BANK FOR
INTERNATIONAL SETTLEMENTS

THIRTY-NINTH ANNUAL REPORT

1st APRIL 1968 — 31st MARCH 1969

BASLE

9th June 1969

TABLE OF CONTENTS

LIST OF TABLES AND GRAPHS

(Graphs are indicated by an asterisk)

Page

IV. Gold, Reserves and Foreign Exchange

V. The Euro-Currency Market

VI. The European Monetary Agreement

Page

VII. Activities of the Bank

THIRTY-NINTH ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 9th June 1969.

Gentlemen,

I have the honour to submit herewith the Annual Report of the Bank for International Settlements for the thirty-ninth financial year, which began on 1st April 1968 and ended on 31st March 1969.

After deduction of the transfers to provisions, the net profit amounted, as last year, to 45,000,000 gold francs.

The Board of Directors again recommends that, in application of Article 53 of the Bank's Statutes, the present General Meeting should allocate 15 million gold francs for the payment of the dividend, 15 million gold francs to the General Reserve Fund and 15 million gold francs to the Free Reserve Fund. If this recommendation is accepted, the dividend will remain unchanged at 75 gold francs and will be payable in Swiss francs in the amount of 107.15 Swiss francs per share. It will consist of the cumulative dividend of 6 per cent. and the maximum supplementary dividend of 6 per cent. provided for by the Bank's Statutes.

Chapter I of this Report surveys developments in the four countries — Germany, France, the United Kingdom and the United States — to which the main sources of imbalance in 1968 can be traced. The next three chapters review developments in various countries in the field of credit, foreign payments, gold production, monetary reserves and foreign exchange. The fifth chapter gives a survey of events in the Euro-currency market and the sixth a review of the operations of the European Monetary Agreement. Chapter VII concerns the Bank's rôle in promoting co-operation between central banks, its current activities and the functions it performs on behalf of the European Coal and Steel Community and as Trustee and Fiscal Agent for international loans.

I. KEY SOURCES OF IMBALANCE.

The unpegging of the market price for gold by ending sales from official reserves in March 1968 effectively overcame one source of trouble in the international payments picture. The crisis atmosphere quickly evaporated and there was some prospect that a period of calm might prevail. But new difficulties arose, partly fortuitous, which produced major exchange crises during the past year. The main sources of imbalance have been in four countries — Germany, France, the United Kingdom and the United States — the developments in which are reviewed in this chapter. First, however, we may look at the conjuncture more broadly.

Following upon the quite general pause or recession from the late months of 1966 to about the third quarter of 1967, a new cyclical expansion was well under way by the first quarter of 1968. This expansion phase continued at a good pace throughout the rest of last year and thus far in 1969. However, the character of the upswing has been basically different among the principal countries. While the past year was not marked by price inflation in most industrial countries, the exceptions were so important as to give an inflationary overtone to the general situation. These main exceptions were the United States, the United Kingdom and France.

Only in the United States was the inflation rather strictly the result of excessive demand. With the background of a large budget deficit and easy monetary conditions, the pause in activity in 1967 was short-lived. After the mid-year renewed expansion got under way at a rapid rate and soon produced over-full employment and pressure on resources. The boom gathered strength owing to the delay in enacting fiscal restraint, and by the time the tax increase became law in June 1968 inflationary psychology was so entrenched that the expansion of activity kept going with no let-up. Monetary policy was shifted to restraint towards the end of the year and severely tightened in the early months of 1969, but the desired signs of slackening were not conspicuous as the mid-year approached. In the meantime the balance on external trade had worsened and soaring interest rates had put considerable pressure on international money and capital markets. While the Canadian economy likewise had an inflationary atmosphere over the past year, this was caused basically by large wage increases rather than by demand pressure on resources; in contrast to the United States, Canada's trade balance improved.

In the United Kingdom the situation had an individual character because of the devaluation of sterling in November 1967. Economic activity increased last year despite strong budgetary restrictions, and additional restraining measures were required in an effort to consolidate the position of the currency at its new parity. Price inflation has been a distinct problem and, while this was partly a consequence of devaluation and increased taxes, it was aggravated by large wage increases and by consumer demand.

The emergence of inflation in France from a rather well-balanced situation also occurred in special circumstances. It was due essentially to the very large negotiated wage increases which were agreed upon to end the social and industrial conflicts that erupted in May–June 1968. Besides the shock to confidence in the currency, there was a strong wage-push against prices and a sudden jump in consumer demand, which had adverse consequences for the balance of payments even though output expanded sharply. After some significant mis-steps, policy has been gradually directed to restoring domestic and external stability.

In continental western Europe generally, developments have been more in line with what is usual in the earlier stages of a cyclical expansion. Both fiscal and monetary policy were geared to stimulate recovery and, in addition, buoyant demand from the United States and the United Kingdom gave a sharp boost to exports. Under these conditions expansion proceeded at a rapid rate and output was soon at record levels. As the upswing started with fair margins of unused resources, there was little pressure on prices or wages in 1968. However, by the spring of this year signs of strain had begun to appear in a few countries, notably in Germany and the Netherlands, where the expansion had been unusually sharp. Moreover, the Netherlands had an outburst of price increases set off by the shift to a value added tax.

Despite a huge expansion of output and wage increases, pressure on prices was not excessive in Japan and a large external surplus was attained.

These diverse trends in national economies worsened the imbalances on external trade transactions, and while there were offsetting capital movements in several important cases they could not be viewed as evidence of a sustainable adjustment.

Germany.

Over the two years after mid-1967 the German economy shook off a recession and moved swiftly to a full-employment level — and even to some strain on resources. It was expected that the large trade surplus, which had emerged with the recession, would decline as domestic demand gained momentum. But, in the event, the trade surplus persisted in 1968. While the proximate cause of the unprecedented flood of funds to Germany in November was the belief in the market that the authorities were considering revaluation of the Deutsche Mark, the trade surplus was a factor in the background. So, too, was the weakness of the French franc and sterling, and even the memory of the revaluation of 1961. To evaluate why the market found revaluation rumours plausible, as well as why the authorities decided against it, it is useful to review developments in the German economy over a longer period.

The combination of large external surplus and a high level of domestic activity was not a new problem for Germany. In March 1961, after monetary restraint had failed to curb the boom because of the inflow of funds which it provoked, the Deutsche Mark was revalued by 5 per cent. as the only possible effective anti-inflationary measure in a situation of fundamental external disequilibrium. While this had perverse exchange-market effects for several months, Germany's balance of payments subsequently weakened quite sharply. In 1962 the current account was in deficit for the first time since 1950, mainly because of a deterioration in the trade balance — partly connected with a cyclical decline in external demand. Germany's share in world exports failed to increase for the first time for many years, while imports rose three times faster than in 1961 despite somewhat easier domestic demand conditions, indicating that the change in parity had a significant effect. The fall in net exports contributed to an easing of inflationary stresses, and this was assisted also by policy action to contain the boom in construction. Industrial producer prices stabilised after mid-1962, compared with the prior average increase ranging up to 3 per cent. per annum since early 1960. However, the labour market remained overstretched and average unemployment, at 0.7 per cent., was even somewhat less than in 1961.

During 1963 economic activity abroad revived and caused the increase in German exports to accelerate to 10 per cent., in line with the growth in other industrial countries' total imports. As German imports rose by only 6 per cent. with the calmer domestic conditions, the trade surplus, at seasonally adjusted annual rates, rose from $0.7 milliard in the first quarter to $2.5 milliard during the last quarter; and the current account as a whole went from a $0.3 milliard deficit to a $1.2 milliard surplus. At the same time there was a swing of $0.5 milliard in the balance on long-term capital account, from an outflow to an inflow, between 1962 and 1963, as well as a monetary inflow through the commercial banks. Together, these developments stimulated a renewed upswing in domestic activity in Germany, while also providing additional monetary liquidity to support it. Given that the economy was still close to full employment when these movements began, it was not long before pressure on resources started to reappear. And industrial producer prices, which had been virtually stable for nearly a year, began to edge up again towards mid-1963.

By the spring of 1964 the growth rate of German exports had started to taper off. But the expansion of total demand was by then being sustained by domestic spending. Since this stimulated German imports, the foreign trade balance weakened and by the second half of 1964 net exports of goods and services accounted for under 0.8 per cent. of gross national product, compared with nearly 2 per cent. a year earlier. Moreover, measures taken to reverse the inflow of foreign capital had significant effect after the spring of 1964.

As a result, economic policy was no longer constricted by the external position. The authorities were, however, slow to move to effective restraint, and over the next eighteen months demand pressures became intense. Overstrain on the economy showed most clearly in the labour market, where by the autumn of 1965 there were, on a seasonally adjusted basis, over four times as many recorded vacancies as registered unemployed. It showed, too, in the increase in wages and prices; from mid-1964 to mid-1965 hourly earnings in industry went up by 10 per cent. and the rise in industrial producer prices accelerated to 3½ per cent.

A substantial deficit developed in the balance of payments. At annual rates, the current account deteriorated continuously from a surplus of \$0.9 milliard in the first quarter of 1964 to a deficit of \$2.1 milliard by the third quarter of 1965. The trade surplus, initially at an annual rate of \$2.3 milliard, ran off completely over this period. Part of the reason was that a return to stability in other important continental European countries — notably Italy and France — caused the rate of increase in German exports to slow to around 7 per cent. a year, with exports to EEC partners during 1964 showing an actual decline. But the main factor behind the disappearance of the trade surplus was a rise in imports at an annual rate of 20 per cent. Although the bringing-forward to mid-1964 of tariff cuts on goods from inside and outside the EEC may have added to the total, the sustained surge in imports was essentially due to the spill-over of the intense overheating which was allowed to develop in Germany.

Monetary policy did become gradually more restrictive from the summer of 1964. Minimum reserve requirements were substantially increased and rediscount quotas were reduced in the autumn of 1965, and the official discount rate was raised to 4 per cent. Fiscal policy, on the other hand, moved in the opposite direction with a DM 2 milliard income-tax cut early in 1965, in addition to a pronounced increase in public-sector expenditure. Moreover, as monetary policy tightened, the net exports of capital which had resulted from the policy measures early in 1964 gave way to renewed borrowing abroad in 1965. This offset part of the absorption of domestic liquidity resulting from the current-account deficit in the balance of payments.

By the spring of 1966 there were signs that some of the edge had been taken off the boom. But there was little relaxation in the labour market, nor any easing of wage and price rises. So the credit squeeze was intensified, with a further reduction of rediscount quotas, and a 1 per cent. increase in the official discount rate to 5 per cent. in May. The effects may be illustrated by the fall in the banks' reserve ratios to little more than 7 per cent. in mid-1966, compared with 12 per cent. two years earlier, and by the rise in public-authority bond yields to over 8½ per cent. from less than 6½ per cent.

Monetary stringency eventually brought the boom to a halt in the second half of 1966. Domestic expenditure, which was still rising quite strongly in the first half-year, declined by 3 per cent. at current prices over the next twelve months; and industrial output fell by 6 per cent. between the spring of 1966 and 1967. Unemployment, seasonally adjusted, rose from 130,000 early in 1966 to 550,000 by the third quarter of 1967, and the number of immigrant workers, which had risen steeply during the boom, fell by over 250,000. Wage pressure subsided, with the increase in hourly earnings falling back to a 4 per cent. annual rate, and industrial producer prices started to decline.

Recession of this order transformed Germany's external current-account position. By the third quarter of 1967 there was a current surplus at a rate of \$2.8 milliard, compared with a \$2.1 milliard deficit only two years earlier, and the trade surplus was running at an annual rate of \$4.5 milliard. Imports were 5 per cent. below their level in the autumn of 1965 — while exports had increased by nearly 20 per cent., reflecting a strong demand from abroad as well as the success of German industry's export promotion.

Looking at the whole period from the 1961 revaluation up to the end of 1967, Germany's external position was marked by increasing fluctuations. While this was sometimes associated with changes in capital flows, it mainly reflected swings in the current account — particularly in trade. Changes in German imports and exports moved inversely during most of this period, as is illustrated by the upper part of the graph on page 9. In the lower parts the fluctuations in German imports and exports are shown against changes in domestic demand and in foreign demand respectively. The change in other industrial countries' total imports is taken as a rough proxy for the state of demand abroad. German imports generally showed a fairly close relationship with domestic demand, except during the severe overheating between mid-1964 and mid-1966, and the recession did little more than restore the earlier relationship. Similarly, German exports moved quite closely in line with other countries' imports, although they tended to be somewhat better maintained during periods when total demand abroad slowed down. It seems, therefore, that the swings in Germany's trade balance were largely determined by the differences in timing of cyclical movements in Germany and in other countries taken together, rather than by changes in relative competitiveness. And the fact that these swings became wider during the period reflects the abnormal strength of the cyclical movement in Germany after 1963. Comparison of relative price changes indicates that there was an improvement in Germany's price competitiveness vis-à-vis many other countries over this period, which no doubt affected the trade balance. As at the end of 1967, however, the price advantage does not seem to have been the key factor behind the huge trade surplus which had emerged.

Once inflationary expectations had been quashed by late 1966, the economic authorities shifted to a policy of strong stimulus. From the end of the year the Bundesbank released some DM 6 milliard of minimum reserves by stages to the banks, and the official discount rate was brought down to 3 per cent. by the spring of 1967. These actions not only helped to stabilise domestic demand but also facilitated the financing of the current-account surplus by promoting large exports of funds, particularly at short term through the banks. Then, too, the government introduced special investment programmes, which together amounted to over 1.5 per cent. of gross national product, as well as granting, temporarily, special depreciation allowances on private investment.

