surprisingly, the Deutsche Mark eased further during November and the first half of December, despite the sterling crisis, and this trend continued during the first months of 1965. In mid-May the Deutsche Mark stood at a premium of about 0.4 per cent. on the dollar in the spot market.

In March 1964, when the Deutsche Mark was very firm, the US Treasury and the Deutsche Bundesbank intervened jointly in the forward market for a total amount of $21 million. These commitments were all liquidated at maturity. Apart from this episode, the main point of interest in connection with forward rates was the reintroduction in March 1964 of special swap facilities at the Bundesbank to enable the banks to invest in US Treasury bills.

Other European currencies. Throughout the period under review the French franc remained at or very close to its upper limit against the dollar. The Italian lira has been kept just above its dollar parity continuously since March 1964, so that the tremendous swing in the balance of payments from deficit to surplus has had no effect on the spot exchange rate. The Belgian franc strengthened considerably, though not uninterruptedly, during the course of 1964 and by October it had reached its upper limit against the dollar for the first time since November 1960. The franc has continued at about this level so far in 1965. During the first half of 1964 the Dutch florin weakened rather sharply against the dollar, under the influence of the balance-of-payments deficit, and in mid-year the spot rate was just below par. The situation reversed itself in the second half of the year and the florin went to its upper limit against the dollar in November 1964 and stayed there until mid-February 1965. It then began to ease somewhat and in mid-May was about ½ per cent. above par.

Canadian dollar. Movements in the Canadian dollar exchange rate during the period under review were strongly influenced by the pattern of capital movements with the United States. During the second half of 1964, when the outflow from the United States was very high, the Canadian dollar strengthened from over Can.$1.08 to Can.$1.07¼ per US dollar towards the end of November. In February 1965 the Canadian dollar began to ease again and by the end of March the spot rate had returned to about Can.$1.08.

Other exchange developments. A number of eastern European countries made changes during the period under review in the rates that apply to foreign tourists. Bulgaria introduced a tourist rate of exchange of Leva 2 = US \$1 in February 1964; previously the official exchange rate of Leva 1.17 had applied to tourists. In Czechoslovakia the tourist rate was changed in May 1964 and again in January 1965. The present rate is Kčs. 16.20 = US \$1, subject to a minimum expenditure of \$3 a day. This compares with the basic rate of Kčs. 7.20 = US \$1. In June 1964 the tourist rate in Rumania was increased from Lei 15 to Lei 18 = US \$1, at which level the premium on the basic rate is 200 per cent.

There have been a number of new measures taken in industrial countries since the spring of 1964 with the object of controlling international capital movements. Most of these measures, however, are not exchange control measures in the normal sense of the term, i.e. they are not direct quantitative controls the motive for which is primarily the balance-of-payments situation.

In the United States and United Kingdom steps have been taken to control capital outflows. The US programme of February 1965, which is a voluntary one, has already been described on page 8. In the United Kingdom, on the other hand, the measures taken in April 1965 included tight exchange controls. More stringent criteria are now applied to requests to use the official exchange market for direct investments outside the sterling area. Applicants must now satisfy the authorities not only that the investments will bring a substantial and continuing benefit to the balance of payments but also that this benefit will, within a short space of time, equal or exceed the original investments. Furthermore, the supply of currency available for making foreign investments through the investment currency market is to be reduced. The whole of any exchange received by UK residents from legacies or other gifts, and 25 per cent. of the proceeds of residents' sales of foreign securities, has now to be sold on the official exchange market. This means that a mixed rate of exchange applies to sales of foreign securities by UK residents.

So far as controls over capital inflows are concerned, the measures introduced in Switzerland in February 1964 have remained in force. So have the various steps, of which mention has been made earlier in this Report, taken in Germany in the spring of 1964.

In Italy the authorities have continued to control the foreign borrowing of the banks. The limits within which the banks have to keep their net foreign borrowing were reduced, with effect from 1st January 1964, to the end-November or end-December 1963 level, whichever was the lower. And with effect from 1st July 1964 the limits were lowered again to the mid-June 1964 or, if lower, the end-June 1964 level of borrowing. It may also be mentioned in connection with developments in Italy that the 30-day payment limit for durable goods imports, introduced in April 1964, was extended in January 1965 to 90 days.

In the Netherlands no authorised bank has been allowed since the beginning of August 1964, except with the specific approval of the authorities, to have spot foreign liabilities that exceed its spot foreign assets by more than Fl. 5 million. Moreover, in view of the growth in the official exchange reserves, the authorities gave permission in February 1965 for commercial banks to take up and hold in their portfolios the full amount of any foreign loan issued on the Netherlands capital market.

Finally, in Austria and Denmark voluntary agreements were reached between the authorities and the commercial banks during the period under review with the object of limiting the banks' import of money. As regards Austria, the agreement reached in September 1964 provided that the banks would not within a certain period repatriate Sch. 1.7 milliard of short-term foreign assets. In Denmark the commercial banks agreed in February 1965 to deposit with the Nationalbank the full equivalent of any further increase in their foreign liabilities.

IV. THE EURO-CURRENCY MARKET.

The purpose of this chapter is to present the available statistics on the Euro-currency market since the last quarter of 1963. The data cover the liabilities and assets vis-à-vis non-residents, in dollars and certain other currencies, of the commercial banks of Belgium, France, Germany, Italy, Japan, the Netherlands, Sweden, Switzerland and the United Kingdom. Together with Canada, these are the countries whose banks are most prominent in the market.

Before examining the figures, it may be noted that it is not feasible to obtain a precise statistical picture of the Euro-currency market, for several reasons. One may define Euro-dollars as dollars acquired by banks located outside the United States and used for lending to ultimate borrowers, either directly in dollars or, after conversion, in another currency. A part of the foreign dollar position of banks outside the United States consists of their liabilities to and claims on the United States itself, both of which are a mixture of Euro-dollar and non-Euro-dollar transactions. Hence, the overall foreign dollar positions of banks outside the United States are larger than their Euro-dollar business, while their foreign dollar positions excluding those vis-à-vis the United States are smaller than their Euro-dollar business. The same considerations apply to the data on other Euro-currency positions.

A second reason why the data have to be interpreted with care is that, whatever overall total may be taken, it will inevitably contain duplication because dollars are often redeposited from one bank to another before being lent to a non-bank customer. Therefore, a change in the gross figures need not imply a corresponding change in the Euro-dollar market as a source of credit for non-bank borrowers.

A third point is that, while Euro-dollars are to be found on both sides of the balance sheets of banks outside the United States, liabilities do not necessarily equal assets. This is because dollars received from or placed with residents are not included in the data and, in addition, there are conversions into dollars from other currencies and from dollars into other currencies. Moreover, even if all Euro-currencies were taken together and positions in these currencies vis-à-vis residents were included, liabilities would differ from assets to the extent that there was conversion either from or to domestic currency. It is, of course, the practice of banks to cover such conversions in the forward market.

Lastly, it may be mentioned that the data are in certain respects incomplete and not fully homogeneous, and that Euro-currency assets of the BIS are included with the assets of Swiss banks.

At the end of March 1965 the total foreign dollar liabilities of the nine reporting banking systems amounted to $11.6 milliard and their total foreign dollar assets to $11.4 milliard. In certain other currencies — sterling, Swiss francs, Deutsche Mark and Dutch florins — their combined foreign liabilities and assets at that date were the equivalent of $3.0 and 3.3 milliard respectively.

The share of each of the reporting banking systems in these totals, as well as the corresponding figures for September 1963, March, September and December 1964, are shown in the first of the two following tables.

From these figures certain simple facts stand out. In the first place, the total dollar positions are something like four times as large as the positions in the four next most important foreign currencies combined. Moreover, dollar liabilities have grown during the period under review by $2.4 milliard, whilst the liabilities in the other four currencies taken together have not changed much. Looking at the individual banking systems, so far as the US dollar is concerned, UK banks accounted at the end of March 1965 for almost 40 per cent. of total liabilities and for 30 per cent. of total assets. Four banking systems — the British, Italian, Japanese and Swiss — accounted for about 85 per cent. of total dollar liabilities. In the other currencies no one country or group of countries stands out in the same way.

The next table gives the foreign positions of the same banking systems at the same dates and in the same currencies, but with their positions vis-à-vis the countries of issue of these currencies, e.g. dollar positions vis-à-vis the United States, excluded. Looking at the dollar positions on this basis, total liabilities were $8.3 milliard and total assets $6.5 milliard at end-March 1965. The predominance of the British banks is more pronounced than in the overall figures, their share of the total dollar liabilities being nearly half. The Japanese figures are very much smaller, while the share of the British, Italian and Swiss banks taken together in the total of dollar liabilities is just over 75 per cent.

Because of the absence of any data regarding the positions of the British banks and of gaps in some other countries' data, the "other currencies" series is rather incomplete. From such figures as there are, however, it seems probable that the differences between the overall totals and the totals excluding positions in each currency vis-à-vis the country of issue of that currency are relatively larger than in the case of the US dollar.

The figures discussed so far include interbank positions between the countries in the reporting area. A substantial proportion of these positions is likely to represent simply a redepositing of funds. After making approximate allowance for this element of duplication, as well as for placements in the US money market, and inserting an estimate for the positions vis-à-vis residents (for which complete figures are not available), it would appear that the net size of the Euro-currency market at the end of March 1965 could be put at about $9 milliard, somewhat more than $7 milliard of which was in US dollars.

Short-term liabilities and assets of nine countries' commercial banks in certain foreign currencies vis-à-vis non-residents.

Countries	End of month	US dollars		Other currencies[1]		Total	
		Liabilities	Assets	Liabilities	Assets	Liabilities	Assets
		in millions of dollars					
Belgium	1963 September	360	260	280	230	640	490
	1964 March	380	310	370	210	750	520
	September	290	320	540	270	830	590
	December	420	360	500	290	920	650
	1965 March	400	440	560	260	960	700
France[2]	1963 September	650	670	630	660	1,280	1,330
	1964 March	610	710	590	560	1,200	1,270
	September	620	720	530	550	1,150	1,270
	December	820	860	550	650	1,370	1,510
	1965 March	730	890	550	580	1,280	1,470
Germany	1963 September	270	570	100	170	370	740
	1964 March	220	720	110	130	330	850
	September	290	620	70	140	360	760
	December	440	640	70	100	510	740
	1965 March	230	700	50	110	280	810
Italy	1963 September	1,540	950	750	400	2,290	1,350
	1964 March	1,240	780	580	300	1,820	1,080
	September	1,250	810	350	270	1,600	1,080
	December	1,530	1,070	350	310	1,880	1,380
	1965 March	1,340	800	430	250	1,770	1,050
Japan	1963 September	1,820	1,660	370	230	2,190	1,890
	1964 March	2,110	1,780	330	300	2,440	2,080
	September	2,230	2,020	390	380	2,620	2,400
	December	2,380	2,210	350	400	2,730	2,610
	1965 March	2,500	2,290	360	400	2,860	2,690
Netherlands	1963 September	270	440	90	270	360	710
	1964 March	280	330	80	220	360	550
	September	300	270	150	260	450	530
	December	360	390	150	280	510	670
	1965 March	360	420	150	300	510	720
Sweden	1963 September	80	150	40	100	120	250
	1964 March	80	180	50	140	130	320
	September	110	200	80	170	190	370
	December	110	230	50	110	160	340
	1965 March	130	180	70	110	200	290
Switzerland[3]	1963 September	1,060	1,660	.	.	.	.
	1964 March	1,220	1,960	.	.	.	.
	September	1,370	2,110	330	490	1,700	2,600
	December	1,590	2,180	300	500	1,890	2,680
	1965 March	1,370	2,210	320	560	1,690	2,770
United Kingdom	1963 September	3,160	2,970	450	490	3,610	3,460
	1964 March	3,100	2,820	440	520	3,540	3,340
	September	3,890	3,220	430	630	4,320	3,850
	December	4,380	3,700	490	620	4,870	4,320
	1965 March	4,560	3,430	510	680	5,070	4,110
Total	1963 September	9,210	9,330	(3,000)	(3,050)	(12,210)	(12,380)
	1964 March	9,240	9,590	(2,850)	(2,880)	(12,090)	(12,470)
	September	10,350	10,290	2,870	3,160	13,220	13,450
	December	12,030	11,640	2,810	3,260	14,840	14,900
	1965 March	11,620	11,360	3,000	3,250	14,620	14,610

[1] Sterling, Swiss francs, Deutsche Mark, Dutch florins. [2] Positions vis-à-vis banks only. [3] Including Euro-currency assets of the BIS.