The impact of these policies on demand was soon felt. The rate of fixed investment picked up in the second half of 1967 and increased more strongly during 1968. And business stocks were rebuilt once uncertainties concerning the treatment of stocks under the transition to the value added system of turnover taxation at the beginning of 1968 had been clarified. Also, consumer spending became progressively more vigorous. In addition to the upswing of domestic demand, the growth of German exports accelerated during 1968. As a result, between the first half of 1967 and the second half of last year total final expenditure at current prices rose at an annual rate of 9 per cent.

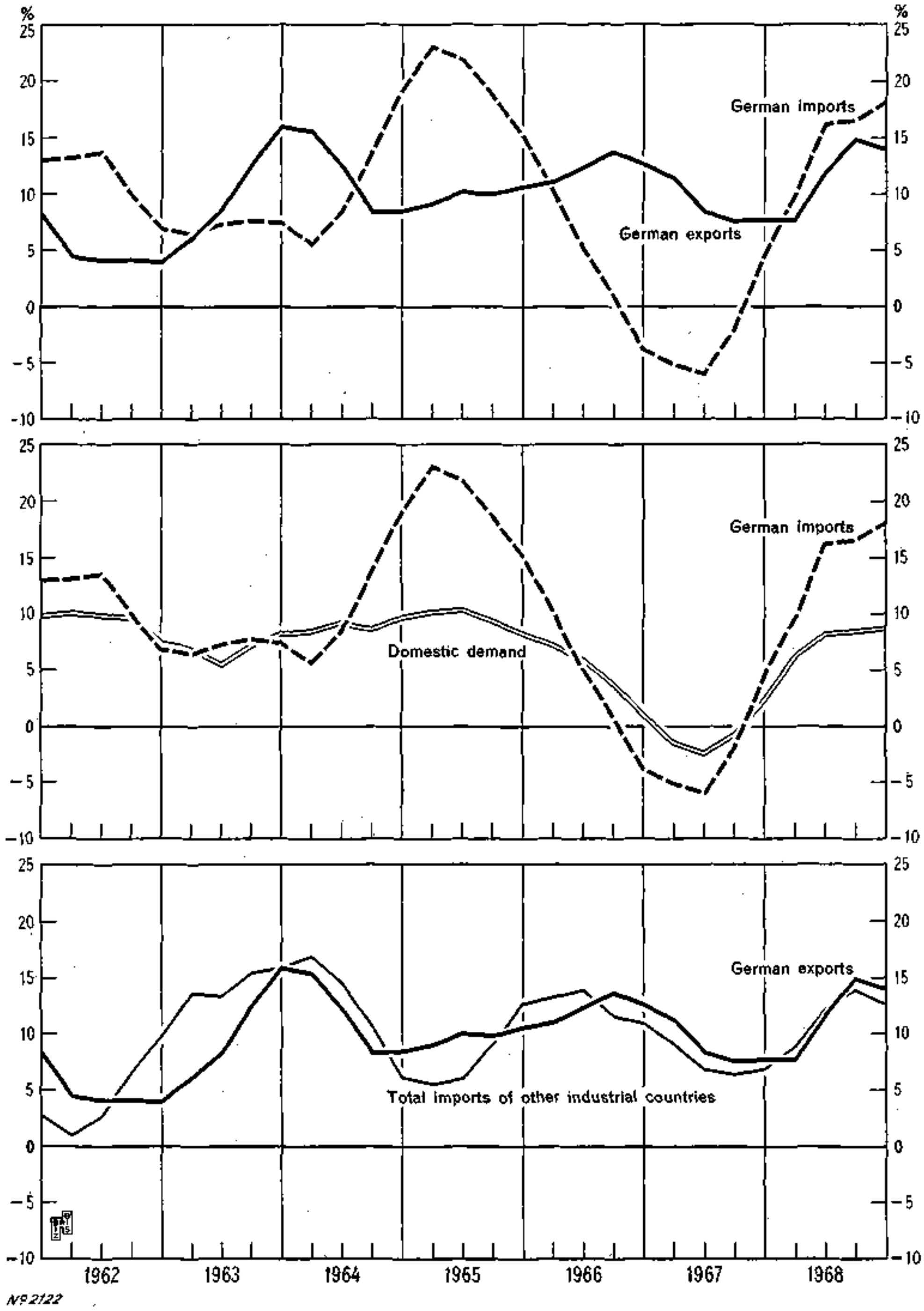
Output responded strongly, industrial production (excluding construction) rising at an annual rate of some 14 per cent. between the first half of 1967 and the second half of 1968. This was achieved partly through reabsorption of spare capacity, reflected in a recovery in the utilisation ratio in industry by the end of 1968 to close to the 90 per cent. figure recorded during the previous boom. There was also a substantial fall in unemployment from its peak of 550,000 in mid-1967 to 225,000 by end-1968 and the unemployment ratio fell to 1.1 per cent. of the dependent labour force. But, in addition, there was a very strong rise in per capita output, which increased in 1968 by 11 per cent. in industry and by 7 per cent. in the economy as a whole.

The rapid expansion of output was not accompanied by pressure on prices and incomes, at least until well into 1968. Average earnings in industry rose by as much as 8 per cent., but this still left room for some decline in unit labour costs. And, excluding the effect on prices of the change to value added taxation, industrial producer prices declined by nearly 0.5 per cent. between mid-1967 and mid-1968, although they then started to increase again, rising by 0.7 per cent. by December 1968.

Although economic recovery did not generate serious signs of strain up to the end of 1968, it induced a strong rise in imports. Between the third quarter of 1967 and the fourth quarter of 1968 German commercial imports increased at an annual rate of over 20 per cent. The fact that the trade surplus did not decline over this period is, therefore, to be explained wholly by the buoyancy of German exports, which also went up at an annual rate of 20 per cent. As may be seen from the top part of the accompanying graph, the relationship between the changes in German exports and imports, generally inverse in the past, became positive from the beginning of 1968.

The strength of German exports in 1968 was largely a reflection of an unforeseen surge in demand abroad. This stemmed partly from abnormal influences, including the strikes in US metal industries and the burst of anticipatory spending ahead of the UK budget early in the year, as well as the rapid increase in French imports after June. It also derived from the high rate of expansion in other countries, which in some cases was partly induced by the stronger economic development in Germany itself. Furthermore, in the fourth quarter exports from Germany were artificially inflated, first by fears of exchange rate adjustments and subsequently by accelerated deliveries by German exporters to avoid a reduction in tax rebate following changes announced in November.

Germany: Changes in exports, imports and domestic and external demand.
Moving averages of quarterly changes over previous year, in percentages.



As a result of these developments, the trade surplus in 1968 amounted to $4.6 milliard, compared with $4.2 milliard in 1967, and there was a corresponding rise in the current-account surplus to $2.9 milliard. The difficulties which a surplus of this size might have created — both domestic and international — were significantly eased by an unprecedented net outflow of long-term capital. This was actively encouraged by the authorities through the continuation of an easy monetary policy, which included Bundesbank support for the government bond market after August 1967 for the first time and which allowed interest rates in Germany to decline against the trend in other important centres. It was encouraged, too, by the effects of the US balance-of-payments programme. As a result, there was a sharp rise in foreign capital-market issues and in loans taken up in Germany (a good part by the banks), which caused the net outflow of long-term capital to increase to $2.8 milliard, compared with under $0.8 milliard in 1967. The basic balance-of-payments surplus during 1968 as a whole, therefore, was limited to only $40 million, and during much of the year there was a basic balance-of-payments deficit.

Germany: Balance of payments.

Items	1962	1963	1964	1965	1966	1967	1968
	in millions of US dollars						
Merchandise trade							
Exports (f.o.b.)	13,245	14,580	16,230	17,910	20,155	21,760	24,885
Imports (c.i.f.)	12,375	13,070	14,710	17,610	18,165	17,545	20,295
Trade balance	870	1,510	1,520	300	1,990	4,215	4,590
Services (net)							
Military receipts	1,025	1,060	1,045	1,030	1,225	1,310	1,340
Travel	− 540	− 480	− 495	− 640	− 765	− 680	− 670
Investment income	− 315	− 305	− 395	− 450	− 370	− 450	− 235
Other	− 175	− 275	− 300	− 260	− 395	− 355	− 390
Total	− 5	—	− 145	− 320	− 305	− 175	45
Unilateral transfers (net)	− 1,300	− 1,265	− 1,325	− 1,600	− 1,565	− 1,575	− 1,760
Current balance	− 435	245	50	− 1,620	120	2,465	2,875
Long-term capital (net)							
Private	235	745	70	560	440	− 415	− 2,500
Official	− 325	− 360	− 330	− 320	− 375	− 380	− 335
Total	− 90	385	− 260	240	65	− 795	− 2,835
Basic balance	− 525	630	− 210	− 1,380	185	1,670	40
Official debt prepayments	—	—	—	—	− 235	—	—
Short-term capital (net)							
Private (other than banks)	125	10	55	210	470	− 410	120
Official	− 45	—	− 260	260	− 80	45	280
Errors and omissions	285	− 125	500	705	150	—	510
Overall balance	− 160	515	85	− 205	490	1,305	950

None the less, there were two outbursts of speculative buying of Deutsche Mark in the second half of 1968. It was increasingly felt that Germany's already favourable competitive position was continuing to improve as a result of the stability of domestic prices at a time of rather strong inflation abroad. It was thought, too, that the change to value added taxation at the beginning of the year would work in the same direction. At the same time it was realised that, if expansion in Germany were allowed to continue unchecked, pressure on resources could soon begin to appear. If in this situation monetary policy, in particular, were to move towards restraint, this would curtail the rate of capital outflow, causing the balance of payments to swing into large surplus; and this danger was emphasised in October by signs that the German capital market was having more difficulty in digesting foreign issues. Against this background, rumours began to circulate of a possible revaluation of the Deutsche Mark. And these rumours gained credence as it came to be sensed that in some influential circles opinion was moving in favour of a wider adjustment of parities.

A first wave of speculation came early in September, during which the Bundesbank had to purchase some $1.4 milliard from the market in the space of about ten days. Most of these funds were rechannelled to the commercial banks through swap operations at attractive rates. Then, in the first three weeks of November there was a much larger inflow of short-term funds. Despite further inducements to the commercial banks to re-export funds, the Bundesbank's reserves went up by $2.4 milliard. In this atmosphere of crisis most European foreign exchange markets were closed on 20th November and a meeting of the Group of Ten Ministers and Governors was convened in Bonn to consider action to restore order.

Although the possibility of some realignment of exchange rates came under discussion, the German Government had decided to maintain the existing parity of the Deutsche Mark. In coming to this decision the government was apparently reluctant to take the irreversible step of revaluation in the face of the prospect of a substantial change in the relative cyclical positions of the major countries; the German economy would be continuing to expand vigorously while inflationary demand in the United States, the United Kingdom and France was being dampened. Then, too, a change in parity would have posed a severe budget problem for the government because of the large increase in support to agriculture that would have been required. Hence, other means of easing the crisis were adopted. The value added tax rebate on exports and the equalising tax on imports were reduced until March 1970 by 4 percentage points, which was equivalent to a revaluation limited to trade in industrial products. Also, steps were taken to discourage the inflow of funds into Germany, particularly by requiring that foreign deposits in German banks above the level of 15th November be held at the Bundesbank. At the same time, substantial restrictive measures on demand were taken in France and in the United Kingdom — the two other countries mainly involved in the November crisis.

When, after the Bonn meeting, foreign exchange markets reopened on 25th November, funds began to pour out of Germany; there was a huge reversal in the net official external monetary position, which declined by close on \$3 milliard over the next three months. Two-thirds of this corresponded to monetary outflows through the banks, while as much as \$1 milliard went to finance a basic balance-of-payments deficit due mainly to net long-term capital exports rising to a new peak level.

After seasonal adjustment, the current surplus from December to February was at an annual rate of only \$1.3 milliard. This was a reaction to the artificially high figure of \$4.2 milliard in the preceding three months, rather than a direct result of the border tax adjustments. And foreign orders to German industry after November, although also falling from the previous exaggerated level, did not suggest any slow-down in demand from abroad by the spring of 1969.

Moreover, by then wage pressure in Germany had strengthened: the first major settlement in 1969, applying to the public sector, amounted to a general increase, including additional increments for low-paid employees, of some 7 per cent., which seemed likely to set a minimum standard in private industry. Besides the prospect of a further strong increase in consumer demand, public-sector expenditure was due to rise by more than in 1968, and business investment outlays were sure to continue upwards. With the scope for a further increase in employment virtually limited to the recruitment of foreign labour, and with the rate of productivity gains already starting to decline, demand pressure on productive capacity was becoming actual.

Since the balance of payments was in sizable deficit, at least for the time being, it was feasible to initiate a policy of moderate internal restraint. Although interest rates were already edging up in response to yields abroad, the Bundesbank stopped supporting the government bond market on its own account in February. Then, in March it was announced that central-bank rediscount facilities were to be cut by 20 per cent. from end-June, and the interest rate charged to the banks on secured advances was raised by ½ per cent. to 4 per cent. In April this rate was again increased, this time accompanied by a 1 per cent. rise in the official discount rate. In March, too, the German Government announced the postponement of some DM 2 milliard of Federal expenditure, as well as an acceleration of company tax payments. The government also called upon the Länder authorities to reduce their borrowing.

After a further loss of reserves in March, the official external position improved substantially in April. Early in that month informal rationing had been introduced on foreign capital-market issues, causing the basic balance of payments to improve. Moreover, there was an inflow of funds from France, as the result of growing political uncertainty there. Net official external assets rose by over \$600 million in April. Then, early in May a further huge surge of speculation on a DM revaluation developed as it was revealed that a change in parity was under official consideration in the Federal Republic. The Bundesbank bought some \$4 milliard of dollars from the market in the space of a few days, particularly before the second week-end of the month, and virtually all other major currencies were adversely affected. Once again, however, the German Government reaffirmed its determination not to revalue, proposing instead the indefinite extension of the November border tax changes, as well as more vigorous action to discourage the inflow of funds. In addition, anticyclical measures were proposed, including the repayment of government debt to the Bundesbank and the freezing of tax revenues in excess of budget estimates. Later in May the central bank increased minimum reserve requirements against bank deposits, particularly those from abroad. These decisions served to relax the immediate tensions in foreign exchange markets, and there was a reflux of funds from Germany.

In spite of the various measures taken to ward off inflation since last November, the rate of expansion of total demand in Germany seems likely to remain very rapid. This would imply a faster rate of price increase, and some toleration of rising prices might be inferred from the decision not to revalue. Taken in conjunction with attempts being made to contain inflation abroad, these developments in Germany would make for some decline in the current-account surplus in 1969 in addition to the reaction to the special influences which applied in 1968.

It seems certain, however, that the surplus will still be high in relation to Germany's cyclical position. But it could be offset by net long-term capital exports, which have in fact already amounted to nearly $1.5 milliard so far this year. From a structural viewpoint it is appropriate that Germany should participate in financing economic development in other parts of the world. For this to be generally sustainable, however, requires that fiscal policy should share the burden of restraint as it becomes necessary. While there have been some failures in this regard in the past, there is evidence now of a better-balanced approach.

France.

The collapse of confidence in the French franc in May 1968 added a new and unexpected element of instability to the already fragile situation in foreign exchange markets. The flight from the French currency was set off by the sudden outburst of social and industrial unrest and by fears that this would lead to a sharp deterioration in France's external position. But what was essentially domestic in origin interacted very strongly with the existing tensions affecting the international payments system. There is no doubt that the general nervousness in foreign exchange markets, which had increased after the sterling devaluation in November 1967, aggravated the pressure on the franc; and the abrupt change in the position of the French currency — from among the stronger to perhaps the most immediately suspect — in its turn intensified uncertainty as to future relative values of currencies more generally.

Economic developments in France in the years before 1968 gave little indication of serious industrial discontent. Moreover, although the final demands of the labour unions were formulated mainly in terms of higher incomes, it is not evident that the strikes were prompted by inadequate progress in living standards.

The government had moved to a restrictive policy in 1963 to relieve the pressure on prices coming particularly from an excessive level of consumer demand. Real private consumption advanced by over 14 per cent. from 1961 to 1963. While this was partly associated with the return of some 700,000 Frenchmen from Algeria, it mainly reflected the rapid rise of employment income, which rose by 28 per cent. in money terms during these two years. The rate of price increase, measured by the gross domestic product deflator, accelerated to 6 per cent. in 1963 and wholesale prices went up by nearly 4 per cent. Hence, a stabilisation programme, which included direct intervention to limit price rises as well as fiscal and monetary restraint, was introduced in September 1963.

Over the next four years employment income increased at an average annual rate of just under 10 per cent. (using the 1959-based national accounts data), and the rate of increase in property income averaged 7 per cent. Altogether personal disposable income, adjusted for the increase in consumer prices (which was held to 3 per cent. a year) rose at an average annual rate of 5 per cent. from 1963 to 1967; and real private consumption increased at an annual rate of 4½ per cent., or at a rate of about 3½ per cent. a year on a per capita basis. While these rates of improvement were about 1 per cent. less than the comparable rates achieved in the five years before stabilisation, the earlier period started from a base of economic recession and also included the clearly inflationary increases in 1962 and 1963. Moreover, the rise in living standards from 1963 to 1967 was still considerable, and compared favourably with that achieved in other advanced countries.

However, the growth of real gross domestic product moderated from an average rate of 5½ per cent. over the years 1958–63 to just on 5 per cent. in the next four years, and this rate did not fully absorb the available productive resources of the economy. There was a rise in average unemployment as production levelled off after 1963; and although expansion was renewed after the middle of 1965, it had only a modest impact on the labour market. From the autumn of 1966 onwards the growth of output slackened under the influence of the weakness of demand abroad, especially in Germany, and of a slower expansion of consumer expenditure in France. Registered unemployment, which had been below 100,000 in 1963, rose continuously (seasonally adjusted) after the first quarter of 1966 to reach 235,000 by the first quarter of 1968. With registered unemployment at this level, total unemployment may have been as much as 400,000, or rather over 2 per cent. of the dependent labour force, although this figure certainly exaggerates the availability of additional manpower in many industrial areas.

It seemed, moreover, that the labour-market situation was beginning to improve. External demand had strengthened after mid-1967 and by early 1968 economic policy was directed towards faster growth. Also, the run-down of business stocks before the introduction of new rates of value added taxation at the beginning of 1968 was being reversed. Whereas industrial production had shown virtually no increase for over a year until the third quarter of 1967, it rose at an annual rate of over 8 per cent. between the late summer of 1967 and the following spring. Although by April 1968 this had not yet been reflected in a fall in unemployment, recorded vacancies were higher and average working hours had increased. It seems unlikely, therefore, that the position in the labour market was a critical factor behind the strike action in May–June.

While the causes of the strikes were socio-political rather than strictly economic, their economic consequences were soon apparent. The immediate impact was a loss of output equal to about 3 per cent. of annual gross domestic product. But the more important result was the large increase in nominal incomes agreed to by the government and employers during joint negotiations with the labour unions at the end of May which helped to bring the strikes to an end. These provided for a 10 per cent. general rise in wages and larger increases in minimum rates, as well as for shorter normal working hours and greater fringe benefits; in addition, the government agreed to raise social security payments. The implication was for a sharp push on costs and prices, and anticipation both of this and of possible exchange restrictions aggravated the flight of funds abroad. The clear priority for economic policy, on both domestic and external grounds, therefore, became to contain as far as possible the potential cost inflation.

It was decided that this objective would best be achieved by encouraging a rapid expansion of output so that an associated high rate of productivity increase might help to absorb the rise in labour costs. Also, business taxes were reduced to help alleviate price increases and tax credits for new investments were reintroduced. Though partly offset by higher taxes on personal incomes, this, together with public expenditure increases, raised the projected overall budget deficit for 1968 (which had been increased from Fr.fr. 1.9 to 5.5 milliard before the strikes) to Fr.fr. 14.0 milliard. In addition, monetary policy was relaxed: to improve, temporarily, bank liquidity, rediscount quotas were raised and the minimum proportion of medium-term paper required to be held by the banks was reduced. And special credit and low-interest facilities were introduced for medium-sized companies and for exporters. These measures may have tended to add to the existing liquidity of the enterprise sector which came with a reduction of inventories following the production losses during the strikes. To protect against the dangers inherent in this policy of strong stimulus, direct control over prices was extended and exchange controls and certain temporary import quotas and export subsidies were introduced to support the balance of payments. At the same time the official discount rate was raised and short-term market interest rates were adjusted upwards to help moderate the flow of funds abroad.

Output recovered rapidly once the strikes were settled. Between March and December industrial production expanded by 7½ per cent. and the whole of this increase came from a rise in per capita output. Employment in manufacturing declined over this period, and although total registered unemployment fell steeply after August, it was still at about the pre-strike level by the end of the year. The increase in hourly wage rates from March to December amounted to nearly 14 per cent. and average earnings may have risen rather more. So, although a strong advance in productivity was achieved, unit labour costs appear to have gone up significantly. Despite the measures taken to ease the pressure on prices, industrial wholesale prices increased by 5½ per cent. between March and December and retail prices by 4 per cent. Whatever its domestic merits, the policy of expansion was adverse for the balance of payments.

In the years immediately before 1968 the large French external surpluses of the early 1960s had declined sharply. Excluding official debt prepayments, the surplus on current and long-term capital transactions with non-franc-area countries had averaged over $1 milliard a year from 1959 to 1963. In 1964 the basic surplus declined to a little over $500 million, largely because the trade balance moved into deficit for the first time since 1958. But, as the trade balance recovered in the following year under the influence of the earlier stabilisation measures, the basic surplus rose again to $750 million.

Then, over the next two years the surplus declined quite sharply to only $275 million in 1967. Measured on a cash basis, the current-account surplus with non-franc-area countries, which had amounted to $460 million in 1965, had just about disappeared by 1967, owing to a weakening on both trade and invisible accounts. The fall in the trade balance over these two years was largely a result of the easing of total demand in other countries in 1966–67, reflected in a slow increase in French exports. The decline in the invisible balance, on the other hand, from a $130 million surplus to a slightly larger deficit, seemed of a more structural nature. It followed a previous deterioration from a net invisible surplus of $540 million in 1960, which had been due mainly to rising French foreign travel expenditure and to increased transfers abroad by immigrant workers. Although the balance on tourist spending showed no further decline after 1965, the level of workers' remittances continued to rise, and in 1967 there was a worsening on government account related to the withdrawal of NATO and US military bases from France.

The net inflow of private long-term capital, which has typically accompanied the French current-account surplus in the 1960s, dipped in 1966 but recovered in the following year to account for almost the whole of the basic surplus. There was, however, an outflow of short-term capital in 1967, partly associated with private gold purchases in the exceptional conditions during the last quarter of the year, which caused the overall balance to go into deficit.

By the beginning of 1968, therefore, while the exaggerated surpluses of the early 1960s had fallen away, the underlying external position was probably still positive or at least in balance. The official reserve position, with net assets of some $7 milliard, was very strong. And, although some concern was expressed about the effect on French industry of the EEC and Kennedy Round tariff cuts scheduled for mid-1968, there was no question of external weakness being an actual problem at that time.

France: Balance of payments.[1]

Items	Average 1959–63	1964	1965	1966	1967	1968[2]
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	5,220	7,625	8,265	8,985	10,150	11,250
Imports	4,900	7,715	7,935	9,015	10,000	11,900
Trade balance	320	— 90	330	— 30	150	— 650
Services (net)						
Investment income	70	55	85	90	105	.
Travel	190	35	— 25	10	— 5	.
Workers' remittances	— 140	— 230	— 275	— 330	— 365	.
Government transactions	70	65	55	35	— 125	.
Other	220	250	290	265	250	.
Total	410	175	130	70	— 140	— 800
Current balance	730	85	460	40	10	— 1,450
Long-term capital (net)						
Private						
Net French investment abroad	10	— 75	— 175	— 215	— 305	.
Net foreign investment in France	420	600	535	370	615	.
Total	430	525	360	155	310	.
Official	— 80	— 80	— 70	— 75	— 45	.
Total	350	445	290	80	265	— 300
Basic balance	1,080	530	750	120	275	— 1,750
Short-term capital, multilateral settlements and adjustments	90	265	390	255	— 310	— 1,400
Official debt prepayments	— 360	—	— 180	— 70	—	—
Overall balance (= changes in monetary items)	810	795	960	305	— 35	— 3,150

[1] On a cash basis. [2] *BIS provisional estimates.*

The situation was transformed by the loss of confidence resulting from the strikes. No official data have been published on the French balance of payments in 1968, but BIS provisional estimates indicate that, for the year as a whole, the overall deficit came to over \$3 milliard. The basic balance was adverse to the extent of some \$1¾ milliard; and there was an outflow of short-term capital of nearly \$2 milliard, including a monetary outflow through the banks of \$½ milliard. Net official foreign assets, therefore, dropped by \$3.7 milliard during the year. Just under half of this total of official financing was met by drawing down claims on the IMF and by foreign borrowing; the balance came out of France's gold and foreign exchange reserves.

It needs to be emphasised that the French balance-of-payments deficit in 1968 came largely from a loss of confidence rather than from a sharp actual decline in the balance of underlying transactions. This is readily apparent in the case of the movement of short-term capital, but is essentially the case also with the basic deficit itself. The previous net import of long-term capital was almost certainly turned into a substantial outflow, with a strong swing in the portfolio balance as investors sought safety abroad, although the flight of capital was aggravated by proposals, announced early in September, for a sharp increase in the French inheritance tax. On current account, a major reason for the weakening on net invisibles was a rise in remittances abroad by foreign workers, who transferred accumulated savings in addition to those from current earnings; and much of the decline in the trade balance, measured on a cash basis, derived from an adverse movement in the terms of payment.

Abstracting from these confidence effects, and from the temporary loss of tourist receipts due to the strikes and uncertainties, the worsening on underlying transactions in 1968 would appear relatively small. In particular, customs data show a decline in the trade balance of only $260 million for the year as a whole. Nevertheless, the position had worsened more seriously by the end of 1968. In the fourth quarter imports, on a customs basis, were over 15 per cent. above their pre-May level and exports were less than 9 per cent. greater, so that the trade deficit was at an annual rate of about $2¼ milliard, compared with less than $1 milliard in the first four months of 1968. Weakness in the trade balance was exaggerated by the unfavourable effect of the currency uncertainty on trade transactions themselves, particularly in the fourth quarter, and by artificially high imports from Germany in December. Basically, though, it reflected the rapid rise in economic activity after June and probably, too, a deterioration in France's competitive position.

Although the franc remained almost continuously at its floor against the dollar in foreign exchange markets from May to November, the volume of selling was less even. Pressure was sustained for nearly two months after the reopening of the Paris exchange market early in June, but tapered off soon after multilateral support totalling $1.3 milliard for France's reserves was announced early in July. Renewed heavy selling for a short period at the beginning of September appeared to originate in speculation on a German revaluation rather than in any tangible change in the position of the franc, although this did almost coincide with the lifting of the exchange controls imposed in May. And speculation in favour of the DM again seemed to set off the much heavier pressure on the franc in November, and this was soon reinforced by the belief that a multilateral realignment of exchange parities was imminent. Despite a general conviction that the franc parity would be lowered after the Bonn meeting, the decision of the French Government was that it should remain unchanged. An important reason appeared to be that devaluation would intensify the strong price pressures still present in the economy and would not therefore re-establish a basis for stable growth. This decision was supported by a major shift in policy, and at the same time new international credit facilities, for an amount of $2 milliard, were arranged.