Short-term liabilities and assets of nine countries' commercial banks in certain foreign currencies vis-à-vis non-residents, excluding positions vis-à-vis the country of issue of the currency in question.

Countries	End of month	US dollars		Other currencies[1]		Total	
		Liabilities	Assets	Liabilities	Assets	Liabilities	Assets
		in millions of dollars					
Belgium.	1963 September	280[2]	190[2]	.	.	.	.
	1964 March	290[2]	220[2]	.	.	.	.
	September	220[2]	230[2]	.	.	.	.
	December	330	260	380	60	710	320
	1965 March	350	300	300	60	650	360
France[3].	1963 September	600	550	350	380	950	930
	1964 March	590	540	350	320	940	860
	September	590	530	300	330	890	860
	December	730	660	400	340	1,130	1,000
	1965 March	660	660	320	340	980	1,000
Germany	1963 September	220	320	50	20	270	340
	1964 March	190	300	50	20	240	320
	September	260	200	50	20	310	220
	December	390	170	40	10	430	180
	1965 March	190	170	20	20	210	190
Italy	1963 September	1,420	570	440	230	1,660	800
	1964 March	1,060	450	330	140	1,390	590
	September	1,010	460	190	120	1,200	580
	December	1,250	600	200	160	1,450	760
	1965 March	1,030	650	230	100	1,260	750
Japan.	1963 September	300	300	.	.	.	.
	1964 March	250	340	.	.	.	.
	September	330	510	100	240	430	750
	December	350	550	100	260	450	810
	1965 March	380	550	100	230	480	780
Netherlands. . .	1963 September	230	250	40	50	270	300
	1964 March	240	230	40	40	280	270
	September	270	190	60	60	330	250
	December	320	300	100	100	420	400
	1965 March	300	340	90	110	390	450
Sweden.	1963 September	70	100	10	20	80	120
	1964 March	70	90	10	30	80	120
	September	80	120	10	30	90	150
	December	80	140	30	30	110	170
	1965 March	90	100	40	30	130	130
Switzerland[4] . .	1963 September	920	1,330	.	.	.	.
	1964 March	1,060	1,530	.	.	.	.
	September	1,210	1,710	180	80	1,390	1,790
	December	1,440	1,610	160	120	1,600	1,730
	1965 March	1,210	1,750	140	160	1,350	1,910
United Kingdom .	1963 September	2,800	1,970	.	.	.	.
	1964 March	2,780	1,740	.	.	.	.
	September	3,400	2,040	.	.	.	.
	December	3,850	2,490	.	.	.	.
	1965 March	4,060	1,970	.	.	.	.
Total . . .	1963 September	6,840	5,580	.	.	.	.
	1964 March	6,530	5,440	.	.	.	.
	September	7,370	5,990	.	.	.	.
	December	8,740	6,780	.	.	.	.
	1965 March	8,270	6,490	.	.	.	.

[1] Sterling, Swiss francs, Deutsche Mark, Dutch florins. [2] Estimates. [3] Positions vis-à-vis banks only.
[4] Including Euro-currency assets of the BIS.

Changes in the overall positions.

Between September 1963 and March 1965 the reporting banks' total liabilities to non-residents in all the reported currencies rose by \$2.4 to 14.6 milliard. The whole of this increase was in their dollar liabilities. On the assets side the picture is not very different. Practically the whole of the increase in total assets came from a rise in dollar assets. Both absolutely and in relative terms, however, dollar assets went up less than dollar liabilities. Assets in the other currencies may have increased somewhat.

On a net basis the total dollar position of the reporting banks vis-à-vis non-residents shifted from assets of \$120 million to liabilities of \$260 million. It would appear that part of this change may have been offset by an improvement in their net position in the other four currencies.

Exclusive of interbank positions within the reporting area, it may be estimated that total dollar liabilities of the reporting banks to non-residents rose during these eighteen months by about \$2 milliard and total dollar assets by \$1.7 milliard. If positions vis-à-vis the United States are also excluded, the increase in dollar liabilities comes to just over \$1 milliard and in dollar assets to \$0.6 milliard.

Total short-term dollar positions of reporting banks vis-à-vis non-residents.

End of month	Including positions vis-à-vis the United States			Excluding positions vis-à-vis the United States		
	Liabilities	Assets	Net position	Liabilities	Assets	Net position
	in millions of dollars					
September 1963	9,210	9,330	+ 120	6,840	5,580	− 1,260
March 1964	9,240	9,590	+ 350	6,530	5,440	− 1,090
September 1964	10,350	10,290	− 60	7,370	5,990	− 1,380
December 1964	12,030	11,640	− 390	8,740	6,780	− 1,960
March 1965	11,620	11,360	− 260	8,270	6,490	− 1,780

From the quarterly data in the preceding table three distinct phases can be seen. From September 1963 to March 1964 there was little change in the size of the reporting countries' foreign dollar positions. Indeed, if positions vis-à-vis the United States are excluded, their liabilities declined somewhat from \$6.8 to 6.5 milliard. The preceding twelve months had seen a considerable expansion of the Euro-dollar market, owing mainly to a very large increase in the net foreign indebtedness of the Italian banks. In August 1963, however, the Italian authorities called for the banks' indebtedness to be reduced. In the absence of offsetting factors, this decision brought the expansion of the market temporarily to a halt. Another feature of this period was the failure of two important business firms which had borrowed substantially in the Euro-dollar market.

The second phase began in the spring of 1964. From then on, until the end of the year, the market expanded again vigorously. Total dollar liabilities increased from \$9.2 to 12 milliard. During the second and third quarters of 1964 the chief influences at work were domestic monetary conditions in the United Kingdom and certain continental European countries. In the last quarter of the year, when the expansion of the Euro-dollar market was particularly marked, developments were affected by the UK balance-of-payments crisis. Another factor was the increase in both liabilities and assets vis-à-vis the United States.

The expansion of the market during the last nine months of 1964 was most pronounced as regards the reporting banks' liabilities, so that their total net position changed from assets of \$350 million in March to liabilities of \$390 million in December 1964.

It appears that a new phase in the history of the market began during the course of the first quarter of 1965. Total gross dollar liabilities of the reporting banks declined slightly, from \$12 to 11.6 milliard, and total net dollar liabilities fell from \$390 to 260 million. The measures taken by the US Government in February 1965 to reduce capital outflows have curtailed an important source of supply of Euro-dollars. During the first quarter of 1965 the European reporting banks' gross dollar liabilities to the United States declined by \$30 million, after having gone up between March and December 1964 by \$410 million. At the same time, the European reporting banks' dollar assets vis-à-vis the United States, which had increased by \$490 million in the preceding nine months, fell by \$70 million during the first quarter of 1965. But for a substantial rise in US Treasury bills held by German banks under the special swap arrangements with the Deutsche Bundesbank, the decline in the European reporting banks' dollar assets vis-à-vis the United States would have been much more pronounced.

Changes in individual reporting countries.

Between September 1963 and March 1965 the UK banks' net dollar liabilities rose by \$940 million and those of Netherlands banks by \$110 million. On the other hand, the net dollar assets of Swiss banks rose by \$240 million, those of German banks by \$170 million and those of Belgian and French banks by \$140 million each.

During the period under review the UK banks accounted for much of the expansion in the Euro-dollar market. At the same time their net foreign dollar liabilities went up from \$190 to 1,130 million. This rise was partly offset by increased net claims in other convertible foreign currencies, with all spot positions being covered in the forward market.

A significant activity of London banks, in particular the London branches of American banks, in the Euro-dollar market, has been to take dollars from outside the United States and to channel them to the United States. This is one reason why their dollar position vis-à-vis non-residents is composed of substantial net claims on the United States and substantial net liabilities to

Changes in the individual reporting countries'
dollar positions vis-à-vis non-residents, September 1963 – March 1965.

Reporting banks of	Including positions vis-à-vis the United States			Excluding positions vis-à-vis the United States		
	Liabilities	Assets	Net positions	Liabilities	Assets	Net positions
	changes in millions of dollars					
Belgium	+ 40	+ 180	+ 140	+ 70*	+ 110*	+ 40*
France	+ 80	+ 220	+ 140	+ 60	+ 110	+ 50
Germany	— 40	+ 130	+ 170	— 30	— 150	— 120
Italy	— 200	— 150	+ 50	— 390	+ 80	+ 470
Japan	+ 680	+ 630	— 50	+ 80	+ 250	+ 170
Netherlands	+ 90	— 20	— 110	+ 70	+ 90	+ 20
Sweden	+ 50	+ 30	— 20	+ 20	—	— 20
Switzerland	+ 310	+ 550	+ 240	+ 290	+ 420	+ 130
United Kingdom	+ 1,400	+ 460	— 940	+ 1,260	—	— 1,260
Total change	+ 2,410	+ 2,030	— 380	+ 1,430	+ 910	— 520

* Estimates.

all other non-residents taken together. Between September 1963 and March 1965 their net claims on the United States rose from $640 to 960 million and their net liabilities to other non-residents from $830 to 2,090 million. The increase in the gap between these two opposite net positions indicates that an increasing proportion of dollars deposited in London had been switched into other currencies, chiefly sterling.

The period since the Euro-dollar market began to expand again, in the spring of 1964, can be conveniently divided into two phases so far as the development of the UK banks' positions is concerned. During the first phase, between March and December 1964, liabilities and assets went up by $1,280 and 880 million respectively. In the first quarter of 1965, however, while liabilities went up by a further $180 million, assets declined by $270 million. Thus, net liabilities increased by $400 million in the last nine months of 1964 and by a further $450 million in the following three months.

Between March and December 1964 liabilities to western Europe rose by $410 million, to Canada by $360 million and to the United States by $220 million. Claims on western Europe rose by $550 million (of which $400 million in the last quarter, partly for seasonal reasons), claims on the United States by $140 million and claims on Japan by $110 million. The main net movements during this period, therefore, were an increase of about $450 million in net liabilities to North America on the one hand, and on the other hand net lending of $140 million to western Europe and of $110 million to Japan.

During the first quarter of 1965, when the overall net position continued to move in the same direction as before, there were large changes in its geographical composition. Liabilities to western Europe went up by $230 million, while those to Canada and the United States declined by $160 million.

At the same time claims on western Europe fell by $540 million, while claims on the United States and Canada rose by $240 million. The net position vis-à-vis western Europe therefore deteriorated by $770 million, while vis-à-vis North America it improved by $400 million. The US measures of February 1965 no doubt explain the improvement vis-à-vis North America and part of the decline in claims on western Europe. The increase in total net dollar liabilities reflects in part a seasonal reflux from the Continent and in part the tightness of domestic monetary conditions.

After the United Kingdom, Japan is the country whose banks have the largest dollar positions vis-à-vis non-residents. Between September 1963 and March 1965 the Japanese banks' total dollar liabilities to non-residents increased from $1.8 to 2.5 milliard and their assets from $1.7 to 2.3 milliard. By far the largest part of their dollar positions on both sides of the balance sheet is vis-à-vis the United States, where their net position deteriorated during this period by $220 million. Their position vis-à-vis the rest of the world improved by $170 million, most of which resulted from loans to countries in Asia and Latin America.