In immediate response to the developing crisis, the Bank of France had tightened control over domestic liquidity. The banks' reserve requirements were increased, as was their minimum proportion of medium-term paper, and a restrictive ceiling was imposed on the expansion of bank credit. The official discount rate was raised from the 5 per cent. level fixed in July to 6 per cent. Then, after the decision to maintain the existing parity had been announced, fiscal measures were taken, including cuts in planned budget expenditure and the substitution of a higher rate of value added taxation for pay-roll tax. The latter change aimed both at increasing budget revenue and at giving direct support to the external balance, since value added tax is payable on imports but is fully recoverable on exports. The effect of these measures was to cut back the budget deficit foreseen for 1969 from the Fr.fr. 11.7 milliard announced in October to Fr.fr. 6.4 milliard. These policies were designed to moderate the expansion of domestic demand, achieving this effect partly through a rise in prices. Since, however, inflationary pressure was still coming also from the upward movement of costs, further direct action to keep down the rate of price increase was taken, including a freeze on prices charged for services and for goods not already covered by controls. In addition, exchange controls, this time more rigorous, were reimposed.

These decisions immediately halted the drain on French net official assets, and between December and February the very heavy losses sustained in November were recovered. This was essentially a result of the measures of exchange control, which required, inter alia, that French residents should repatriate foreign currency claims; that French banks should reduce, and subsequently balance, their net position in foreign currencies; and which severely limited access by French residents to forward foreign exchange, thereby reducing the need for the banks to hold the spot foreign currency balances built up after May. The initial impact of the exchange controls seemed to wear off in March, when France again began to suffer a loss of reserves. And in April uncertainties associated with the French President's resignation caused a considerable outflow of funds to develop. This outflow continued into May as renewed speculation on a DM revaluation accelerated.

It is still too early for a clear view of the full effects of the post-November policies, which were strengthened early in May through a prolongation of the ceiling on bank lending until the end of the year and by a tightening of consumer credit. In the early months of 1969 the rate of growth of industrial output seemed to moderate only slightly and was associated with a rise in both total employment and average working hours. This, together with the high level of wage rates, suggested that consumer demand, which had already increased strongly in the latter part of 1968, was likely to remain buoyant. Much will depend upon the rate of increase in wages this year — and the stand taken by the government against further strong wage demands in March indicated stiffer resistance. At the same time, the prospect is for a considerable rise in investment, although this might be dampened by credit restriction; and, although much reduced, the budget deficit remains. Allowing for the rebuilding of business stocks, which were depleted by the end of 1968, and for a rise in exports, it seems that, while the growth of total demand will no doubt taper off, it should remain high, implying a further increase in the volume of imports.

In these conditions it is not easy to foresee a rapid improvement in the balance on external trade transactions. The November tax changes made domestic goods relatively more attractive than imports only to the extent that the abolition of pay-roll taxation was passed on in prices. Even if this were done to the full extent, the relative price advantage would, in the general case, be only 2½ per cent. at the most. And the temporary import quotas introduced in June were removed by the end of 1968. Moreover, the more favourable treatment of exports under the new taxation system does little more than compensate for the removal of export subsidies (equal to 6 per cent. of wage costs from June to November and to 3 per cent. thereafter until February) and for increases in the special discount rate for exporters. Administrative support for the trade balance has not, therefore, been substantially increased. The outcome on visible account will be influenced more by the rise in demand in France and by the rate of expansion in markets abroad. The invisible balance, on the other hand, could improve. Tourist earnings should recover to a more normal level. Also, France will benefit from larger payments by the EEC Agricultural Fund. At the same time, the exchange controls now limit the outflow of French resident capital abroad. It seems unlikely, however, that any very substantial voluntary return of funds will occur until the weakness on trade transactions has been demonstrably overcome.

The situation will not be easy in the months ahead. Provided wages are kept under control and a high rate of productivity increase is sustained, pressure on prices could begin to recede. This could contribute to confidence but would still leave the prospect of a significant current-account deficit for some time in the future.

United Kingdom.

In the United Kingdom the change in the sterling parity from $2.80 to $2.40 in November 1967 was expected to produce a major shift of demand, both overseas and at home, towards British products, sufficient to bring the balance of payments on current and long-term capital account to a comfortable surplus position. As this alone would have given a sharp stimulus to the economy, complementary measures of fiscal and monetary restraint were required to limit the rise in aggregate demand and thus facilitate the switch of resources into exports and import reduction. Restraint was not intended to prevent a rise in output, nor some narrowing in the economy's margin of spare capacity. Since this margin was not large, however, and since there was uncertainty about the trend of exports, imports and money incomes after devaluation, it is clear that the authorities were endeavouring to tread a rather narrow path, relying on quick action later in case of unforeseen difficulties.

When devaluation was announced, unemployment stood at 2.3 per cent. of the labour force, but the level of unfilled vacancies, to judge from past experience, was more consistent with an unemployment ratio of nearer 2 per cent. Moreover, to an extent not fully appreciated until a few months later, spare capacity was rapidly being absorbed by an upsurge of consumer spending resulting from policy measures taken during the summer and autumn. Credit restrictions and wage restraint had been relaxed and various government transfer payments increased, while public-sector demand for goods and services remained on a strongly rising trend. At the time of devaluation action was limited to a retightening of credit policy, including a rise in Bank rate to 8 per cent., selective restrictions on bank advances and a stiffening of hire-purchase terms. Cuts in public spending programmes and increases in company taxation were announced for the fiscal year 1968–69. In January 1968 much larger reductions in public spending were announced, on both the military and civil side, thus making a substantial contribution to reducing its rate of growth in real terms from 7½ per cent. in the fiscal year 1967–68 to 1 per cent. in 1969–70. It was stated that the budget would include significant further increases in taxation.

Expectations of higher prices arising both from devaluation and from the forthcoming tax changes gave a further boost to consumer spending, which rose at an annual rate of 12 per cent. in the first quarter. Even faster was the rise in imports, which climbed by 8 per cent. in volume from one quarter to the next and by 13 per cent. in sterling value. The general atmosphere of currency distrust also encouraged active buying of equities, including a large outflow into Australian mining shares. The situation on the foreign exchange market, which had in any case remained unfavourable to sterling since devaluation because of disturbances associated with heavy speculative gold-buying, was aggravated by the increase in imports and the outflow of portfolio capital. All these developments reached a crescendo in early March, when the pound came under severe pressure and the authorities drew substantially on the $1.5 milliard of new central-bank facilities made available to the United Kingdom at the time of devaluation. When the gold pool countries decided on 17th March to stop supplying gold to the market, the support facilities for sterling were raised to bring the total of credits immediately available (including the IMF stand-by) to $4 milliard.

The 1968 budget, presented two days later, increased taxes by amounts estimated to yield £923 million in a full year. Corporation tax was raised from 40 to 42½ per cent. — as had been announced at the time of devaluation — and a special one-year levy was introduced on large investment incomes. But the bulk of the increases fell on indirect taxation, with purchase tax, excise duties, motor-vehicle duties and selective employment tax all substantially higher. In all, these changes were estimated to reduce real private consumption in the second half of 1968 2 per cent. below the level of a year earlier. Legislation for continued restraint on money incomes and prices was also proposed in the budget speech. In the year beginning July 1968 wage increases, apart from exceptional productivity agreements, were restricted to a maximum of 3½ per cent., and dividends were also limited.

In the monetary sphere, too, further action proved necessary. Bank lending to the private sector in the first half of 1968 rose by £765 million, against increases of £235 and 410 million in the corresponding periods of 1967 and 1966 respectively. In accommodating lending on this scale, the banks reduced their holdings of government securities much more than seasonally. About late May the Bank of England moved to tighten credit further. Previously significant omissions from the bank credit ceiling — export and fixed-rate shipbuilding loans — were now brought within the ceiling, which was set at 104 per cent. of the November 1967 level, the figure already reached in the case of the main domestic banks. About this time also the Bank started to give less support to the gilt-edged market, allowing weakness to be more reflected in the actual trend of bond prices and interest rates.

The numerous measures of policy adopted or announced between November and May affected the course of demand and output in varying degrees during the rest of 1968. As to demand from abroad, the expected rise in exports was realised, helped not only by devaluation but also by the exceptional buoyancy of international trade in 1968. For the United Kingdom comparison with 1967 is complicated by the dock strikes in the autumn of that year, which held back some exports until the start of 1968. But, making rough allowance for this, the increase in export volume for 1968 was approaching 10 per cent., which is three times the average annual increase for the previous decade. The rise was continuous throughout the year but was fastest in the third quarter.

As to domestic demand, public-sector expenditure levelled off slightly faster than planned. The increase on current and capital account together in 1968 was about 1 per cent. in volume. At the same time, private enterprise investment in both fixed assets and inventories remained rather flat until the autumn, when there was some pick-up. Private consumption, however, was expansive. The exceptional spending spree of the first quarter, which pushed personal savings well below their normal relationship to disposable income, died away soon after the budget, and in the second quarter total consumption in real terms returned to its mid-1967 level. Thereafter, however, an upturn set in which persisted to the end of the year. In the second half of 1968, instead of the expected drop in real terms of 2 per cent., there was an increase of nearly 1 per cent. compared with the corresponding period of 1967. For the year 1968, private consumption was up 2½ per cent. over 1967.

The revival of consumer spending after mid-year reflected at first the movement of personal incomes, though it was again aggravated by a drop in the rate of personal saving in the fourth quarter. Nominal earnings in industry were up 2½ per cent. on the previous six months and over 8 per cent. on the second half of 1967. This was partly due to increased hours worked, but the more important factor was wage awards well in excess of the 3½ per cent. target. Retail prices also rose substantially — by 2.2 and 5.6 per cent. respectively over the same two periods, but more than half of this was due to devaluation and tax changes. Wage increases of the above size were not obviously due to general pressure on the labour market; indeed, average unemployment of 2.3 per cent. for 1968 was slightly higher than that for 1967. There was some rise in the number of unfilled vacancies, indicating selective labour shortages, but total vacancies also remained well below the peak figures of 1965–66. It was to be expected that the price increases following devaluation would give rise to wage demands, particularly as devaluation occurred only five months after the easing of wage restraint. But the marked increase in industrial unrest reflected also union opposition both to the continuation of wages legislation and, later in the year, to government proposals for the reform of strike law.

The real gross national product rose in 1968 by 3 per cent., which was considerably less than the growth in total final expenditure. The difference reflects mainly an increase of 9 per cent. in the volume of imports of goods, most of which occurred in the first few months after devaluation. The dock strikes may have exaggerated somewhat the steepness of the rise at this time, but their effect on imports was less than on exports. Later on the trend flattened out. Gains in import volume in 1968 were 10 per cent. for industrial raw materials, 16 per cent. for semi-manufactures, and 11 per cent. for finished goods. Such large increases were rather surprising in the aftermath of devaluation, even allowing for the fact that output was showing a cyclical recovery and that this was the first upswing since the ending of the import surcharge in November 1966. Stock-building, which can explain some comparable rises in imports in the past, is not estimated to have been at an exceptional level in 1968. And foreign suppliers generally did not hold prices down: import unit values in sterling terms rose by 11 per cent. almost at once. While there were special factors (such as speculative purchases of silver on non-resident account) and while short-term fluctuations in the volume of imports are to some extent random, its failure to fall back from the high level reached at the start of the year suggests that the economy's preference for imported goods is stronger than had been realised. If so, future export levels will also need to be that much better in order to secure a lasting balance in the external accounts.

The high demand for imports was one major factor preventing an early improvement in the trade balance in line with the growth of exports. The other factor was a worsening of the terms of trade by 3½ per cent., due to a larger rise in sterling import prices than in export prices after devaluation; on the 1967 volume of trade this in itself would have increased the trade gap by nearly £200 million. The actual visible balance for 1968 showed a deficit of £795 million, compared with £640 million in 1967. Against this, the surplus on invisibles increased by £135 million and the outflow of long-term capital fell by £80 million. The latter was due almost entirely, but the former only in small part, to temporary factors, including the postponement of interest and amortisation payments on the North American loans at the year-end. With the errors and omissions item showing a turn-round from positive to negative of £310 million, the total deficit to be financed below the line was up by £250 million at £550 million. This deficit was, in effect, covered by drawing in June the IMF stand-by credit of £583 million arranged at the time of devaluation.

United Kingdom: Balance of payments.

Items	1967	1968				
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter
	seasonally adjusted, in millions of £ sterling					
Merchandise trade (f.o.b.)						
Imports	5,565	6,790	1,670	1,685	1,720	1,740
Exports and re-exports	5,025	6,105	1,490	1,435	1,570	1,610
Trade balance	− 540	− 685	− 180	− 230	− 150	− 130
Payments for US military aircraft	− 100	− 110	− 25	− 30	− 35	− 20
Services (net)	240	375	65	130	115	70
Current balance	− 400	− 420	− 140	− 130	− 70	− 80
Long-term capital						
Official	− 60	20	− 20	30	20	− 5
Private						
UK investment abroad	− 435	− 620	− 180	− 165	− 100	− 170
Foreign investment in the UK	375	560	70	115	270	105
Total long-term capital (net)	− 120	− 40	− 130	− 20	190	− 70
Basic balance, seasonally adjusted	− 520	− 460	− 270	− 150	120	− 150
Basic balance, before adjustment	− 520	− 460	− 295	− 105	65	− 120
Balancing item	220	− 90	− 85	5	15	− 20
Total balance	− 300	− 550	− 380	− 100	80	− 140

The management of sterling, however, was also complicated during the summer and autumn by other factors. Firstly, overseas sterling-area countries, concerned about possible future exchange losses, began to reduce the sterling assets in their reserves. Consultations were started to limit the threat to monetary stability of such conversions of sterling. After extensive discussions during the summer, it was announced in September that a group of twelve central banks and the BIS had agreed to make available to the United Kingdom a medium-term credit facility (described in Chapter IV) of $2,000 million for the purpose of offsetting fluctuations in overseas sterling-area sterling balances. In association with it, agreements were also concluded between the United Kingdom and the overseas sterling countries whereby the bulk of their official sterling holdings received a US dollar-value guarantee, conditional in each case upon the country maintaining a minimum sterling proportion in its reserves. The scheme came into effect late in September and soon put an end to the diversification of the sterling area's reserves.

Besides the movement of these reserve balances, there was a large outflow of private sterling funds during the year, especially during the exchange-market crises in March and November. In addition, there was a substantial increase in the sterling finance provided by UK banks for British exports and for third-country trade, and to limit this to some extent the use of sterling for the finance of trade between non-sterling-area countries was banned after October. Altogether, gross claims in sterling on non-official holders outside the sterling area rose during 1968 from £794 to 1,041 million, while liabilities fell from £656 to 537 million. There was also no incentive for funds to return through the Euro-dollar market, as covered interest-arbitrage margins between Euro-dollars and sterling remained continuously unfavourable to sterling. This reflected the strong demand for Euro-dollars, coming particularly from US banks, as well as the weakness of sterling in the forward exchange market. To meet the outflows that occurred, the Bank of England drew heavily on its facilities with other central banks, and in addition the reserves fell by £114 million over the year.

As the limited extent of improvement in the balance of payments and the comparative strength of home demand became more apparent, additional policy measures were adopted to rectify the situation. A substantial tightening of consumer credit was announced at the start of November. Then, after the upheaval in the exchange markets later that month, additional restraints were introduced: purchase taxes and excise duties were raised by 10 per cent. and credit restrictions were intensified. Bank loan ceilings were lowered from 104 per cent. of the November 1967 level to 98 per cent. for the clearing and Scottish banks and 102 per cent. for other banks, to be achieved by March 1969 — although fixed-rate export and shipbuilding credits under state guarantee, previously included in the ceilings, were now once again excluded from them on grounds of equity between individual banks. In addition, an import deposit scheme was introduced for one year, covering semi-manufactures and finished products. Importers were obliged to make an interest-free deposit of 50 per cent. of the value of the relevant categories of imports to the customs authorities for a period of six months. It was estimated that deposits would build up to a level of about £600 million by May 1969, contributing substantially to the tightening of liquidity. The combined impact of the November measures, including the consumer credit restrictions, was expected to reduce consumer spending by 1 per cent. in the first half of 1969.

In debt-management policy, the aim of retarding monetisation of the public debt continued to be emphasised. Nevertheless, in the fourth quarter the non-bank public reduced its holdings of gilt-edged securities by £193 million, bringing total net sales for the year to £207 million, compared with net purchases of £286 million in 1967. The authorities allowed the selling of gilt-edged to be partly reflected in market prices, and yields on long-dated government stock, which had climbed gradually from 6.5 per cent. early in 1967 to 7.6 per cent in June 1968, rose to 8 per cent. by the year-end and around 9 per cent. in May 1969.

The money supply in 1968 rose by 6½ per cent., compared with 10 per cent. the year before. Domestic credit demand declined only marginally in 1968; public-sector borrowing requirements dropped substantially while remaining on the high side, and those of the private sector increased somewhat. The lower rate of monetary expansion was, therefore, related to the much larger absorption of domestic liquidity via the external deficit.

In the first quarter of 1969 the government budgetary position moved into substantial, more than seasonal, surplus, making severe inroads on the liquidity of the private sector. Conditions on the capital market became tight, with yields on industrial bonds rising to over 9 per cent. and several security issues by companies being left in the hands of underwriters. Demand for bank advances remained strong and at the end of January the Bank of England sent a further letter to the clearing banks, pointing out that bank lending was still substantially above the new target for March, that this target required a reduction in the seasonally adjusted total of lending to the private sector of 3 per cent., or £150 million, and that it therefore seemed necessary for the banks to increase their pressure for repayments by lower-priority borrowers. On 27th February Bank rate, which had previously been reduced in two stages to 7 per cent., was again raised to 8 per cent. to bring it more into line with market rates at home and abroad and to reinforce the credit restraint.

During these months sterling was again somewhat stronger as the exchange markets regained their calm and the overseas sterling area moved into seasonal balance-of-payments surplus. The improvement may also have been due partly to an inflow of short-term funds associated with the import deposit scheme and the tight credit conditions. The underlying balance of the economy, however, did not change much. Consumer spending levelled off, but the revival in industrial investment was maintained; unemployment fell somewhat and there was no further improvement in the trade balance.

In this situation the 1969–70 budget was designed to maintain the existing degree of restraint on home demand. Corporation tax was raised from 42.5 to 45 per cent., purchase-tax rates were put up and there were increases in the duty on petrol, gambling and wines. The most important change, however, was the increase in the selective employment tax to take effect from

United Kingdom: The budget.

Items	Financial years			
	1968–69		1969–70	
	Estimates after budget changes	Results	Estimates before budget changes	Estimates after budget changes
	in millions of £ sterling			
Revenue				
Tax revenue	12,475	12,888	14,007	14,464
Other receipts	400	475	544	544
Total revenue	12,875	13,363	14,551	15,008
Expenditure				
Supply services	10,725	10,810	11,613	11,800
Consolidated Fund standing services	764	805	751	751
Total expenditure	11,489	11,615	12,364	12,551
Surplus	1,386	1,748	2,187	2,457
Loans from National Loans Fund (net)	− 1,744	− 1,423	− 1,631	− 1,631
Overall surplus (+) or deficit (−)	− 358	+ 325	+ 556	+ 826

7th July 1969; this increase by itself will account for 40 per cent. of the estimated rise in revenue of £340 million in a full year. As a result, the central government was expected to repay over £800 million of debt in the new fiscal year, compared with actual net repayments of £281 million in the previous year. On the monetary side effective redemption yields on government securities held by tax-paying investors were increased by exempting them from long-term capital gains tax, and the cost of bank credit to individuals was raised by withdrawing tax relief on payments of interest on bank loans. The Chancellor emphasised that he wanted the clearing and Scottish banks to continue to make substantial progress towards their credit limits (restricted lending had fallen in March and fell again in April, leaving the banks as a whole not much above their ceilings). A new contractual savings scheme was also announced, offering tax concessions on personal savings of up to £10 per month. Altogether and allowing for an increase in pensions of 11 per cent. in the autumn, the budget was calculated to permit an expansion of the gross domestic product by almost 3 per cent. over the next twelve months, with exports and fixed investment the dynamic elements of demand and real private consumption showing little change.

The forecast published together with the budget proposals assumes that exports of goods and services will increase by 6 per cent. in volume and imports by 3–3½ per cent. between the first halves of 1969 and 1970. Together with a small gain in the terms of trade, this would imply a substantial improvement in the trade balance and in the overall balance of payments. This objective must continue to receive high priority, as progress towards external surplus has been slow. While the high level of imports relative to gross national product in 1968–69 was not easily foreseeable, the delay in applying budget restraint and the large wage demands after devaluation compounded the difficulties. To make the present policy of budget surplus and monetary restraint effective, wage increases in the months ahead will have to be very small.

United States.

Economic activity in the United States remained rather flat in the first half of 1967, despite the relaxation of monetary policy before the start of the year. In the second half, however, the expansionary impulse of the large Federal budget deficit reasserted itself. In fact, Federal Government outlays (including transfers) were running about 13 per cent. above the level of a year earlier while receipts had risen by only 6 per cent.; also, house construction recovered sharply as mortgage funds again became readily available. Between June and December industrial production rose at an annual rate of over 8 per cent. and by the start of 1968 the economy had regained boom conditions, with all major components of final domestic demand expanding strongly. The unemployment ratio was down to 3.6 per cent. in the first quarter, indicating considerable pressure on resources. Wage settlements early in the year meant that average hourly earnings were advancing at an annual rate of 6 per cent., while consumer prices were increasing at a rate of about 4 per cent.

In this situation at the start of 1968 the need for fiscal and monetary restraint was evident. A tax increase in the form of a 6 per cent. surcharge on income-tax liabilities had first been proposed by the Administration in early 1967; the request was raised to 10 per cent. in August and repeated in the 1968 budget message. Immediate approval of this measure was still not in prospect, however, and since a cut-back in Federal Government spending, especially for military purposes, did not seem feasible, the task of restraining the boom at first fell wholly on monetary policy.

The monetary situation had already been allowed to tighten somewhat in the latter part of 1967, as evidenced by the sharp rise in interest rates. The three-month Treasury bill rate climbed from 3.5 per cent. in June to 5 per cent. in December, while long-term government bond yields rose from 4.8 to 5.4 per cent. This, however, reflected the volume of government financing needs — the actual budget deficit for these six months amounting to $19.3 milliard — rather than pressure on bank liquidity. The authorities began retightening the banks' reserve positions in November, and continued to do so for both domestic and external reasons until May 1968. Member-bank borrowings from the Federal Reserve increased from $130 million to nearly $750 million (about the same level as in the third quarter of 1966) and the expansion of bank loans and investments slowed down from 11½ per cent. in 1967 to an annual rate of 6½ per cent. in the first half of 1968. There was also a further rise in interest rates. Three half-point increases brought the discount rate to 5½ per cent. in April, its highest level since 1929. The 5½ per cent. ceiling payable on large-denomination certificates of deposit was replaced, as Treasury bill rates moved above this level, by a graduated scale ranging from 5½ per cent. for the shortest maturities to 6¼ per cent. for maturities of 180 days or more. The banks subsequently increased their prime lending rate from 6 to 6½ per cent.

Despite monetary restraint, output rose just as fast in the second quarter as in the first, while prices rose somewhat faster. Altogether in the first half of 1968 real gross national product was over 4½ per cent. higher than a year earlier, with the chief gains in demand coming from Federal Government outlays, private consumption and house-building. Consumer prices had also risen by 4 per cent. and wholesale prices of finished goods by 3 per cent.

Policy entered a new phase when Congress finally passed the tax increase at the end of June. Besides the one-year surcharge of 10 per cent. on income taxes, retroactive to 1st April for individuals and 1st January for corporations, the new measure prolonged excise taxes of 7 per cent. on cars and 10 per cent. on long-distance telephone calls and provided for a speeding-up of tax collections from corporations. In addition, it stipulated a cut of $6 milliard in the Federal Government's proposed expenditure for 1968–69, but some of this was evidently going to be offset by increases in defence and other items exempted from the expenditure ceiling.

United States: Federal budget.

Items	Financial years 1967-68 actual result	1968-69 probable result	1969-70 first estimate	1969-70 revised estimate
	in milliards of US dollars			
Receipts				
Personal and corporate income taxes . . .	97.4	122.5	128.3	128.3
Employment taxes and contributions. . . .	29.2	34.8	39.9	39.9
Other	27.1	28.8	30.5	30.5
Total receipts	153.7	186.1	198.7	198.7
Expenditure				
National defence	80.5	81.0	81.5	80.4
Health and welfare	43.5	48.8	55.0	112.5
Other	54.9	55.1	58.8	
Total expenditure	178.9	184.9	195.3	192.9
Budget surplus (+) or deficit (—). . . .	— 25.2	+ 1.2	+ 3.4	+ 5.8

The increase in taxes, coming on top of a spell of tight credit, was expected to have a rather forceful impact in restraining demand pressures, and perhaps even to depress activity below the full-employment level. Monetary policy was therefore rather hurriedly relaxed as a precaution. Member-bank borrowings declined during the summer and early autumn and market interest rates retreated by up to half a percentage point.

This monetary ease turned out to be premature, as the tax increase did not produce the results anticipated from it. Instead of tapering off in the latter part of the year, the boom heightened still further and continued strongly into the first half of 1969. This was due to private-sector demand, which remained buoyant despite the reduction in the budget deficit. On a national accounts basis the Federal deficit narrowed from an annual rate of $9.4 milliard in the first half-year to $1.3 milliard in the second half and changed to a small surplus in the first quarter of 1969. Evidently, after several years of rising prices and in a situation of strong pressure on resources, this was not sufficient to contain the rise in disposable incomes or the upward trend of business investment.

The quarter immediately following the tax increase saw a large gain in consumer spending, especially on cars and other durables, and a decline in the personal savings ratio from 7.5 to 6.3 per cent. This tapered off during the autumn, but by then a renewed upswing in capital expenditure had begun, with private fixed investment increasing by 4½ per cent. in real terms between the third and fourth quarters. As a result, output in the second half of 1968 continued to expand strongly, though at a somewhat slower pace than in the first half. Pressure on resources intensified and the unemployment ratio declined further to 3.3 per cent. Costs and prices rose at much the same rate as before. For the year as a whole, gross national product was up by 5 per cent. in real terms and by 9 per cent. in current prices.

The continuing expansion was associated with a much faster growth of bank credit in the second half-year, facilitated by the easier monetary policy adopted during the summer. Between June and December the banks' loans and investments increased at an annual rate of 15 per cent., compared with 6½ per cent. in the previous six months. Although there was a slow-down in the growth of non-bank credit, the combined total of funds raised by non-financial borrowers was about 18 per cent. higher in the second half-year than in the first. As the strength of the boom became more apparent, the authorities moved to retighten monetary policy. Member-bank borrowings at the Federal Reserve began to rise again in the fourth quarter, reaching over $800 million in January 1969 and maintaining this level into the spring months. The discount rate, which had been lowered to 5¼ per cent. in August, was raised to 5½ per cent. in December and to 6 per cent. in April, when reserve requirements on demand deposits were also increased by ½ per cent. Market interest rates followed a similar course, the Treasury bill rate going from 5.1 per cent. in August to 6.2 per cent. in January and remaining generally above 6 per cent. thereafter. This was higher than the Regulation Q ceilings on certificates of deposit and as the volume of these certificates declined the banks stepped up their bids for Euro-dollar deposits. The London Euro-dollar rate rose to 8½ per cent. in February, while US banks' liabilities to their foreign branches increased from about $7 milliard in the fourth quarter of 1968 to nearly $10 milliard in late March 1969. The higher cost of deposits naturally affected lending rates: the prime rate, which had been cut to 6¼ per cent. in September, was increased four times between December and March to reach 7½ per cent. In the long-term markets, the yield on US Government bonds went above 6 per cent. in March and that on corporate bonds above 7 per cent.