During the period under review the dollar positions of the Swiss banks became the third largest amongst those of the nine reporting countries. Total liabilities went up between September 1963 and December 1964 from $1.1 to 1.6 milliard and assets (including Euro-dollar assets of the BIS) from $1.7 to 2.2 milliard. The net creditor position vis-à-vis the United States improved by $230 million, while there was a deterioration of about the same amount vis-à-vis the rest of the world. In the last quarter of 1964 net claims of Swiss banks on the United Kingdom declined by $250 million and net claims on the United States rose by $180 million. End-year operations may explain part of the withdrawal of dollars from London but not the rechannelling of funds to the United States. During the first quarter of 1965, an opposite change occurred. Net claims on the United States declined by $120 million, as a result of a reduction in assets. Vis-à-vis other non-residents claims rose by $140 million and liabilities fell by $230 million, so that the net position improved by $370 million.

As a result of limits imposed by the Italian authorities, the net liabilities of Italian banks to non-residents in the five reported currencies were reduced between September 1963 and December 1964 by $440 million. In US dollars, net indebtedness fell by $130 million, owing to a rise in assets. There was an improvement of $200 million in the net position outside the United States, whilst net claims on the United States declined by $70 million. The reduction of the Italian banks' foreign indebtedness was much more pronounced in the four other reported currencies. Total liabilities declined from $750 to 350 million between September 1963 and December 1964, and the net position improved by $310 million.

In the first quarter of 1965 the net exchange liabilities of Italian banks to non-residents began to increase again. In US dollars, the net position vis-à-vis the United States deteriorated by $350 million, chiefly because assets were reduced. On the other hand, the net position outside the United States improved by \$270 million, mostly as a result of a decrease in liabilities. Net foreign liabilities in other reported currencies increased by \$140 million. Contrary to what happened in dollars, however, gross liabilities in these currencies increased.

During the period under review German banks added \$170 million to their net external dollar assets. At the same time, there was a substantial increase in the proportion of their dollar assets held in the United States. Between September 1963 and March 1965 the banks' total dollar claims on non-residents went up by \$130 million, assets in the United States increasing by \$280 million and other assets declining by \$150 million. The increase in dollar assets in the United States resulted mainly from the introduction in March 1964 of special swap facilities at the Bundesbank for US Treasury bill investments by the commercial banks. During the first quarter of 1965 the banks' holdings of US Treasury bills continued to increase, while their other dollar claims on non-residents declined by about \$100 million.

French banks' dollar assets and liabilities vis-à-vis non-residents (banks only) increased considerably during the period under review. Up to the end of 1964 their net dollar positions showed little change. During the first quarter of 1965, however, their net dollar assets went up from \$40 to 160 million. Half of this change resulted from a decline in liabilities outside the United States and the remainder from an improvement in the position vis-à-vis the United States. Both liabilities and assets in the other reported currencies, though still substantial, have been reduced by \$80 million since September 1963.

The Belgian banks' external net position in dollars improved by \$140 million between September 1963 and March 1965. Most of this change occurred during the first quarter of 1965, when their net dollar claims on the United States rose by \$80 million. In the other four reported currencies, on the other hand, the Belgian banks' net position vis-à-vis non-residents deteriorated by \$250 million during the period under review, their liabilities doubling from \$280 to 560 million.

In the Netherlands the overall net dollar claims of the banks were reduced by \$110 million, mostly as a result of increased liabilities, between September 1963 and March 1965. At the same time, and contrary to what happened in Germany, there was a pronounced shift of assets away from the United States. Dollar claims on the United States were reduced by \$110 million, while claims on other non-residents went up by \$90 million.

Suppliers and users of Euro-dollars.

An area break-down of the reporting European countries' combined foreign dollar liabilities and assets as at the end of December 1964 is shown in the next table. The position within the eight European countries is not

Dollar positions of the reporting European banks outside their own area, December 1964.

Vis-à-vis / Position	Gross positions: Liabilities	Gross positions: Assets	Net position
	in millions of dollars		
Other western Europe	800	380	— 420
Eastern Europe	260	460	+ 200
Canada	890	430	— 460
Japan	40	460	+ 420
Latin America	610	300	— 310
Middle East	680	110	— 570
Other	740	120	— 620
Total	4,020	2,260	— 1,760
United States	1,250	3,200	+ 1,950
Grand total	5,270	5,460	+ 190

included because it would not be comparable with the other figures in the table, statistics on liabilities and assets of the individual reporting banks vis-à-vis their residents not being available.

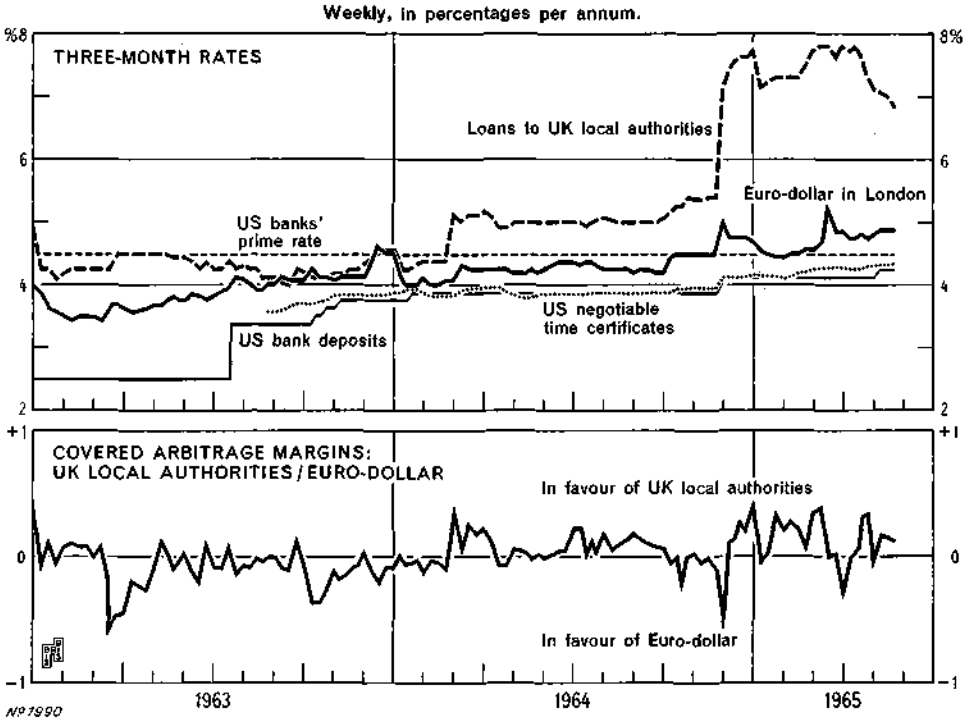
As regards dollars obtained from outside the United States, it appears that the biggest single source of supply was Canada, with $890 million. Substantial amounts were also obtained from all the other areas or countries listed in the table except eastern Europe and Japan. These were the two principal borrowers at the end of 1964, with $460 million each, and on a net basis they were the only borrowers. Africa and Asia (the chief components of the item "other" in the table) and the Middle East were easily the largest net suppliers of dollars. Together with Latin America, these areas supplied a net amount nearly twice as large as Canada and other western Europe put together. A good part of the inflow from Africa and the Middle and Far East probably comes from large American and international firms operating in those areas.

The total net dollar liabilities of the eight European banking systems outside their own area and outside the United States came to $1.8 milliard at the end of 1964. These liabilities were somewhat more than offset by net claims on the United States. Between March and December 1964, when the Euro-dollar market was expanding rapidly, the eight reporting European countries' net foreign dollar liabilities outside the United States went up by $650 million, whilst their net dollar claims on the United States rose by only $100 million. This shows that what they borrow net from outside the United States is not necessarily balanced by what they place net in the United States. The difference is mainly accounted for by their transactions in dollars with their residents, including their own central banks, and the figures clearly indicate that between March and December 1964 these banks made substantial net use of the Euro-dollar market for loans to residents.

Interest rates.

The considerable expansion of the Euro-dollar market which began in the spring of 1964 was not at first accompanied by an increase in Euro-dollar deposit rates. From the end of the third quarter of 1964 onwards, however, there was a marked upward trend and in March 1965 rates were about ½ per cent. higher than six months earlier. On the demand side it was the tightening of credit in Europe, particularly the United Kingdom, that caused the upward movement. Supply, on the other hand, was affected firstly by the increase in US interest rates in late 1964 and afterwards by the measures taken to curtail US capital outflows.

Rates of Interest in London and New York.
Weekly, in percentages per annum.



The July 1963 increase in maximum deposit rates payable by US banks under Regulation Q and the accompanying rise in the US discount rate had pushed up the rate for three-month Euro-dollar deposits to 4¼ per cent. in September 1963. Apart from seasonal fluctuations, it stayed at this level for about a year. In October 1964 renewed demand pressures in Europe pushed the rate up to 4½ per cent. The sterling crisis and the accompanying increases in the UK and US discount rates then brought it temporarily up to 5 per cent. in November, after which it fell back to 4¾ per cent. Euro-dollar rates began to go up again in February 1965 and reached a peak of 5¼ per cent. in mid-March following withdrawals of US funds from Europe. It would appear, however, that this led to a shift of European and other dollars assets to the Euro-dollar market to take advantage of the increase in rates, since the three-month Euro-dollar deposit rate soon eased to $4^7/_8$ per cent. In late May, however, the rate went up again to 5 per cent.

One of the most important demand elements in the Euro-dollar market has been the UK local authorities. Whenever their rates for short-term money have exceeded the corresponding Euro-dollar deposit rates on a covered basis, it has been profitable for banks to take dollars on deposit and switch them into sterling for lending to local authorities. During most of the first five months of 1964 there was very little to choose between Euro-dollar deposit rates on a covered basis and UK local-authority money rates, but during June 1964 a covered arbitrage margin in favour of local authorities began to emerge and continued throughout the third quarter of the year. This margin probably explains why most of the 1964 change in the net dollar position of the UK banks occurred during those months.

The rise in Euro-dollar rates during October 1964 moved the covered arbitrage margin in favour of the Euro-dollar. During December, however, as a side effect of the Bank of England's intervention in the forward exchange market, the margin turned again in favour of the local authorities and remained there practically throughout the first quarter of 1965, when the net dollar liabilities of UK banks rose by $450 million. A seasonal decline in local authorities' money rates turned the margin in favour of the Euro-dollar again from mid-March to mid-April. Subsequently, the decline in the cost of forward cover reversed the position again until end-May, when the widening of the forward discount of sterling swung the margin in favour of New York.

The margins between Euro-dollar rates and comparable US short-term interest rates, which had narrowed substantially in the course of 1963 and early 1964, have since then widened again without, however, reaching the level that had prevailed up to the first half of 1963. The three-month interest premium over US bank certificates of deposit amounted to only about 0.1 per cent. per annum during January and February 1964 but increased to about 0.6 per cent. during the fourth quarter of the year and averaged about 0.5 per cent. during April 1965.

At the same time the narrowing of the spread between the US banks' borrowing and lending rates has continued. The maximum rates payable by US banks under Regulation Q were raised again in November 1964 from 4 to 4½ per cent. for deposits at over 90 days, and from 1 to 4 per cent. for deposits at less than 90 days. Moreover, the three-month Euro-dollar deposit rate has since then exceeded the US banks' prime lending rate of 4½ per cent. So far these developments do not seem to have hurt the Euro-dollar market. First of all, the prime rate is not the full cost of credit; secondly, only a few potential Euro-dollar borrowers could claim that rate; thirdly, the amount of new money that US banks may lend to foreigners is, since February 1965, supervised by the American monetary authorities.

V. THE EUROPEAN MONETARY AGREEMENT.

The European Monetary Agreement, which came into force on 27th December 1958, has two principal features: the European Fund and the Multilateral System of Settlements. It is operated within the framework of the Organisation for Economic Co-operation and Development by the Council of the OECD and a Board of Management. The Bank for International Settlements, acting as Agent, is entrusted with the execution of all financial operations under the Agreement.