The return to monetary restraint was reflected in a slower growth of bank credit and the money supply in the first quarter of 1969, but aggregate domestic demand remained very strong and output continued to expand. The index of industrial production averaged 169.7, compared with 167.4 in the previous quarter. There were some underlying indications that the boom might be starting to taper off, and the rate of expansion of real gross national product, at 3 per cent. per annum, showed a decrease for the third quarter in succession. The nominal increase in gross national product of $16 milliard, however, was about the same as in the previous quarter because of a larger price rise. And forecasts of substantial further gains in capital spending by industry during 1969 pointed to the expansionary psychology prevalent in the business community.

Confronted with this situation, the new Administration decided to strengthen somewhat the existing degree of fiscal restraint, supported by restrictive credit policy, in order to curb inflation in the year ahead. The aim was not to induce a sudden end to the economy's momentum but rather a gradual easing of inflationary tensions. The budget estimates for 1969–70 were reviewed and a cut of $4 milliard was proposed from previously recommended expenditures, raising the planned surplus to $5.8 milliard, compared with an anticipated surplus in 1968–69 of $1.2 milliard. On the tax side, immediate repeal of the 7 per cent. investment-tax credit was proposed, as well as the extension of the income-tax surcharge, but with the rate reduced from 10 to 5 per cent. as from 1st January 1970.

The upsurge of the domestic economy led predictably to a sharp deterioration in the US balance of payments on goods and services in 1968. Imports of goods rose by 23 per cent. to $33.3 milliard and, although exports also increased by nearly 10 per cent. to $33.4 milliard, the surplus on merchandise trade virtually disappeared. About one-eighth of the increase in imports was attributable to actual or anticipated strikes in the copper and steel industries, but the remainder reflected the general pressure of demand. A rise of $440 million in net income from foreign investments provided some offset to the deterioration on trade account, but the total surplus on goods and services narrowed from $3.5 milliard to $0.8 milliard. Despite this, the overall balance of payments, both on the liquidity basis and on the official reserve transactions basis, showed a much better outturn in 1968 than in previous years, because of a large turn-round in capital movements after the first quarter.

United States: Balance of payments.

Items	1967	1968 Year	1968 1st quarter	1968 2nd quarter	1968 3rd quarter	1968 4th quarter
	in millions of US dollars, seasonally adjusted					
Merchandise trade						
Exports, excluding military	30,465	33,380	7,915	8,380	8,835	8,250
Imports, excluding military	26,990	33,275	7,880	8,335	8,590	8,470
Trade balance	3,475	105	35	45	245	− 220
Services (net)						
Investment income	5,705	6,145	1,380	1,570	1,640	1,545
Military expenditure	− 3,100	− 3,140	− 805	− 760	− 740	− 830
Foreign travel	− 1,550	− 1,320	− 340	− 340	− 375	− 265
Other services	− 1,040	− 980	− 240	− 175	− 230	− 330
Total services	15	705	− 5	295	295	120
Balance on goods and services	3,490	810	30	340	540	− 100
US Government grants and capital (net)	− 4,210	− 3,975	− 1,160	− 1,070	− 940	− 805
US private capital (net)						
Direct investment	− 3,020	− 2,745	− 375	− 1,035	− 1,170	− 165
Other long-term capital	− 1,270	− 1,050	− 200	− 60	− 175	− 620
Short-term capital	− 1,215	− 1,065	− 130	− 355	− 455	− 120
Foreign capital (net)	3,185	8,385	1,410	2,485	1,830	2,655
Errors and omissions	− 530	− 200	− 275	− 485	420	145
Balance on liquidity basis	− 3,570	160	− 700	− 180	50*	990*
Increase in US liquid liabilities other than to foreign monetary authorities, less increase in official non-liquid liabilities	170	1,460	130	1,690	370	− 730
Balance on official reserve transactions basis	− 3,400	1,620	− 570	1,510	420	260

* Subsequent revisions are: 3rd quarter $80 million; 4th quarter $850 million.

The improvement on capital account was due to various factors affecting both US and foreign capital. First, US policy measures — the stiffer restrictions on capital outflows introduced at the start of 1968, as well as the tight monetary policy — reduced the net outflow of US corporate capital from an average of $2.9 milliard in 1966–67 to about $380 million in 1968. The fourth quarter of the year saw a particularly large transfer of corporate funds of $550 million to the United States. Direct foreign investment declined only slightly, but a much larger proportion was financed by borrowing abroad, notably on the Euro-bond market. Sales of private US bonds overseas rose from about $450 million in 1967 to $2.2 milliard in 1968. In addition, the gross foreign assets of US banks and brokerage houses showed a decline of $360 million, compared with a rise of $540 million in 1967, a turn-round of $900 million.

Secondly, there was a large increase in foreign purchases of US equities, from $800 million in 1967 to $1,950 million in 1968. In part, this probably reflected the attractiveness of US equities in a period of boom, and another important factor was political uncertainties arising from the situation in France and Czechoslovakia.

Altogether, the balance on private capital movements (excluding changes in liquid liabilities) improved by $4.6 milliard to yield an inflow of $1 milliard in 1968. In addition, outflows on account of government grants and long-term credits contracted by $235 million. These gains substantially outweighed the deterioration on goods and services, so that the deficit to be covered by other private or official monetary movements declined from $4.2 to 2.2 milliard. However, non-official foreign dollar holdings increased by $3.8 milliard, owing essentially to Euro-dollar borrowing by US banks, so that there was a surplus on official settlements of just over $1.6 milliard.

The liquidity balance also showed a small statistical surplus, despite the large increase in liquid liabilities to private foreigners, because $2.4 milliard of liabilities to official institutions were converted from liquid into non-liquid instruments.

In the first quarter of 1969 the balance of payments on the liquidity basis reverted to substantial deficit. The current-account position worsened somewhat, with the trade balance adversely affected by the US dock strike. Also, the temporary inflow of US corporate funds at end-1968 was heavily reversed, and foreign official purchases of non-liquid US Government securities were much smaller than before. As a result, although US companies raised a further $500 million in overseas bond markets and although foreign purchases of US equities were maintained, the liquidity balance showed a deficit of $1.8 milliard. None the less, on official settlements there was a surplus of $1.1 milliard, essentially because of a further increase in US banks' liabilities to their foreign branches, of $3 milliard.

It will be seen, therefore, that in a basic sense the US external position worsened in the past year. While this was temporarily offset by large shifts on capital account, such compensation was due to unusual circumstances not likely to be repeated in the year ahead. Short-term interest rates in Europe tended upwards in the first few months of 1969 and several continental countries took measures to halt or reverse the outflow of liquid funds to the Euro-dollar market. At the same time European bond markets tightened and in April a number of corporate issues were postponed or poorly received. A slackening of the US economy would, of course, benefit the trade balance, but to what extent is uncertain, as the inflation of the past few years has weakened the price competitiveness of US industry in relation to other major countries, especially Germany, Japan and Italy. Hence, it is understandable that US official views on the balance-of-payments prospects have not been optimistic.

Reserve creation in the monetary system.

Besides the imbalances of the four countries discussed above, both Japan and Italy were in a substantial surplus position during the past year. The Japanese surplus, which was $1 milliard in 1968, was mainly of a cyclical character as there had been a deficit the year before. Italy's surplus has been more persistent; despite a larger current-account balance in 1968, the overall surplus was held to just under $600 million as capital exports reached the huge figure of over $2 milliard.

In addition to the adjustment problems involved in large deficits and surpluses, the system has suffered strains for some years because autonomous reserve growth in total has been inadequate. In this respect, however, the past year was less unfavourable than the year before, although the improvement is not readily apparent from the global reserve statistics.

The dividing-line came in March 1968, when the peg was lifted from the market price of gold, and the years to be contrasted are April 1968–March 1969 and the preceding twelve months. The essential improvement between these two periods was that the large loss of gold reserves to the market in the previous year was stopped in the past year. As shown in the next table, countries' gold reserves actually increased by $1.1 milliard in 1968–69, whereas they fell by $2.6 milliard in 1967–68. From the standpoint of the functioning of the system, the gold increase last year was not as favourable as it looks, since $360 million of the $1.1 milliard came from transfers from international institutions (mainly the IMF) to countries' official stocks. Besides, $625 million of the remainder was accumulated in South Africa's reserves directly from domestic production and, hence, did not enter the system in an active sense. In 1967–68 transfers of gold from international institutions to countries amounted to $290 million, so that the system's decrease in monetary gold was almost $2.9 milliard; this was despite the fact that South Africa sold almost all of its new production.

The gain to the system from this change in the official gold position between the two years can be seen as follows: the decline in the total official gold stocks in 1967–68 required a corresponding official-account deficit for all

Changes in global reserves, 1966-69.

Areas and periods	Gold	Foreign exchange	IMF reserve positions	Total
	in millions of US dollars			
All countries				
April 1966 – March 1967	− 480	+ 1,100	+ 330	+ 950
April 1967 – March 1968	− 2,595	+ 5,065	− 530	+ 1,940
April 1968 – March 1969	+ 1,130*	+ 55*	+ 400	+ 1,585
Group of Ten				
April 1966 – March 1967	− 570	+ 15	+ 390	− 165
April 1967 – March 1968	− 3,390	+ 4,355	− 660	+ 305
April 1968 – March 1969	− 60	− 645	+ 205	− 500
Other developed countries				
April 1966 – March 1967	+ 85	− 40	− 120	− 75
April 1967 – March 1968	+ 275	+ 150	+ 80	+ 505
April 1968 – March 1969	+ 870	+ 245	+ 110	+ 1,225
Developing countries				
April 1966 – March 1967	+ 5	+ 1,125	+ 60	+ 1,190
April 1967 – March 1968	+ 520	+ 560	+ 50	+ 1,130
April 1968 – March 1969	+ 320*	+ 455*	+ 85	+ 860
Group of Ten, excluding United States and United Kingdom				
April 1966 – March 1967	+ 345	+ 215	+ 760	+ 1,320
April 1967 – March 1968	− 725	+ 2,275	− 780	+ 770
April 1968 – March 1969	− 175	− 1,265	− 640	− 2,080
United Kingdom				
April 1966 – March 1967	− 360	+ 45	−	− 315
April 1967 – March 1968	− 185	− 350	−	− 535
April 1968 – March 1969	− 15	− 235	−	− 250
United States				
April 1966 – March 1967	− 555	− 245	− 370	− 1,170
April 1967 – March 1968	− 2,480	+ 2,430	+ 120	+ 70
April 1968 – March 1969	+ 130	+ 855	+ 845	+ 1,830

* *Latest available figure.*

countries taken together; but with the official gold stocks somewhat better than constant in 1968–69, countries' official-account deficits would be more than offset by other countries' surpluses. One cannot say which countries absorbed the net deficit of the system in 1967–68, or benefited by the improved gold situation last year, for several reasons: data are not available on the country distribution of private speculative gold purchases or on the means used to finance them; and, in any case, the private gold-buying would be mixed up with other factors influencing external balances. Considering strictly the direct effect of a net decline in monetary gold, a deficit position in 1967–68 would have resulted for countries whose residents bought gold with domestic funds. As gold-buying was prohibited in the United Kingdom and the United States, neither country would have suffered from this direct effect.

However, the external positions of the United States and the United Kingdom were much affected by the gold speculation in other ways. In the case of the United States, the gold-buying wave affected confidence in the dollar so that there was a significant flight from foreign-held dollars mainly into gold but also to some extent into other currencies. It seems certain, too, that leads and lags in payments and foreign capital inflows to the United States were temporarily adverse. Thus, the US payments position and official financing requirement were worsened by the gold-buying wave; the absence of these pressures after March 1968 was surely a necessary condition for the US shift to an official settlements surplus, though not a direct cause.

Similar forces operated in the case of the United Kingdom, with much greater impact. It is clear that gold was bought heavily by holders of sterling in various parts of the world and, besides, confidence in the new parity of the pound could hardly be immediate after November 1967 with such turmoil in the gold market. In any case, it is evident that official financing requirements were very large in the months of massive gold speculation.

These factors help explain the paradoxical changes in global reserves shown in the table for the past two years, particularly in the reserves of the Group of Ten countries. Even though the system lost gold in 1967–68 and gained gold last year, global reserves increased more in 1967–68 than in 1968–69. This came about through the extraordinary rise of over $5 milliard in total foreign exchange holdings in the earlier year, while their increase last year was negligible.

Sources of changes in global reserves.