As a result of the review of the Agreement carried out during 1964, the Board of Management submitted to the Council of the OECD at the end of 1964 the broad lines of a programme for the examination of certain reforms which might be made in the working of the Agreement. The Council approved this programme, which, however, was to be regarded as neither binding nor exhaustive, and instructed the Board to submit detailed proposals for reforms not later than 30th June 1965, in preparation for a comprehensive review of the Agreement to be carried out by the Organisation before 30th September 1965. Meanwhile, the Agreement was renewed without change for a further year, to 31st December 1965.

This chapter deals with the operations and management of the European Fund and the Multilateral System of Settlements up to March 1965.

1. Operations under the Agreement.

European Fund.

A. Granting and Utilisation of Credits. The table on the next page sets out the credits granted from the European Fund which were outstanding during the year March 1964 to March 1965, together with the interest rates and service charges applied to them. All amounts drawn were paid, and are repayable, in gold. Details of credits relating to earlier periods are contained in the Bank's thirty-fourth Annual Report, Chapter VI.

At the end of March 1964 credits totalling $95 million* were outstanding. This amount represented the total of the third and fourth credits to Turkey, which were fully drawn. A new short-term credit of $20 million was made available to Turkey with effect from 10th April 1964 and was drawn in full on 17th April. This fifth credit was repaid in monthly instalments of $5 million between the end of November 1964 and the end of February 1965. The first repayment instalment of the fourth credit to Turkey, originally due on 31st October 1964, was postponed by decision of the Council of the OECD until 31st October 1965.

* For convenience the dollar sign ($) is used throughout the text of this chapter, whether the amount referred to is in US dollars, gold or EMA units of account.

EMA: Credits granted from the European Fund.

	Amount granted (in millions of units of account)	Period available	Interest on amounts drawn (in percentages per annum)	Service charge on amounts undrawn (in percentages per annum)
Credits repaid since 31st March 1964				
Turkey (3rd credit; 1st tranche) .	20.0	1st April 1962 to 31st March 1965	3.75	0.25
Turkey (5th credit)	20.0	10th April 1964 to dates below*	3.00	0.25
Credits available at 31st March 1965				
Turkey (3rd credit; 2nd tranche) .	25.0	1st August 1962 to 31st July 1965	3.75	0.25
Turkey (4th credit)	35.0	15th March 1963 to dates below*	3.50	0.25
	15.0	30th June 1963 to dates below*		
Turkey (6th credit; 1st tranche) .	20.0	31st March 1965 to dates below*	3.75	0.25
Credit granted but not available at 31st March 1965				
Turkey (6th credit; 2nd and subsequent tranches)	25.0	30th July 1965 to dates below*	3.75	0.25
	5.0	29th October 1965 to dates below*		
	15.0	15th March 1966 to dates below*		
	5.0	31st October 1966 to dates below*		

* The fifth credit was repayable in four instalments of 5 million each, which fell due on 30th November 1964, 31st December 1964, 31st January 1965 and 28th February 1965. The fourth credit is repayable as follows: 10 million on 31st October 1965, 15 million on 15th March 1966, 15 million on 31st October 1966 and 10 million on 15th March 1967. The sixth credit is repayable as follows: ten instalments of 5 million each on 30th June and 31st December 1968, 31st March, 30th June, 30th September and 31st December 1969, and 31st March, 31st May, 29th July and 28th October 1970; one instalment of 15 million on 14th March 1971; and one instalment of 5 million on 30th October 1971.

By the Council's decision of 30th March 1965 a sixth credit, totalling $70 million, was granted to Turkey in various tranches, designed to enable Turkey to refinance part of its outstanding debts to the European Fund, which fall due for repayment between 1965 and 1967. The amounts and the period of availability of the various tranches have been determined in such a way that the cash repayments to be made by Turkey on account of its total debt to the European Fund amount to $15 million in 1965 (including the two instalments, of $5 million each, of the fifth credit repaid at the end of January and February 1965), $10 million in each of the years 1966 to 1968 and $20 million in each of the years 1969 to 1971. The first tranche of $20 million has been made available with effect from 31st March 1965. The second tranche of $25 million and the third tranche of $5 million will be made available as from 30th July and 29th October 1965 respectively. The release of the fourth tranche of $15 million as from 15th March 1966 and of the fifth tranche of $5 million as from 31st October 1966 is subject to a further decision, which the Board of Management will take in due course.

The first tranche of $20 million was drawn on 31st March 1965 and utilised for the refinancing of the first tranche of the same amount of the third credit, which was due for repayment on that date.

On the various credits granted from the European Fund between June 1959 (when the first drawing was made) and March 1965 there were twenty drawings totalling \$239.5 million; of this amount \$144.5 million was repaid. The net amount drawn and outstanding at the end of March 1965 was, therefore, \$95.0 million.

The table on the utilisation of credits granted shows the position at the value date for multilateral settlements (the fifth working day of the following month) for each month of 1963–65 in which changes occurred, and at the value date for December in earlier years. Fuller details of the earlier period were given in the Bank's thirty-fourth Annual Report, Chapter VI.

EMA: Utilisation of credits granted.

At value date for settlements for month	Turkey		Spain		Iceland		Totals		
	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Total credit granted
	in millions of units of account								
1959									
December. . . .	0.5	21.0	51.0	24.0	—	—	51.5	45.0	96.5
1960									
December. . . .	15.0	21.5	76.0	24.0	5.0	7.0	96.0	52.5	148.5
1961									
December. . . .	—	50.0	—	—	7.0	5.0	7.0	55.0	62.0
1962									
December. . . .	—	80.0	—	—	5.0	—	5.0	80.0	85.0
1963									
February	—	60.0	—	—	5.0	—	5.0	60.0	65.0
March	—	95.0	—	—	—	—	—	95.0	95.0
1964									
April	—	115.0	—	—	—	—	—	115.0	115.0
November. . . .	—	110.0	—	—	—	—	—	110.0	110.0
December. . . .	—	105.0	—	—	—	—	—	105.0	105.0
1965									
January.	—	100.0	—	—	—	—	—	100.0	100.0
February	—	95.0	—	—	—	—	—	95.0	95.0
March	—	95.0	—	—	—	—	—	95.0	95.0

B. Calling-up of the capital. There has been no call-up of capital and the amount of contributions paid in has remained unchanged at \$38 million since 7th March 1960.

Multilateral System of Settlements.

Under the EMA certain specific balances must be brought into the Multilateral System of Settlements at the end of each month; these are outstanding balances of interim finance drawn and balances in respect of bilateral payments agreements which provide for credit margins. Balances which a central bank of a member country holds in the currency of another member country may also be brought in at the discretion of the holder.

The value date for settlements in respect of each month is the fifth working day of the following month.

No amounts of interim finance have been drawn during the year under review, and the last of the seven bilateral payments agreements originally notified, that between Greece and Turkey, was terminated with effect from 31st October 1964. Since then the settlement mechanism has not been used by member countries. It continues to play its rôle by giving to central banks of member countries an exchange guarantee in US dollars on holdings of other members' currencies whenever a change occurs in the buying or selling rate of the currency concerned, as described in detail in earlier Annual Reports. On three occasions since the coming into force of the EMA balances on accounts between central banks of member countries have been brought into the settlement at the option of the holder. The balances in question were reported as a result of a modification in the Swedish exchange margins in November 1959 and the Icelandic devaluations of February 1960 and August 1961. In each case the amounts settled were small.

Since the coming into force of the EMA payments to or by the European Fund in respect of the multilateral settlements have totalled $37.8 million.

2. Management of the European Fund and the Multilateral System of Settlements.

The Board of Management of the EMA supervises the execution of the Agreement and advises the Council of the OECD on all related matters. The Board also follows the general economic and financial situation of member countries on the basis of reports made by the Secretariat or by the various committees of the Organisation and, on occasion, by special missions. In discharging these functions the Board meets when necessary, recently about six times a year. M. Hay remains Chairman of the Board.

The Bank for International Settlements, as Agent, presents monthly reports on the operations and the investments of the European Fund and on the working of the Multilateral System of Settlements and also provides the Board with monthly material on the international gold and foreign exchange markets and on the evolution of central-bank reserves.

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

Credits and claims outstanding, which at the opening of business amounted to $35 million representing long-term claims on Norway and Turkey transferred from the EPU, stood at $123.1 million at the end of 1963, of which $95 million represented outstanding drawings from credits and $28.1 million the balance of the long-term claims on Norway and Turkey. The total rose to a high point of $143.1 million in April 1964 as a result of the drawing of the $20 million short-term credit granted to Turkey and then

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

At value date for settlements for month	Assets				Total of Statement	Liabilities	
	Liquid resources	US Treasury account	Uncalled capital of member countries	Credits and claims out-standing		Capital Fund	Income and expendi-ture account
	in millions of units of account						
Opening	113.0	123.5	328.4	35.0	600.0	600.0	—
1959 December	104.4	123.5	302.9	80.0	610.9	607.5	3.4
1960 December	106.4	123.5	297.9	87.5	615.3	607.5	7.8
1961 December	109.2	123.5	297.9	87.8	618.4	607.5	10.9
1962 December	90.4	123.5	297.9	110.5	622.3	607.5	14.8
1963 December	82.1	123.5	297.9	123.1	626.6	607.5	19.1
1964 January	82.2	123.5	297.9	123.1	626.7	607.5	19.2
February	82.1	123.5	297.9	123.1	626.6	607.5	19.1
March	81.6	123.5	297.9	123.1	626.2	607.5	18.7
April	61.7	123.5	297.9	143.1	626.3	607.5	18.8
May	61.8	123.5	297.9	143.1	626.3	607.5	18.8
June	63.7	123.5	297.9	143.1	628.3	607.5	20.8
July	63.5	123.5	297.9	143.1	628.0	607.5	20.5
August	63.5	123.5	297.9	143.1	628.1	607.5	20.6
September	63.6	123.5	297.9	143.1	628.2	607.5	20.7
October	63.7	123.5	297.9	143.1	628.3	607.5	20.8
November	68.8	123.5	297.9	138.1	628.4	607.5	20.9
December	79.3	123.5	297.9	130.6	631.4	607.5	23.9
1965 January	83.8	123.5	297.9	125.6	630.9	607.5	23.4
February	88.9	123.5	297.9	120.6	631.0	607.5	23.5
March	89.1	123.5	297.9	120.6	631.2	607.5	23.7

fell between November 1964 and February 1965 as a consequence of the repayment of this credit and as a result of the fourth amortisation payment of the long-term claims on Norway and Turkey.

The drawing of the short-term credit was entirely met out of the liquid resources, which during the year to March 1965 increased by $7.5 million.

The payment of interest on contributions called up continued on the basis of the method adopted last year, whereby the cumulative amount of interest paid to each country represents 90 per cent. of its total income share at the end of the half-year in respect of which interest is paid. The two distributions made, for the first and second halves of 1964, brought the cumulative amount of interest so far paid to member countries to $4.4 million.

PART III

ACTIVITIES OF THE BANK.

1. Operations of the Banking Department.

The balance sheet of the Bank as at 31st March 1965, certified by the auditors, is reproduced at the end of the present Report.

* * *

BIS: Annual balance-sheet totals
(first section).

Financial years ended 31st March	Total of balance sheet	Movement
	in millions of francs	
1961	3,973	+ 543
1962	4,732	+ 759
1963	4,950	+ 218
1964	5,778	+ 828
1965	7,850	+ 2,072

The total of the first section of the balance sheet as at 31st March 1965 amounted to 7,850,380,538 francs,* against 5,777,990,295 francs on 31st March 1964. It thus showed a rise of 2,072,390,243 francs, which reflects the increasing activity of the Bank in executing the tasks entrusted to it. The increase for the financial year 1963–64 was 827,921,441 francs.

The table shows the development of the end-of-year balance-sheet totals over the past five years.

The following items are not included in the balance sheet: gold under earmark, bills and other securities held in custody for the account of central banks and other depositors; the assets (gold under earmark, bank balances, bills and other securities) held by the Bank as Agent for the Organisation for Economic Co-operation and Development in connection with the European Monetary Agreement, as Depositary under the Act of Pledge concluded with the High Authority of the European Coal and Steel Community and as Trustee or Fiscal Agent for international government loans. As was done in the case of the balance sheet as at 31st March 1964, the amounts in question are shown at the foot of the assets column under the heading "Memorandum accounts (b)". The figures are given in the table on the next page.