Items	April 1966–March 1967		April 1967–March 1968		April 1968–March 1969	
	in millions of US dollars					
Change in global reserves		+ 950		+ 1,940		+ 1,585
Gold		− 480		− 2,595		+ 1,130
IMF reserve positions		+ 330		− 530		+ 400
from: gold subscriptions	+ 365		+ 55		+ 25	
members' credit tranche drawings	− 35		− 585		+ 375	
Foreign exchange from special transactions		− 245		+ 8,245		+ 2,140
US Government non-marketable bonds	− 345		+ 755		+ 1,590	
Central-bank facilities (estimated)	+ 100		+ 7,000		+ 550	
UK dollar security portfolio	—		+ 490		—	
Other foreign exchange (residual)		+ 1,345		− 3,180		− 2,085

It can be seen from the table showing the sources of changes in global reserves that the extraordinary rise in exchange reserves in 1967–68 was entirely dependent upon an increase of $8.2 milliard in exchange reserves arising out of special transactions. This huge reserve creation was associated with the official financing requirements of the United Kingdom and the United States and came about in two main ways: by about $7 milliard through the use of central-bank facilities and by $755 million through new issues of Roosa bonds. The figure of $7 milliard for the statistical effect on reserves of the use of central-bank facilities reflects mainly the short-term assistance taken by the Bank of England from other monetary authorities, both in the months leading up to devaluation as well as during the ensuing gold crisis. It reflects also the rather substantial drawings by the Federal Reserve on its swap network during the 1967–68 gold crisis. With regard to this figure of $7 milliard, it must be remembered that assistance taken by the Bank of England from the United States has a double statistical effect on reserves, since the dollars received by the United Kingdom and the counterpart in sterling received by the United States are both counted.

In the following year 1968–69 total exchange reserves showed virtually no change, and those of the Group of Ten even declined somewhat — by $645 million. The payments imbalances on official account within the Group of Ten were no less than in the preceding twelve months — in fact, the sum of official-account surpluses rose sharply from $1.4 to 5.7 milliard while the sum of official-account deficits went up slightly, from $5.9 to 6.1 milliard. The financing of these imbalances, however, was rather different from what it had been the year before. This appears from the fact that the total creation of reserves through special transactions was little more than $2 milliard — consisting of $0.5 milliard through central-bank facilities and $1.6 milliard through new Roosa bonds. The two main deficit countries, France and the United Kingdom, financed a large part of their deficits without recourse to special transactions, either out of reserves or through borrowing from the IMF. The main surplus country, the United States, substantially reduced its recourse to the Federal Reserve swap network over this period, although at the same time the amount of Roosa bonds issued about doubled. They were used principally to finance the official settlements surplus that emerged in Canada from the spring of 1968 onwards, but also in connection with the military offset agreement between the United States and Germany.

Neither of these two periods was notable for the stability of the international monetary system. But, of the two, 1967–68 was certainly the more troubled — with the devaluation of sterling, the speculative gold wave and the abandonment of the price peg in the gold market, all within the space of a few months. Hence, the larger rise of global reserves in 1967–68 cannot be taken as a favourable sign; in fact, it was just because 1967–68 was so troubled a year that special transactions were undertaken on a scale that, despite the loss of gold from the system, produced a $2 milliard rise in global reserves. Thus, the growth of reserves in the system has depended, in the absence of an autonomous mechanism for bringing this about, upon monetary disturbances. And it is questionable whether the assets created in this way, under the force of circumstances, can simply be counted as additions to the global stock of reserves, while ignoring the corresponding liabilities. The creditor countries, at any rate, are not apt to ignore them.

II. MONEY, CREDIT AND CAPITAL MARKETS.

In 1968 monetary conditions in North America and the United Kingdom developed along lines strikingly different from those in continental western Europe. Inflation took firm hold in the United States and was associated with a heavy demand for credit and sharply rising interest rates. From late 1968 onwards, as monetary policy was progressively tightened, interest rates moved up to historic highs. They also rose to exceptionally high levels in Canada and the United Kingdom, partly in defence of the external position but also because monetary restraint was imposed to counteract domestic price inflation.

In contrast, most continental countries maintained relative monetary ease from early 1967 until nearly the end of 1968 so as to sustain the upswing in economic activity. For some surplus countries the aim was also to encourage compensatory capital outflows.

Since late 1968 the economic situation and policy attitudes on the Continent have been changing. Various countries have found themselves, often rather suddenly, approaching the limits of productive capacity, and they have introduced credit restraint measures consistent with both their domestic and their external requirements. Looking beyond this, however, certain of these countries, and others as well, have shown increasing concern about a cumulative loss of official currency reserves induced by the strong pull of funds abroad. Some selective measures have been taken to counteract excessive outflows, but the scope for such action has its limits. On the other hand, to allow the outflow of funds to raise domestic interest rates beyond a certain point runs the risk of curbing domestic expansion as well as impeding external adjustment via the current account.

This chapter first examines recent interest rate movements in the light of changes in financial flows. It then goes on to analyse developments in various countries — including those of eastern Europe — which were not treated in Chapter I.

Inflation and interest rates.

After the general relaxation of monetary restraint late in 1966, interest rates on both sides of the Atlantic moved down in parallel until the early spring of 1967. Subsequently, however, there was, as shown in the following table, a striking divergence in the behaviour of rates. In the two years up to March 1969 nominal yields on long-term government bonds rose quite sharply in the United States, Canada, the United Kingdom and Japan. On the Continent, on the other hand, yields declined in Germany and Switzerland and were little changed elsewhere — apart from a large increase in France and more moderate ones in the Netherlands and Sweden.

Comparative changes in bond yields and domestic prices.

Countries	Yield on long-term government bonds				Annual increase in consumer prices to		
	March 1967	March 1968	March 1969	Change from March 1967 to March 1969	March 1967	March 1968	March 1969
	in percentages			in percentage points	in percentages		
United Kingdom	6.5	7.3	8.8	+ 2.3	3.5	3.4	6.3
France	6.1	6.4	7.9	+ 1.8	2.8	3.8	6.0
Canada	5.5	6.9	7.2	+ 1.7	3.2	4.3	4.4
United States	4.4	5.4	6.0	+ 1.6	2.7	3.9	5.1
Japan	7.6	8.7	8.9	+ 1.3	4.0	5.3	3.9
Netherlands	6.0	6.5	7.0	+ 1.0	2.9	3.9	7.9
Sweden	5.9	6.3	6.7	+ 0.8	4.7	2.1	1.9
Denmark	8.1	8.5	8.4	+ 0.3	4.3	10.5	4.3*
Austria	7.1	7.9	7.4	+ 0.3	4.5	3.1	2.6
Italy	5.3	5.7	5.6	+ 0.3	1.9	1.7	1.7
Belgium	6.8	6.5	6.8	—	2.9	2.9	3.6
Switzerland	5.2	4.7	4.8	— 0.4	3.8	3.4	2.5
Germany	7.2	6.7	6.4	— 0.8	2.2	1.5	2.3

* February.

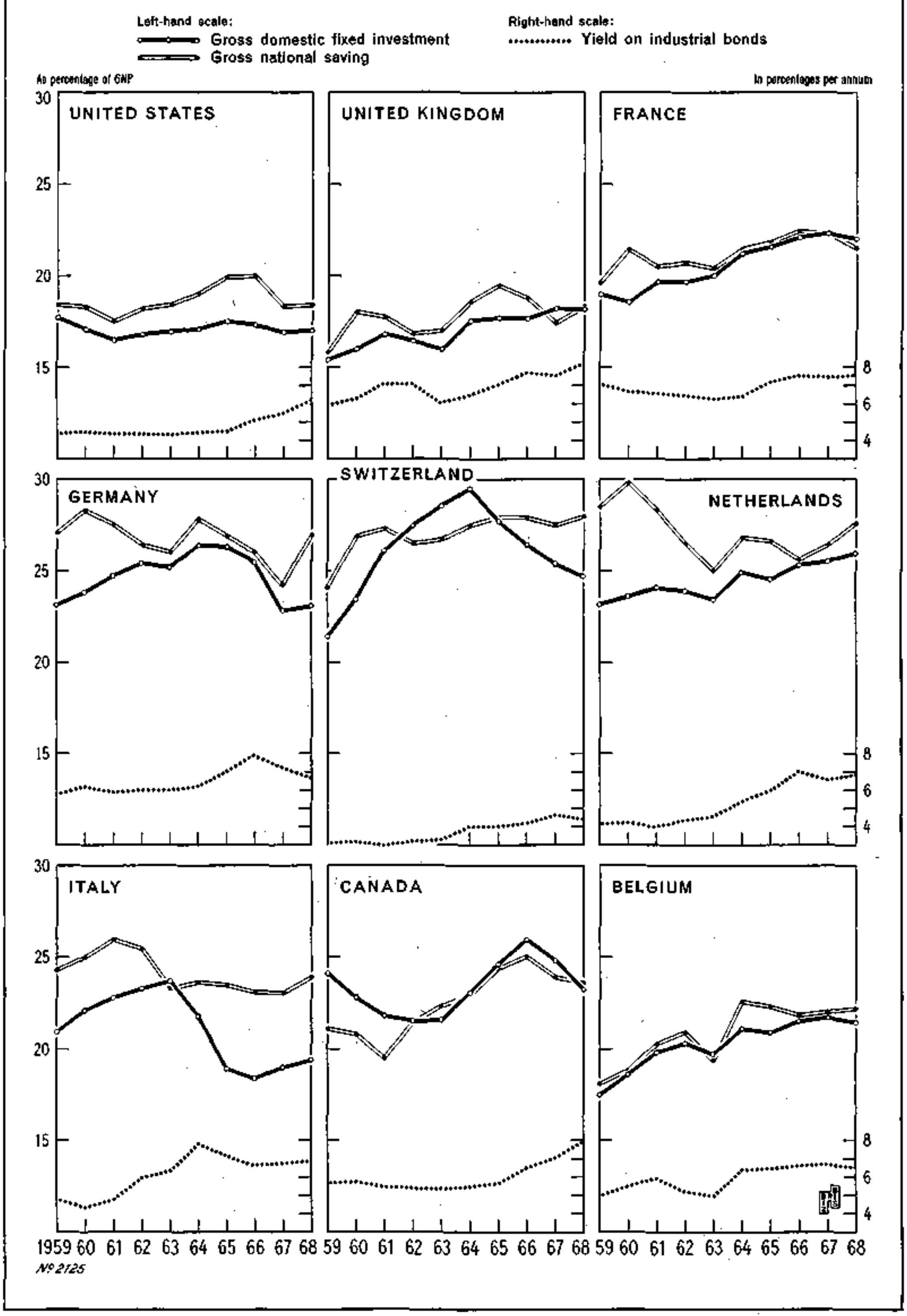
In terms of international alignment, these developments tended virtually to close the long-existing gap between US yields and average yields on the Continent. Moreover, yields in the United Kingdom rose well above those that were typical on the Continent, while those in Canada also moved up to a comparatively high level. In all three countries the increase was largely bound up with the persistence or intensification of domestic inflationary pressures. Hence, in the United Kingdom and the United States any resulting improvement on external capital account served only to alleviate a weak current-account position. The balance-of-payments adjustment was therefore more compensatory than real. In Japan, and to a lesser extent in Canada, a strengthening of current-account positions in 1968 had reduced the need for capital inflows. To that extent high long-term interest rates were not fully justifiable on external grounds.

By the same token, the behaviour of interest rates in most continental countries was primarily a reflection of the relative absence of inflationary pressures during a phase of recovery and early upswing. From an international point of view, therefore, one cannot without qualification say that a better underlying balance in interest rates has been achieved over the past two years. This will become evident only as aggregate demand is restored to more normal levels and — what may sometimes be another matter — action is taken to attain longer-term objectives with respect to the external current account.

Saving, investment and interest rates.

In sorting out various factors that have influenced the recent behaviour of interest rates, it is useful first to look at broad trends in saving and

Saving, investment and bond yields.*



* Yield on government bonds for Belgium and Switzerland and on private bonds for the Netherlands.

investment. Experience suggests that long-term interest rates can normally be expected to move fairly closely in line with the rate of domestic fixed capital formation. This reflects the fact that saving propensities are usually more stable than those relating to investment. However, this is not always the case, as changes in the saving components, either autonomous or caused by large shifts in external demand, can actively influence interest rates. And, of course, interest rates are influenced by changes in expectations with regard to demand, prices and policy.

In the United States, for instance, it seems clear from the graph that the sharp rise in long-term yields from 1966 to 1968 cannot be put down primarily to the strength of fixed capital investment. On the contrary, high rates helped, mainly by curbing housing outlays, to reduce fixed investment relative to gross national product. The behaviour of rates was influenced mainly from the saving side. Most important, the Federal Government's budget shifted on a national accounts basis from a surplus of $1.2 milliard in 1965 to a deficit of $11.4 milliard (annual rate) in the eighteen months up to the middle of 1968. After that time, it is true, the budget position improved notably, but interest rates went on rising. In this phase, however, investment in plant and equipment had begun to accelerate, partly because of increasing costs and inflationary expectations.

In Canada the rate of fixed investment fell back appreciably from 1966 to 1968; gross national saving declined less, and the external current account improved. Yet long-term interest rates continued to rise. The main reasons appear to be the close links with US markets and a similar spreading of inflationary expectations.

In the United Kingdom the rate of fixed investment showed a gradually rising trend from the middle 1950s up to about 1967. Although this development was partly the result of deliberate policy measures, the authorities were less successful in ensuring the saving needed to finance the higher rate of investment. From about 1964 onwards the public sector's investment increasingly exceeded its own saving and added to pressures on financial markets. In the private sector, moreover, cost inflation led to a relative decline in business profits and also undermined external competitiveness. The 1967 devaluation helped to restore profit margins, though further increases in wages partly eroded its effects. The most encouraging recent development has been the shift in the Exchequer position from a large positive to a negative borrowing requirement. As fixed investment, both public and private, was cut back somewhat in 1968, the further rise in long-term yields must be explained more in terms of the reaction of monetary policy to continued wage pressures and external requirements.

In Germany, Italy and Switzerland, on the other hand, the rate of fixed investment in 1968 remained quite low by past standards. As a proportion of gross national product, gross fixed investment in Italy came to 19.4 per cent. compared with a previous peak of 23.7 per cent., in Germany to 23.1 per cent. against an earlier 26.4 per cent., and in Switzerland to

24.7 per cent. against 29.5 per cent. These changes partly reflect a slowing-down in house-building activity, but plant and equipment outlays were also well below their trend rates of growth. In all three countries gross national saving has kept to a high and stable level for some years now.