The total of the first part of the monthly statement increased steadily during the financial year. From 5,778 million on 31st March 1964 it rose to 6,167 million on 31st May. The 7 milliard mark was passed on 31st December

* Except where otherwise indicated, the term "francs" in this Part signifies *gold* francs. The method of conversion into gold francs (units of 0.290 322 58... grammes fine gold – Article 5 of the Statutes) of the various currencies included in the balance sheet is the same as that adopted in preceding years; the conversion is based on the exchange rates quoted for the various currencies against dollars and on the US Treasury's selling price for gold at the end of the financial year.

BIS: Memorandum accounts (b).

Items	Financial years ended 31st March 1964	1965
	in millions of francs	
Earmarked gold	1,370	1,383
Bank balances	36	39
Bills and other securities	901	780
Total of items not included in the balance sheet	2,307	2,202

1964 and the highest figure since the foundation of the Bank — 7,850 million — was reached at the end of the financial year.

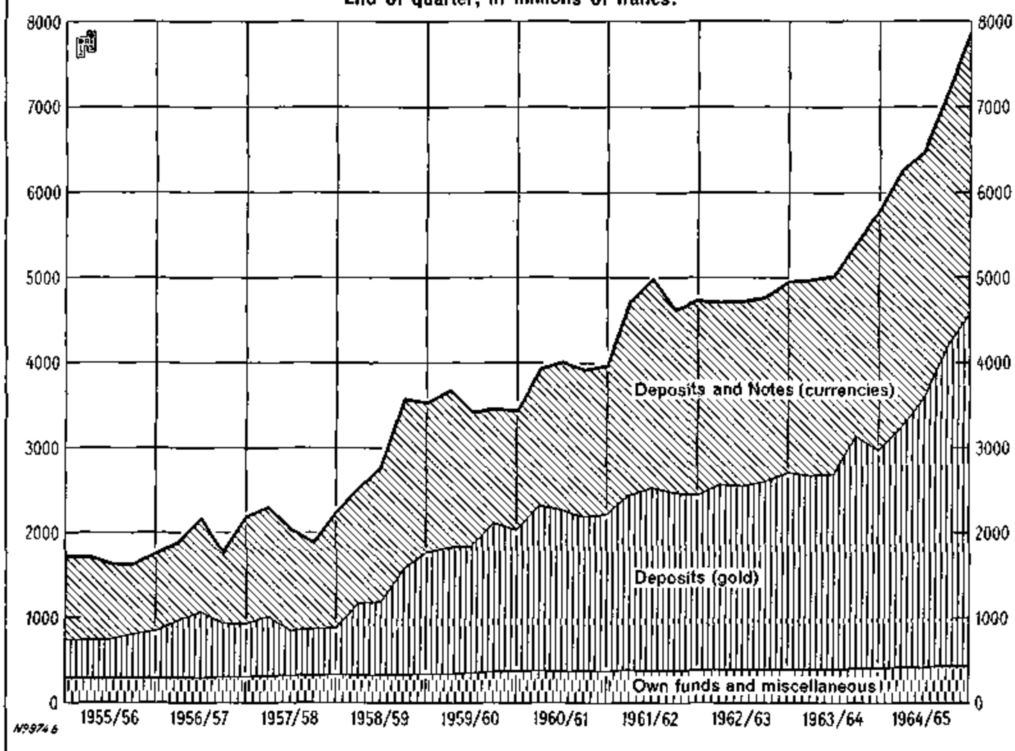
COMPOSITION OF RESOURCES (liabilities).

A. Own funds.

The Bank's Share Capital remained unchanged at 500 million francs, of which 125 million was paid up.

The reserves in the form of the Legal Reserve Fund and the General Reserve Fund rose only slightly, from 25.4 million francs on 31st March 1964 to 25.8 million on 31st March 1965, the Legal Reserve Fund having reached

BIS: Liabilities.
End of quarter, in millions of francs.*



* First part of statement of account.

its statutory ceiling of 10 per cent. of the paid-up capital. As a result of the year's operations (see below, Section 6, "Financial results") the balance of the Profit and Loss Account, which comprises the profit for the financial year ended 31st March 1965 and the balance brought forward from the preceding year, amounted to 31.3 million on 31st March 1965, against 25.1 million a year earlier. The amount of the item "Provision for contingencies" rose from 204 million on 31st March 1964 to 214.5 million on 31st March 1965. For the item "Miscellaneous" the figure was 28.8 million at the beginning of the year and 36.9 million at the end.

Thus, at the end of March 1965 the Bank's own funds (miscellaneous included) amounted to 433 million francs, i.e. slightly less than 6 per cent. of its borrowed funds (7,417 million) and a little more than 5½ per cent. of the total of the balance sheet on the same date (7,850 million). These percentages do not take into account the non-paid-up capital (375 million francs). If the latter amount is included, the percentages of the Bank's own funds as a proportion of its borrowed funds and of the total of the balance sheet would be 11 and 10 respectively.

The following table shows the figures for the Bank's own funds and its borrowed funds and the percentage ratio between them at the end of each of the last five financial years.

BIS: Composition of resources.

Financial years ended 31st March	Own funds	Borrowed funds	Total	Ratio of own funds to borrowed funds	Ratio of own funds to balance-sheet total
	in millions of francs			in percentages	
1961	370	3,603	3,973	10	9
1962	379	4,353	4,732	9	8
1963	389	4,561	4,950	9	8
1964	408	5,370	5,778	8	7
1965	433	7,417	7,850	6	6

B. Borrowed funds.

The following tables show the origin, nature and term of the Bank's resources.

The deposits of central banks increased by over 30 per cent. compared with 31st March 1964 and those of other depositors by about 18 per cent. The item "Notes" relates to notes issued by the Bank and sold to commercial

BIS: Resources, by origin.

Origin	Financial years ended 31st March 1964	1965	Movement
	in millions of francs		
Central banks	4,590	6,034	+ 1,444
Other depositors	780	919	+ 139
Notes	—	464	+ 464
Total	5,370	7,417	+ 2,047

BIS: Resources, by nature and term.

Term	Deposits in gold: Financial years ended 31st March 1964	1965	Movement	Deposits in currencies: Financial years ended 31st March 1964	1965	Movement	Notes: Financial years ended 31st March 1964	1965	Movement
	in millions of francs								
Sight	1,938	3,051	+ 1,113	44	67	+ 23	—	—	—
Not exceeding 3 months	583	982	+ 399	2,243	2,129	— 114	—	330	+ 330
Between 3 and 6 months	—	—	—	455	446	— 9	—	88	+ 88
Between 6 and 9 months	21	72	+ 51	—	51	+ 51	—	46	+ 46
Between 9 and 12 months	20	28	+ 8	21	57	+ 36	—	—	—
Over 1 year	—	—	—	45	70	+ 25	—	—	—
Total	2,562	4,133	+ 1,571	2,808	2,820	+ 12	—	464	+ 464

banks with the agreement of the central banks of the markets concerned and, sometimes, at their suggestion. These securities are denominated in national currencies and are at short term. At the end of the financial year they had been issued on three different markets.

Over the financial year deposits in gold rose by 61 per cent.; deposits in currencies remained at their level of 31st March 1964. While at the beginning of the financial year deposits in gold represented 48 per cent. of the total and deposits in currencies 52 per cent., the position on 31st March 1965 was reversed (ratios of 56 per cent. and 38 per cent. respectively), notes accounting for the balance of 6 per cent.

The increase in deposits in gold was mainly due to a growth of sight accounts. The latter went up by 57 per cent. in the course of the financial year. Deposits at not exceeding three months increased by 68 per cent. and rises were also recorded in the other categories of deposit.

The total of deposits in gold increased without a break from the beginning of the financial year until the end of February 1965. There were fairly wide variations, however, between sight and time deposits. Thus, while the figure for deposits at not exceeding three months stood at 583 million at the beginning of the financial year, it declined to 209 million as at 31st October and then rose to 982 million as at 31st March 1965.

The development of bank deposits in gold was, as in the previous year, often brought about by the Bank itself. Thus, during the first part of the financial year a certain volume of time deposits which the Bank could temporarily not utilise was converted into sight deposits. Later, reverse operations converting sight deposits into time deposits allowed the Bank to have at its disposal resources enabling it, inter alia, to participate in international operations of monetary assistance.

There were far less pronounced movements in deposits in currencies. Sight deposits remained, as usual, within relatively narrow limits (minimum 35 million, maximum 73 million); the fluctuations in the overall total of time deposits were also not very great, the minimum level having been 2,361 million and the maximum 2,824 million. Fresh time accounts of central banks at more than six months were substituted, for an approximately equivalent amount, for deposits at not exceeding three months.

EMPLOYMENT OF RESOURCES (assets).

BIS: Total cash and investments.

Nature	Financial years ended 31st March 1964		1965		Movement	
	in millions of francs					
Cash						
Gold	2,318		3,398		+ 1,080	
Currencies	48	2,366	300	3,698	+ 252	+ 1,332
Investments						
Gold	313		416		+ 103	
Currencies	3,030	3,343	3,667	4,083	+ 637	+ 740
Total						
Gold	2,631		3,814		+ 1,183	
Currencies	3,078	5,709	3,967	7,781	+ 889	+ 2,072

The table above shows the distribution of the Bank's assets according to their nature.

The development of the Bank's gold position is shown in the following table, which gives the maximum and minimum figures for the financial year.

As in the previous financial year, particularly wide fluctuations occurred in the various items reflecting the Bank's gold position. The figure for the Bank's bullion holdings has risen without a break since 30th April 1964, the increase over the year amounting to 1,080 million. Since its investments in gold went up from 313 to 416 million, assets in gold (bullion and investments) increased in aggregate by 1,183 million.

BIS: Gold position.

End of month	Spot position: Gold in bars and coins	Spot position: Investments in gold	Spot position: Deposits in gold	Spot position: Net balance	Forward operations: Net balance	Final net gold position
	in millions of francs					
1964						
March	2,318	313 (min.)	2,562 (min.)	69	245	314
April	2,128 (min.)	314	2,693	— 251	569	318
June	2,622	321	2,820	123	183	306 (min.)
August	2,964	361	3,034	291 (max.)	21 (min.)	312
1965						
February	3,325	409	4,222 (max.)	— 488 (min.)	817 (max.)	329
March	3,398 (max.)	416 (max.)	4,133	— 319	651	332 (max.)

The net balance of forward operations remained consistently positive throughout the year. This was largely due to the conclusion of operations involving forward sales of currencies against gold. Most of these transactions were at short term; they were on a particularly large scale from November until the end of the financial year.

The distribution of the Bank's assets according to their term calls for the following observations.

A. Sight funds, rediscountable investments and investments cashable on demand.

The movements in the item "Gold in bars and coins" (which consisted entirely of gold in bars) have already been commented upon.

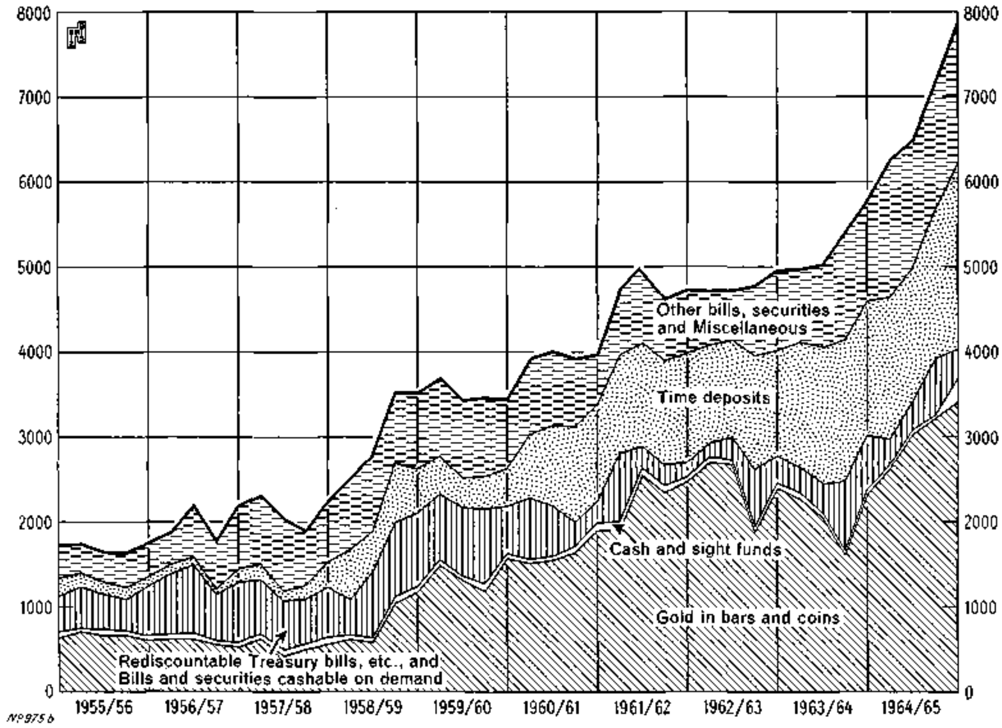
The figure for the item "Cash on hand and on sight account with banks" was 48 million at the beginning of the financial year. It remained around this level (reaching its maximum of 52 million on 31st January 1965) until 28th February (when it touched its minimum of 39 million). As at 31st March it had risen to 300 million as a result of swap operations which provided the Bank with a very substantial volume of sight funds.

On 31st March 1965 total gold and currency holdings represented 47 per cent. of the total of the first part of the Bank's balance sheet, compared with 41 per cent. a year earlier.

There were large fluctuations in the Bank's holdings of "Rediscountable Treasury bills". The total fell from 574 million at the beginning of the financial year to its lowest point of 222 million on 31st August 1964; it subsequently rose to a peak of 598 million on 31st December and then declined to 270 million at the end of the financial year. The wide movements in this item were partly the result of swap operations effected within the

BIS: Assets.

End of quarter, in millions of francs.*



* First part of statement of account.

framework of co-operation between central banks. The Bank, moreover, made considerable use of the mobilisation facilities offered by this type of investment.

Movements in the Bank's holdings of "Bills and securities cashable on demand", investments which can be mobilised at sight, remained within extremely narrow limits, the total never rising above 69 million, its level at the beginning of the financial year, or falling below 62 million (minimum, recorded on 31st December 1964). On 31st March 1965 it stood at 63 million.

At the beginning of the financial year the total of the Bank's sight funds and rediscountable investments, comprising the assets items so far analysed, was thus 3,009 million francs and represented 52 per cent. of the first part of the balance sheet. On 31st March 1965 the corresponding figures were 4,031 million francs and 51 per cent. During this period the percentage of sight deposits on the liabilities side rose from 34 to 40. The Bank's liquidity remains very high.

B. Time deposits and investments.

As in the previous financial year, a substantial part of the fresh currency resources received by the Bank, in the form of deposits or as a result of swap operations, was invested in time deposits and advances or other bills and securities.

The total of the item "Time deposits and advances", which stood at 1,594 million on 31st March 1964, had declined to 1,457 million by 31st May. After remaining at a slightly higher level until towards the end of the year, it registered a fairly appreciable increase at the beginning of 1965, which brought it to 2,191 million on 31st March 1965.

The figures for the item "Other bills and securities" fluctuated somewhat differently. The total of 1,106 million as at 31st March 1964 represented the minimum for the financial year, while the maximum — 1,659 million — was reached at the end of the following month. Subsequent movements in this item were rather less marked and the total at the end of the financial year stood at 1,559 million.

The following table shows the distribution of the Bank's time investments according to their term and compares their composition at the beginning and end of the financial year.

The increase recorded in the total was almost entirely attributable to the rise in time funds invested at not exceeding three months; the decline in investments at between three and six months was roughly counterbalanced by the increase in those at more than nine months. As was the case at the end of the previous financial year, these items include a substantial volume of funds which can be mobilised at very short notice.

BIS: Time deposits and advances and other bills and securities.

Periods	Financial years ended 31st March 1964	1965	Movement
	in millions of francs		
Not exceeding 3 months	1,774	2,795	+ 1,021
Between 3 and 6 months	742	639	− 103
Between 6 and 9 months	63	63	—
Between 9 and 12 months	57	111	+ 54
Over 1 year	64	142	+ 78
Total	2,700	3,750	+ 1,050

As for investments at over six months, the total of which increased somewhat, they represented 7 per cent. of the total shown in the above table on 31st March 1964 and 8 per cent. of the total on 31st March 1965.

* * *

The main features of the development of the Bank's activity mentioned in the last Annual Report — an increase in the resources entrusted to it, particularly in gold, and a steady growth of swap transactions in currencies and in gold against currencies — were again the mainsprings of the further very substantial expansion of its operations during the past financial year. In addition, there were the issues and sales of notes, which were shown in the balance sheet at 31st March 1965 at 464 million.

The total volume of the Bank's operations amounted, in fact, to the equivalent of 72.2 milliard francs in 1964–65, compared with 58.9 milliard in 1963–64 and 38.6 milliard in 1962–63.

While there was a further increase in both the number and volume of swap transactions in currencies, in particular within the framework of international operations, there was also a substantial growth of gold transactions, which had already shown a very marked recovery in the previous financial year. Apart from normal purchases and sales of gold, a series of gold swaps against currencies was concluded on an increasing scale with a certain number of central banks. These operations enabled the Bank to lend its assistance in currency conversions and in credit operations within the framework of co-operation between monetary authorities.

Geographical exchanges of gold involving substantial amounts were also effected for the benefit of the members of the Bank.

The high profits for the past financial year were the result of various factors, but were in general attributable to the expansion of the Bank's resources.

As in previous years, the second section of the balance sheet consists solely of the assets and liabilities connected with the execution of the Hague Agreements of 1930. The total for the section remains unchanged at 297,200,598 francs.

2. The Bank as Trustee and Fiscal Agent for international government loans.

In conformity with the agreements in force the Bank continued in the year under review to perform the functions of Fiscal Agent of the Trustees for the new bonds of the German External Loan 1924 (Dawes Loan) and of Trustee for the new bonds of the German Government International Loan 1930 (Young Loan) which were issued by the Government of the Federal Republic of Germany in accordance with the London Agreement on German External Debts of 27th February 1953.

The financial year 1964–65 ended for the Dawes Loan on 15th April 1965 and for the Young Loan on 1st June 1965. The interest in respect of the financial year 1964–65 amounted to the equivalent of about 12.7 million francs for the Dawes Loan and of about 37.0 million francs for the Young Loan; it was duly paid to the Bank and distributed by the latter among the Paying Agents. Redemption of both loans was effected in respect of the financial year 1964–65 partly by purchases of bonds on the market and partly by drawings.

The question whether the exchange guarantee attached to the Young Loan under the terms of the London Agreement is applicable in the case of the revaluation of the Deutsche Mark in 1961 has not yet been settled. The matter is in the hands of the governments of the countries in which issues of the Loan were made.

German External Loan 1924
(Dawes Loan).

Issue	Currency	Nominal value			
		Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years: 1958–59 to 1963–64	1964–65	Balance after redemption
		Conversion bonds			
American . . .	$	44,095,000	9,307,000	1,837,000	32,951,000
Belgian . . .	£	583,100	89,500	16,600	477,000
British	£	8,276,400	1,272,600	230,500	6,773,300
Dutch.	£	1,319,100	183,400	38,000	1,097,700
French	£	1,927,200	292,400	53,400	1,581,400
Swedish . . .	S.kr.	14,209,000	1,994,000	385,000	11,830,000
Swiss	£	1,130,500	169,700	31,600	929,200
Swiss	Sw.fr.	8,251,000	1,127,000	222,000	6,902,000
		Funding bonds			
American . . .	$	8,204,000	1,429,000	223,000	6,552,000
Belgian	£	157,700	28,500	4,400	124,800
British	£	2,231,800	397,300	61,300	1,773,200
Dutch.	£	290,800	44,400	8,400	238,000
French	£	498,300	89,700	13,800	394,800
Swiss.	£	115,000	19,800	3,400	91,800
Swiss.	Sw.fr.	415,000	68,000	11,000	336,000

German Government International Loan 1930
(Young Loan).

Issue	Currency	Nominal value*			
		Bonds issued	Bonds purchased or drawn for redemption in respect of the financial years 1958–59 to 1963–64	Bonds purchased or drawn for redemption in respect of the financial years 1964–65	Balance after redemption
		Conversion bonds			
American . . .	$	55,416,000	3,796,000	746,000	50,874,000
Belgian	B.fr.	202,694,000	13,926,000	2,656,000	186,112,000
British	£	17,701,600	1,203,600	231,200	16,266,800
Dutch	Fl.	52,411,000	3,447,000	715,000	48,249,000
French	Fr.fr.	444,906,000	30,218,000	5,845,000	408,843,000
German . . .	DM	14,467,000	976,000	189,000	13,302,000
Swedish . . .	S.kr.	92,763,000	6,342,000	1,213,000	85,208,000
Swiss	Sw.fr.	58,379,000	4,003,000	764,000	53,612,000
		Funding bonds			
American . . .	$	8,994,000	627,000	111,000	8,256,000
Belgian	B.fr.	45,643,000	3,220,000	571,000	41,852,000
British	£	4,223,500	295,500	52,700	3,875,300
Dutch	Fl.	8,464,000	572,000	115,000	7,777,000
French	Fr.fr.	98,031,000	6,687,000	1,221,000	90,123,000
German . . .	DM	413,000	29,000	5,000	379,000
Swedish . . .	S.kr.	6,014,000	422,000	75,000	5,517,000
Swiss	Sw.fr.	1,405,000	98,000	17,000	1,290,000

* Nominal value on 1st May 1965 established in accordance with the provisions of the London Agreement on German External Debts of 27th February 1953 but without taking account of the revaluation of the Deutsche Mark in March 1961.

The Bank is also Trustee for the assented bonds of the Austrian Government International Loan 1930 and for the coupons of that loan which the Federal Republic of Germany has undertaken to pay to the extent of 75 per cent. of the nominal value. In both cases servicing was carried out in conformity with the relevant agreements.

The following table shows the position as regards the assented bonds of the loan and their redemption.

Austrian Government International Loan 1930.

Issue	Currency	Nominal value			
		Bonds assented	Bonds purchased or drawn for redemption in respect of the financial years 1959 to 1963	Bonds purchased or drawn for redemption in respect of the financial years 1964	Balance after redemption
American . . .	$	1,667,000	316,000	70,000	1,281,000
Anglo-Dutch .	£	856,600	158,700	34,300	663,600
Swiss	Sw.fr.	7,102,000	1,108,000	246,000	5,748,000

3. The Bank as Depositary under the terms of the Act of Pledge concluded with the High Authority of the European Coal and Steel Community.

The Bank has continued, in conformity with an Act of Pledge concluded between it and the High Authority of the European Coal and Steel Community on 28th November 1954, to perform the functions of Depositary in respect of the loans of the High Authority which are secured in accordance with the provisions of that Act.

The total amount of these secured loans was originally equivalent to about 817 million francs. Repayments by the High Authority up to 1st April 1965 amounted to the equivalent of about 213 million francs, so that the

Secured loans of the High Authority of the European Coal and Steel Community.

Series of Secured Notes of the High Authority	Dates of issue	Countries of issue	Lenders	Original amounts of loans		Amounts unredeemed on 1st April 1965	Rates of interest %	Year of final maturity
1st	1954	United States	US Government	$	100,000,000	76,800,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	160,800,000	3½	1982
3rd	1955	Germany	Rheinische Girozentrale und Provinzialbank, Düsseldorf	DM	25,000,000	18,780,000	3¾	1981
			Landesbank für Westfalen (Girozentrale), Münster	DM	25,000,000	18,780,000	3¾	1981
4th	1955	Luxemburg	Caisse d'Epargne de l'Etat, Luxemburg	B.fr.	20,000,000	16,080,000	3½	1982
				L.fr.	5,000,000	—	—	—
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[1]	2,206,290	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	38,750,000	4¼	1974
7th[2]	1957	United States	Public issue	$	25,000,000	19,300,000	5½	1975
10th	1957	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	91,507,178	5⅜	1982
11th[2]	1958	United States	Public issue	$	35,000,000	32,700,000	5	1978
13th	1960	United States	Public issue	$	25,000,000	25,000,000	5⅜	1980
14th	1960	United States	Public issue	$	3,300,000	—	—	—
				$	3,300,000	—	—	—
				$	3,400,000	3,400,000	5	1965
15th	1961	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	100,000,000	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	50,000,000	4½	1981

[1] This loan, which was contracted in French francs, was converted into Deutsche Mark in 1959. The original amount was 350,000,000 old French francs. [2] The Secured Notes of the 8th, 9th and 12th Series have been entirely redeemed.

total amount outstanding was reduced to the equivalent of about 604 million francs. Further particulars of these loans are given in the preceding table.

The High Authority has used the proceeds of these loans to grant credits in the member countries of the European Coal and Steel Community.

During the financial year 1964–65 the Bank received from the borrowers and distributed among the Paying Agents the equivalent of about 32 million francs in respect of interest and the equivalent of about 39 million francs in respect of redemption. Anticipatory capital repayments by borrowers were utilised by the High Authority partly to reduce its outstanding loan liabilities and partly to grant new credits.

The High Authority has also raised loans which are not secured in accordance with the Act of Pledge, but the Bank has no function in connection with such loans.

4. The Bank as Agent for the Organisation for Economic Co-operation and Development (European Monetary Agreement).

The introduction and working of the European Monetary Agreement have been described in previous Annual Reports of the Bank and the description is brought up to date in Chapter V of Part II of the present Report.

The Bank continued to act as Agent for the execution of the financial operations of the EMA under the Organisation for Economic Co-operation and Development. The expenses of the Bank in this capacity amounted to 376,221 francs in the twelve months to March 1965; this amount has been duly reimbursed by the Organisation (as shown in the Profit and Loss Account for the financial year ended 31st March 1965).

5. Development of co-operation between central banks and international organisations.

Co-operation between central banks in the field of research and exchanges of information has been strengthened. In addition to the regular meetings of the Board of Directors, the Bank has continued to organise a number of meetings of central-bank experts either to study economic and monetary problems of general interest or to examine specific questions, such as the development of the gold and Euro-currency markets. The Bank's services have assisted in the work of these groups.

The BIS also assumed during the year the functions referred to in the Ministerial Statement of the Group of Ten. In conformity with this statement, which dates back to 1st August 1964, the members of the Group provide the Bank for International Settlements with statistical data bearing on the means utilised to finance surpluses or deficits on their external account. These statistical data are circulated to all participants and to Working Party 3 of the OECD. The Governors of the central banks of the Group, when they meet at the Bank, also exchange information at the earliest practicable stage on undertakings between members of the Group for new or enlarged credit facilities. Thus the basis has been created for multilateral surveillance of the various elements of liquidity creation. The past year has already shown how useful this co-operation can be.

Finally, the Bank has been associated in the work carried out by the Group of Ten, in particular its Study Group on the creation of reserve assets.

The development of co-operation between central banks has also strengthened the relations between the BIS, on the one hand, and the OECD and the IMF, on the other, by extending their collaboration to new fields.

6. Financial results.

The accounts for the thirty-fifth financial year ended 31st March 1965 showed a surplus of 34,519,144 francs. The comparable figure for the preceding financial year was 27,417,055 francs.

From the year's surplus the Board of Directors has decided that it is necessary to transfer 1,500,000 francs to the provision for exceptional costs of administration and 10,500,000 francs to the provision for contingencies; the net profit for the year thus amounts to 22,519,144 francs and, with the addition of the balance of 8,744,892 francs brought forward from the previous year, there is a sum of 31,264,036 francs available.

The Board of Directors recommends that the present General Meeting should distribute, as last year, a dividend of 37.50 francs per share, involving a distribution of 7,500,000 francs. The Board also proposes that, as an exceptional measure, a lump sum should again be applied to the reduction of the amount of the undeclared cumulative dividend. This sum, which has been fixed at 14,000,000 francs, will represent an extraordinary distribution of 70 francs per share. The total distribution will thus amount this year to 107.50 francs, payable on 1st July 1965 in the amount of 153.60 Swiss francs per share. As regards the shares in respect of which the dividend cannot be paid on that date, the conversion to Swiss francs will be effected on the day of payment. The balance carried forward will be 9,764,036 francs.

The amount of the undeclared cumulative dividend will, as a result of this distribution, be reduced from 199.47 to 129.47 francs per share. It is recalled that the provisions of the Statutes relating to the cumulative dividend give shareholders the assurance that no remuneration will be paid in respect of the long-term deposits made under the Hague Agreements of 1930 by the Creditor Governments and by the German Government unless the shareholders have received in full the dividend permitted by Article 53(b) and (c) of the Statutes.

The accounts of the Bank and its thirty-fifth Annual Balance Sheet have been duly audited by Messrs. Price Waterhouse & Co., Zurich. The Balance Sheet, the Report of the Auditors and the Profit and Loss Account will be found at the end of this Report.

7. Changes in the Board of Directors and in the Management.

The mandate of Dr. M. W. Holtrop as Chairman of the Board and President of the Bank being due to expire on 30th June 1964, he was re-elected to these offices under Article 39 of the Statutes at the meeting of the Board held on 8th June 1964 for a period of three years ending on 30th June 1967.

Sir Otto Niemeyer, who had been Vice-Chairman of the Board since 1946, did not offer himself for re-election when his mandate came to an end on 8th December 1964. In February 1965 Sir Otto Niemeyer resigned as a member of the Board, a post which he had held since June 1932. The members of the Board, at its meetings held on 14th December 1964 and on 8th March 1965, paid him a warm tribute for the very valuable services he had given to the Bank over so many years.

At the meeting of the Board held on 11th January 1965 M. Maurice Frère, who was Chairman of the Board from 1946 to 1958 and President of the Bank from 1948 to 1958, was elected Vice-Chairman of the Board for a period of three years as from 1st January 1965 to 31st December 1967.

At the meeting of the Board held on 12th April 1965 the Chairman announced that Lord Cromer had appointed Mr. M. J. Babington Smith as a member of the Board to fill the vacancy caused by the resignation of Sir Otto Niemeyer. This appointment was made under Articles 28(2) and 29 of the Statutes for the unexpired period of Sir Otto Niemeyer's term of office ending on 6th May 1966. He was welcomed by the Chairman on his first attendance at a meeting of the Board.

The mandates of Herr Blessing, President of the Deutsche Bundesbank, and Dr. Brinckmann as members of the Board were due to expire on 31st March and 31st May 1965 respectively. The Chairman of the Board announced at the meeting held on 8th March 1965 that the ex officio members of the Board had, under Article 28(2), paragraph 3, of the Statutes, re-elected Herr Blessing and Dr. Brinckmann for further periods of three years ending on 31st March and 31st May 1968 respectively.

The mandate of Dr. W. Schwegler, who had been elected to the Board under Article 28(3) of the Statutes, being due to expire on 31st March 1965, he was re-elected at the meeting of the Board held on 8th March 1965 for a further period of three years ending on 31st March 1968.

At the meeting of the Board held on 11th January 1965 the Chairman announced that M. Brunet had appointed M. Gilbert Bouchet, General Manager of the Foreign Department of the Bank of France, as his second Alternate in the place of M. Julien-Pierre Koszul, who had retired from the Bank of France. The Bank is grateful to M. Koszul for his valuable services over several years.

Mr. F. G. Conolly, a Manager of the Bank since 1948, retired at the end of March 1965. At the Board meeting held on 8th March 1965 the

Chairman, on behalf of the Board, expressed his gratitude for Mr. Conolly's excellent work and devoted services over more than thirty-three years.

At its meeting held on 8th March 1965 the Board appointed Dr. Antonio Rainoni, formerly Assistant Manager in the Monetary and Economic Department, a Manager of the Bank as from 1st April 1965.

Mr. Malcolm Parker, Administrative Assistant Manager, retired at the end of November 1964. At the Board meeting held on 9th November 1964 the Chairman thanked him for his valuable and faithful services.

At the Board meeting held on 9th November 1964 the Chairman announced that Mr. Jan Knap, formerly a Sub-Manager, had been appointed Assistant Manager as from 1st December 1964.

CONCLUSION.

While the economic situation in both North America and western Europe over the past year was generally one of high activity, the problems that policy had to contend with vis-à-vis both the domestic economy and the balance of payments were quite different in the United States, the United Kingdom and the continental countries.

In the United States domestic activity was given a strong impulse by a large reduction in taxes, with the result that output continued to expand at a rapid rate. It is noteworthy that the present expansion phase of the business cycle has now lasted for four and a half years, making it the longest peace-time upswing in US history. This record has been made possible not only by well-designed public policy, aimed at stimulating market forces, but by the well-balanced response of the private economy itself. Wage increases have generally remained within the limits of the rise in productivity, and price stability has been maintained. In addition, the increases in the various components of investment and consumption have not shown the kind of distortions that often marked previous business cycles. While unemployment is still a problem, its level has been significantly reduced from that of a year ago. At the present time the outlook is for a continued expansion.

The main problem for the United States in the past year was again with respect to the balance of payments. For most of the year the situation appeared to be much improved, as the current account showed a more favourable balance and as the interest equalisation tax on purchases of foreign securities seemed to be keeping the outflow of capital within bounds. But the capital outflow increased substantially in the fourth quarter of 1964, particularly in the form of bank lending, and clearly called for new measures to restore a reasonable balance. The method chosen by the authorities in February 1965 was a programme of voluntary restraint covering not only banks but the external activities of other financial institutions and large industrial firms. The initial response to this programme has been favourable, but it would be premature to say that its success in solving the persistent balance-of-payments problem is already assured. For one thing, the immediate improvement was achieved in large part by a reflux of funds from abroad which were at high levels after the large outflow of the previous four months. For another, an enduring success for the programme implies not only reaching a balance in the external accounts but strengthening the US reserve position. A persistent effort will be needed to ensure this result.

In the United Kingdom economic policy over most of the past year was aimed at maintaining an adequate rate of growth of domestic activity, so as to escape from the relative stagnation that had characterised so much of the past decade. In view of the fact that industry was at some disadvantage in international competition, it was recognised that this effort involved a risk to the balance of payments. However, it was hoped that by combining larger gains in productivity with restraint on wage increases the external deficit would be kept within bounds and that it would be overcome by increased competitiveness without too long a delay.

However, the forces of demand proved to be more powerful than anticipated. In particular, there were unusually large increases in both public and private investment, as well as in purchases of durable consumer goods, especially motor-cars. This situation led to a large external deficit as imports soared and the export potential was restricted by heavy domestic demand. At the same time, unemployment declined sharply and the pressure on the labour market was shown by a much higher rate of wage increases.

The authorities first tried to deal with the situation by acting primarily on the external deficit through a temporary surcharge on imports — still hoping that the basic position of sterling would be restored by longer-term measures. But this approach led to a loss of confidence in sterling and to a large flight of funds from London. Very substantial outside assistance was required to maintain the exchange stability of the currency and Bank rate was raised to 7 per cent. to help stem the outflow.

With the budget speech of April 1965, it may be said that a policy of restraint to demand became definite and the tax increases in the budget were soon followed up by measures to contain sharply the expansion of bank credit. In addition, very strong assurances were given of the government's intention to maintain the parity of sterling. In these circumstances the market position of the currency has improved — and indeed the current external deficit is much less than it was a year ago. However, wages have been increasing at a high rate and a deficit in the balance of payments well into 1966 is anticipated. Hence, it is clear that the restrictive policy will have to be maintained in the months ahead, and it may have to be strengthened.

In continental western Europe the authorities over the past year have generally been maintaining or reinforcing measures to bring inflationary pressures under control. This effort has had some degree of success, although the situation cannot yet be said to be satisfactory. Wholesale prices are much closer to stability than was the case a year ago and the rise in consumer prices is perhaps only half of what it was. For wages, however, the rate of increase is still quite large, despite the rather easier situation in the labour market in some countries. This condition points to the need for all parties to co-operate in an effective incomes policy to enable all to benefit by adequate growth with financial stability. Many of the countries have reached the point where further deterioration in their competitive position could involve difficult balance-of-payments problems.

For some time now the expansion of production in many continental countries has been much more moderate, partly as a result of steps taken to curb inflation, and it is evident that its increase this year will be less than last year. There are countries such as Italy and, to a lesser extent, France where there is now an unused margin of available resources. Policy steps to stimulate fuller resource utilisation have been limited, however, by the danger of setting off a new round of price increases.

In the past few months the payments imbalance between the United States and Europe has been considerably lessened – as a direct result of the voluntary restraint programme in the United States as well as of special measures in various continental countries to limit the inflow of capital. While one can see the necessity at times for using such direct steps to keep control over capital flows, one must be concerned about these limitations on free convertibility. It is not only that their effectiveness could weaken after a time but that they imply that capital flows, more so than other elements in the balance of payments, are the appropriate route for adjusting overall imbalances. Hence, there is a danger of growing distortions if the underlying disequilibrium in interest rates and the availability of capital funds is neglected. In the United States the active domestic expansion generated by the tax reductions gave the opportunity for tighter monetary policy to help the external position, but little was done along this line. In Europe, similarly, the need for domestic restraint might well have been met to a greater extent by fiscal and budgetary measures, thereby allowing a higher priority in monetary policy for external considerations. As it happened, however, little correction of the international monetary disequilibrium could be expected from the rising trends of interest rates which occurred.

This point is relevant to the debate that has been going on for several years over the international monetary system — with few signs that opposing points of view are being resolved. As a variety of arrangements have been utilised to finance the deficit countries, it has been abundantly clear that the difficulties were not in any shortage of liquidity but in the process of adjusting the principal deficit and surplus positions. And as the process of adjustment cannot be expected to take place automatically, the weakness has been in the national policy measures directed to this end. Primary responsibility in this matter will always rest on the deficit countries, although surplus countries cannot escape their share of the task if the financial system is to function effectively.

For the first time in some years there is some prospect of a substantial reduction in the payments imbalance between the United States and Europe. If this occurs, the potential problem of inadequate means for increasing reserve assets may come closer to reality. From the standpoint of aggregate reserves, it would be likely to take considerable time before the system as a whole were short of liquidity. But from the standpoint of the annual margin for increasing reserves, various countries might feel themselves adversely affected after a rather shorter time. A situation of balance in the external position of the reserve currencies would provide the conditions for more fruitful discussion of this problem.

Respectfully submitted,

Gabriel Ferras

General Manager.

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AS AT 31st MARCH 1965

BALANCE SHEET

ASSETS — IN GOLD FRANCS (UNITS OF 0.290 322 58...

			%
Gold in bars and coins ...		3,397,865,567	43.3
Cash on hand and on sight account with banks ...		300,198,862	3.8
Rediscountable Treasury bills ...		270,274,959	3.4
Bills and securities cashable on demand ...		62,756,261	0.8
Time deposits and advances			
Not exceeding 3 months ...	1,572,282,567		20.0
» » » » (gold) ...	3,405,463		0.1
Between 3 and 6 months ...	528,668,158		6.7
Between 6 and 9 months ...	20,711,786		0.3
Between 9 and 12 months ...	56,674,603		0.7
Over 1 year ...	8,591,459		0.1
		2,190,334,036	
Other bills and securities			
Gold			
Not exceeding 3 months ...	284,223,958		3.6
Between 3 and 6 months ...	83,207,638		1.1
Between 6 and 9 months ...	26,770,739		0.3
Between 9 and 12 months ...	19,036,823		0.2
Currencies			
Not exceeding 3 months ...	935,403,232		11.9
Between 3 and 6 months ...	27,450,592		0.4
Between 6 and 9 months ...	15,325,381		0.2
Between 9 and 12 months ...	34,856,310		0.5
Over 1 year ...	133,022,928		1.7
		1,559,297,601	
Miscellaneous assets ...		1,360,029	0.0
Buildings and equipment ...		1	0.0
Own funds employed in execution of the Hague Agreements of 1930 for investment in Germany (see below) ...		68,291,223	0.9
		7,850,380,538	100

Execution of Hague

Funds invested in Germany (see Note 2)	
Claims on Reichsbank and Golddiskontbank; bills of Golddiskontbank and Railway Administration and bonds of Postal Administration (matured) ...	221,019,558
German Treasury bills and bonds (matured) ...	76,181,040
	297,200,598

MEMORANDUM ACCOUNTS

a. Forward gold operations:	
Net balance: gold receivable (currencies to be delivered) ...	650,498,448
b. Funds, bills and other securities administered or held by the Bank for account of third parties:	
Earmarked gold ...	1,382,422 831
Bank balances ...	38,886,250
Bills and other securities ...	780,407,060

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 of the and explanations we have required. Subject to the value of the funds invested in Germany, we report that in drawn up so as to exhibit a true and correct view of the state of the Bank's affairs according to the best of *above-described gold franc equivalents* of the currencies concerned.

ZURICH, 5th May 1965.

AS AT 31st MARCH 1965

GRAMMES FINE GOLD — ART. 5 OF THE STATUTES) LIABILITIES

			%
Capital			
Authorised and issued 200,000 shares, each of 2,500 gold francs	500,000,000		
of which 25% paid up ...		125,000,000	1.6
Reserves			
Legal Reserve Fund ...	12,500,000		
General Reserve Fund ...	13,342,650		
		25,842,650	0.3
Deposits (gold)			
Central banks			
Between 9 and 12 months ...	27,583,556		0.4
Between 6 and 9 months ...	72,518,871		0.9
Not exceeding 3 months ...	843,674,108		10.7
Sight ...	2,706,492,795		34.5
Other depositors			
Not exceeding 3 months ...	137,820,684		1.8
Sight ...	344,825,556		4.4
		4,132,915,570	
Deposits (currencies)			
Central banks			
Over 1 year ...	70,266,687		0.9
Between 9 and 12 months ...	56,929,960		0.7
Between 6 and 9 months ...	35,266,051		0.4
Between 3 and 6 months ...	396,425,706		5.1
Not exceeding 3 months ...	1,796,412,899		22.9
Sight ...	28,882,399		0.4
Other depositors			
Between 6 and 9 months ...	15,487,615		0.2
Between 3 and 6 months ...	49,506,159		0.6
Not exceeding 3 months ...	333,208,702		4.2
Sight ...	37,619,310		0.5
		2,820,005,488	
Notes			
Between 6 and 9 months ...	45,610,505		0.6
Between 3 and 6 months ...	88,152,784		1.1
Not exceeding 3 months ...	330,156,420		4.2
		463,919,709	
Miscellaneous ...		36,933,085	0.5
Profit and Loss Account			
Balance brought forward from the financial year ended 31st March 1964 ...	8,744,892		
Profit for the financial year ended 31st March 1965 ...	22,519,144		
		31,264,036	0.4
Provision for contingencies ...		214,500,000	2.7
		7,850,380,538	100

Agreements of 1930

Long-term deposits	
Annuity Trust Account deposits of Creditor Governments (see Note 3) ...	152,606,250
German Government deposit ...	76,303,125
	228,909,375
Own funds employed in execution of the Agreements (see above) ...	68,291,223
	297,200,598

NOTE 1 — For Balance Sheet purposes the currency amounts of the assets and liabilities have been converted into gold francs on the basis of quoted or official rates of exchange or in accordance with special agreements applicable to the respective currencies.

NOTE 2 — Under an Arrangement dated 9th January 1953 between the Government of the Federal Republic of Germany and the Bank, which forms a part of the Agreement on German External Debts of 27th February 1953, it has been agreed that the Bank will not demand prior to 1st April 1966 the reimbursement of the principal of its investments in Germany described above, including arrears of interest thereon at 31st December 1952.

NOTE 3 — The Bank has received confirmation from Governments whose deposits amount to the equivalent of 149,920,380 gold francs that they cannot demand from the Bank, in respect of their claims on the Annuity Trust Account, the transfer of amounts greater than those of which the Bank can itself obtain reimbursement and transfer by Germany in currencies approved by the Bank.

Bank for the financial year ended 31st March 1965, and we report that we have obtained all the information our opinion the above Balance Sheet and Memorandum accounts, together with the Notes thereon, are properly our information and the explanations given to us and as shown by the books of the Bank, as expressed in the

PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT

for the financial year ended 31st March 1965

		Gold francs
Net income from the use of the Bank's own funds and the deposits entrusted to it		41,328,706
Commission earned as Trustee, etc. ...		705,958
		42,034,664
Costs of administration:		
Board of Directors — fees and travelling expenses ...	301,786	
Executives and staff — salaries, pension contributions and travelling expenses ...	6,151,635	
Rent, insurance, heating, electricity ...	29,409	
Renewals and repairs of buildings and equipment ...	462,833	
Office supplies, books, publications, printing ...	347,515	
Telephone, telegraph and postage ...	194,741	
Experts' fees (auditors, interpreters, economists, etc.)	65,782	
Cantonal taxation ...	35,149	
Miscellaneous ...	302,891	
	7,891,741	
Less: Amounts recoverable for expenses as Agent of the Organisation for Economic Co-operation and Development (European Monetary Agreement) ...	376,221	7,515,520
		34,519,144
The Board of Directors has decided that it is necessary to transfer		
to the provision for exceptional costs of administration	1,500,000	
to the provision for contingencies ...	10,500,000	12,000,000
NET PROFIT for the financial year ended 31st March 1965 ...		22,519,144
Add: Balance brought forward from the preceding year ...		8,744,892
Total profits available ...		31,264,036
which the Board of Directors recommends to the Annual General Meeting called for 14th June 1965 should be dealt with as follows:		
Dividend of 37.50 gold francs, plus an amount of 70.— gold francs, which increases the distribution to 107.50 gold francs per share and reduces the amount of the undeclared cumulative dividend from 199.47 gold francs to 129.47 gold francs per share ...		21,500,000
Balance to be carried forward ...		9,764,036
		31,264,036

BOARD OF DIRECTORS

Dr. M. W. Holtrop, Amsterdam	Chairman of the Board of Directors, President of the Bank
Maurice Frère, Brussels	Vice-Chairman

Hubert Ansiaux, Brussels
M. J. Babington Smith, London
Karl Blessing, Frankfurt a/M.
Dr. Rudolf Brinckmann, Hamburg
Jacques Brunet, Paris
Dr. Guido Carli, Rome
The Earl of Cromer, London
Henri Deroy, Paris
Dr. Donato Menichella, Rome
Dr. Walter Schwegler, Zurich
Per Åsbrink, Stockholm

Alternates

Dr. Paolo Baffi, Rome, or
Prof. Pietro Stoppani, Rome
Bernard Clappier, Paris, or
Gilbert Bouchet, Paris
M. H. Parsons, London, or
R. G. Raw, London
Cecil de Strycker, Brussels

MANAGEMENT

Gabriel Ferras	General Manager
Dr. Milton Gilbert	Economic Adviser, Head of the Monetary and Economic Department
Dr. Antonio d'Aroma	Secretary General, Head of Department
Dr. Hans H. Mandel	Head of the Banking Department
D. H. Macdonald	Manager
Georges Janson	Manager
Henri Guisan	Legal Adviser
Dr. Antonio Rainoni	Manager

Georges Royot	Assistant Manager
Jan Knap	Assistant Manager