In Belgium and the Netherlands, as in the United Kingdom, the rate of fixed investment has been on a rising trend for about a decade. But in Belgium this acceleration, even though accompanied in some years by large increases in prices, did not have a very pronounced effect on interest rates. The reason was mainly that saving increased appreciably in all sectors — household, business and public. In the Netherlands the saving ratio after 1963 did not keep pace with the further speeding-up of investment and this was associated with a deterioration in the external current account. These developments, together with substantial annual increases in prices, contributed to a fairly steep rise in long-term interest rates. External factors, however, played a part, as they did in Switzerland, where interest rates had also been low by international standards.

In France the relationship between saving and investment improved markedly as a result of the 1958 stabilisation programme, and long-term interest rates declined for several years thereafter. Concerted new policies from 1962 onwards — one being to bring the central government's budget into balance — aimed at increasing saving so as to facilitate a high rate of investment. The policy proved more successful on the saving than on the investment side, thereby contributing to a continuing strong external position and to a slower increase in domestic prices. The rate of fixed investment accelerated, but public investment had to play a relatively greater rôle from 1965 onwards, by which time an erosion of self-financing capacity dampened industry's propensity to invest. At the same time, long-term interest rates began to move upwards. This process continued when a deterioration in the budget position set in, beginning in 1966. The events of 1968 cut fairly sharply into both private and public saving, despite budgetary counter-measures, thus forcing up interest rates and compelling some curtailment in investment in both sectors.

Bank credit and liquid-asset formation.

Paradoxically, monetary expansion was quite rapid last year even in those countries where interest rates rose the most. This is reflected in the following table in the behaviour of the money supply plus quasi-monetary assets (mainly savings and time deposits) held with the banking system. Money and quasi-money rose in the United States by 9 per cent., in Canada by 14.8 per cent. and in the United Kingdom by 6.6 per cent. In each case the increase was high in relation both to the growth in the real national product (5, 4.7 and 3 per cent. respectively) and to past standards.

In all three countries the difficulty in limiting monetary expansion was largely due to the heavy new credit requirements of the public sector,

The banking system: Monetary survey.

Countries	Years	Annual changes in main assets: Net foreign assets	Annual changes in main assets: Credit to public sector	Annual changes in main assets: Credit to private sector	Annual changes in main liabilities: Money	Annual changes in main liabilities: Quasi-money	Gross national product at market prices	Money and quasi-money[1] as a percentage of GNP
		in milliards of national currency units						
Austria	1966	— 1.20	2.57	14.88	2.47	11.25	262.09	54.4
	1967	4.92	3.41	8.94	3.45	10.58	279.13	55.8
	1968	4.54	3.45	11.16	3.87	12.13	295.10	57.7
Belgium	1966	— 5.60	18.50	22.30	21.20	12.80	916.30	45.4
	1967	7.90	6.60	25.40	10.80	21.60	977.10	46.2
	1968	— 11.00	32.60	26.60	26.10	18.20	1,043.40	47.4
Denmark	1966	0.24	— 0.02	4.77	2.24	2.04	77.09	48.0
	1967	0.11	1.17	2.84	1.77	1.77	84.34	48.6
	1968	0.04	1.86	5.09	3.65	2.41	93.15	48.9
Finland[2]	1966	— 455	223	1,376	129	1,215	27,627	41.9
	1967	— 250	10	1,752	— 31	1,053	29,904	42.6
	1968	1,006	— 415	902	488	1,176	33,314	42.3
France	1966	1.83	0.99	15.09	13.52	5.38	531.90	38.9
	1967	1.24	4.32	22.79	8.86	16.66	572.10	39.9
	1968	— 15.87	4.40	32.58	16.51	9.62	624.70	40.9
Germany	1966	3.24	6.00	19.40	1.40	20.59	480.80	42.0
	1967	5.12	13.60	15.10	7.42	19.51	485.10	46.6
	1968	11.24	7.40	27.60	5.17	29.58	528.80	49.4
Italy	1966	343	897	2,723	1,922	1,737	39,829	67.3
	1967	225	150	3,420	2,425	1,595	43,553	70.1
	1968	346	1,474	2,722	2,362	1,736	46,741	73.6
Netherlands	1966	— 0.27	1.17	1.09	1.20	0.61	74.81	34.2
	1967	0.31	0.49	2.57	1.16	2.33	82.27	34.8
	1968	— 0.31	1.37	2.37	2.16	1.93	90.46	36.1
Norway	1966	0.07	0.52	2.06	0.82	1.50	54.62	51.9
	1967	1.17	— 0.27	1.84	0.83	2.08	60.14	51.4
	1968	1.03	1.17	1.95	1.87	2.10	64.33	53.2
Spain	1966	— 11.54	17.83	134.21	51.41	78.68	1,477.37	66.4
	1967	— 8.09	16.86	156.56	65.07	95.67	1,616.52	68.8
	1968	6.12	32.53	195.39	66.34	159.54	1,760.00	74.3
Sweden	1966	0.57	1.26	2.69	1.22	1.64	113.46	33.7
	1967	— 0.16	1.21	4.92	1.30	3.67	121.95	34.7
	1968	— 0.07	0.60	5.26	2.30	4.55	130.17	37.3
Switzerland	1966	0.43[3]	0.79	4.70	1.11	4.36	64.63	128.6
	1967	0.66[3]	0.80	6.23	2.26	6.25	68.94	130.9
	1968	2.55[3]	0.95	8.10	4.08	8.66	73.18	138.4
United Kingdom[2]	1966	125	441	112	528	—	37,942	33.9
	1967	— 258	1,259	456	1,497	—	39,710	34.6
	1968	— 1,075	1,384	723	963	—	42,424	35.3
United States	1966	— 0.60	2.70	17.00	5.50	11.20	747.60	42.4
	1967	— 0.10	24.30	16.40	13.30	22.00	789.70	43.7
	1968	0.90	13.80	30.40	11.90	20.60	860.60	43.3
Canada	1966	— 0.34	0.65	0.75	0.71	0.53	58.10	34.6
	1967	0.01	1.28	2.08	1.59	1.51	62.11	36.6
	1968	0.33	0.75	2.06	1.64	1.86	67.37	38.2
Japan	1966	123	837	4,542	1,429	2,699	35,131	77.6
	1967	— 214	882	5,154	1,653	2,923	41,563	75.8
	1968	403	759	5,094	1,786	3,270	48,877	74.2

[1] Annual averages based on quarterly data. [2] In millions of national currency units. [3] National Bank only.

Source: IMF, *International Financial Statistics.* For Spain, national statistics.

exacerbated in the case of the United Kingdom and Canada by the public's monetisation of outstanding debt. In the United States the Federal Government's borrowing in the credit markets rose from $6.3 milliard in 1966 to $16.9 milliard in 1968. In Canada the central government's budget fell into deficit in the year 1967–68, and the provincial governments were also heavy borrowers. In the United Kingdom the Exchequer's net borrowing requirement averaged a fairly high £520 million annually over the calendar years 1964–66 and then mounted to £1,135 million in 1967 before falling back to £750 million in 1968. As the table shows, the increase in the banking system's lending to the public sector as a whole was relatively large in all three countries over the past two or three years. In each case various budget measures had by early 1969 brought about a marked decline in the central government's borrowing needs.

In the United States the sharp acceleration in credit to the private sector in 1968 was partly a reflection of the easier monetary conditions that were allowed to prevail after the introduction of the fiscal restraint programme at the end of June. From late 1968 onwards, however, monetary policy was progressively tightened again, leading by early 1969 to a slower pace of credit expansion. In Canada the continued fast growth of money and quasi-money in 1968 was associated partly with the private sector's strong demand for credit but also with an external surplus. Interest rates moved upwards, though monetary conditions were fairly easy over much of the year. On the other hand, in the United Kingdom both the large external deficit and the ceiling on bank lending helped to brake monetary expansion.

In all continental western European countries the rate of growth of money and quasi-money in 1968 was as high as or higher than in 1967. In most cases the rates of expansion fell within a range of 10–15 per cent. and were generally well in excess of the growth in real gross national product. However, these increases occurred at a time when activity was still short of full resource utilisation, and the rise in prices was moderate.

The monetary impact of budget and debt-management policies, as reflected in the table largely under credit to the public sector, was fairly expansionary in most continental countries in 1968 — often more so than in 1967. But, in contrast to the United States, Canada and the United Kingdom, these policies gave an added stimulus to demand at a time when inflation had not yet become an acute problem. Central-government budgets for 1969, however, are generally more cautious and involve a certain degree of restraint.

In Italy the central government's financing requirement rose substantially last year and was covered largely by recourse to the banking system. As an external surplus contributed to liquid-asset creation, the government's monetary financing served primarily to compensate the effects of a weakening of private credit demand. On the other hand, in Belgium, where private credit demand continued to grow, the Treasury's financing requirement increased and its monetary financing rose even more, serving to offset the liquidity drain associated with an external deficit. In France, with a much larger shift into external deficit, the continued growth of money and quasi-money was partly a result of the Treasury's budget deficit and monetary financing; however, it was due far more to the sharp acceleration in credit to the private sector.

In the Netherlands, which had a small external deficit in 1968, increased monetary financing of the budget deficit was the main factor underlying an acceleration in liquid-asset formation. The same was true of Norway, though in this case against the background of an external surplus of a size similar to that in 1967. In Denmark and Spain, where devaluations had occurred in November 1967, there was a pronounced acceleration in liquid-asset formation associated with a speeding-up of credit to both the public and the private sectors. This development may help to explain why these countries did not achieve greater improvement in their external balance in 1968. In Finland, another devaluing country, money and quasi-money also grew faster, but this was coupled with a marked slowing-down in domestic credit expansion, both public and private, and a major improvement in the balance of payments.

In certain countries — Germany, Japan, Sweden, Switzerland and Austria — the relative importance of monetary financing by the public sector declined in 1968. This may not have been altogether inappropriate, however, in view of the amount of liquidity creation via other sectors. For instance, in Germany, Japan and Switzerland the volume of liquidity created as a counterpart to an external surplus was much greater than in 1967 and in Austria it was about as large as in that year. Moreover, private credit demand accelerated sharply in Germany and to some extent also in Austria, while expanding about as strongly as before in Japan and Switzerland.

Monetary policy on the Continent remained generally easy in 1968, for the second consecutive year. A partial exception was France, which raised its official discount rate from 3½ to 5 per cent. in July and then to 6 per cent. in November, when it also imposed a ceiling on bank credit to the economy. Otherwise, official discount rates either remained at the relatively low levels to which they had been reduced in 1967 or came down still further. Belgium lowered its rate from 4 to 3¾ per cent. in March, Sweden's rate was brought down in two steps from 6 to 5 per cent. by October and Denmark moved in three stages from 7½ to 6 per cent. by August.

This situation began to change towards the end of the year, particularly after the rise in the US discount rate in December. This was followed by an increase in the official discount rate by ¾ per cent. in Belgium and ½ per cent. in the Netherlands, which also imposed a ceiling on credit expansion. There were further increases in February 1969 of 1 per cent. in the United Kingdom and Sweden and in March of ½ per cent. in Belgium and 1 per cent. in Denmark. Following a second US increase of ½ per cent., in April, the Netherlands and Belgium raised their rates from 5 to 5½ per cent. and Germany moved shortly after from 3 to 4 per cent. In May rates were increased from 7 to 9 per cent. in Denmark and from 5½ to 6 per cent. in Belgium.

Changes in official discount rates since 1966.

Country and date of change	Official discount rate in %
Austria	
27th June 1963	4½
18th April 1967	4¼
26th October 1967	3¾
Belgium	
2nd June 1966	5¼
2nd February 1967	5
23rd March 1967	4¾
11th May 1967	4½
14th September 1967	4¼
26th October 1967	4
7th March 1968	*3¾*
19th December 1968	*4½*
6th March 1969	*5*
10th April 1969	*5½*
29th May 1969	*6*
Canada	
6th December 1965	4¾
14th March 1966	5¼
30th January 1967	5
7th April 1967	4½
27th September 1967	5
20th November 1967	6
22nd January 1968	*7*
15th March 1968	*7½*
2nd July 1968	*7*
29th July 1968	*6½*
3rd September 1968	*6*
18th December 1968	*6½*
3rd March 1969	*7*
Denmark	
11th June 1964	6½
19th December 1967	7½
19th March 1968	*7*
13th June 1968	*6½*
29th August 1968	*6*
31st March 1969	*7*
12th May 1969	*9*
France	
8th April 1965	3½
3rd July 1968	*5*
13th November 1968	*6*
Germany	
13th August 1965	4
27th May 1966	5
6th January 1967	4½
17th February 1967	4
14th April 1967	3½
12th May 1967	3
18th April 1969	*4*
Greece	
17th January 1963	5½
25th July 1967	4½
25th June 1968	*5*
Japan	
26th June 1965	5.475
1st September 1967	5.84
6th January 1968	*6.205*
7th August 1968	*5.84*
Netherlands	
4th June 1964	4½
2nd May 1966	5
15th March 1967	4½
20th December 1968	*5*
9th April 1969	*5½*
Spain	
9th June 1961	5
27th November 1967	$5^{5}/_{8}$
Sweden	
9th April 1965	5½
10th June 1966	6
3rd February 1967	5½
10th March 1967	5
15th December 1967	6
9th February 1968	*5½*
11th October 1968	*5*
28th February 1969	*6*
Switzerland	
3rd July 1964	2½
6th July 1966	3½
10th July 1967	3
United Kingdom	
3rd June 1965	6
14th July 1966	7
26th January 1967	6½
16th March 1967	6
4th May 1967	5½
19th October 1967	6
9th November 1967	6½
20th November 1967	8
21st March 1968	*7½*
19th September 1968	*7*
27th February 1969	*8*
United States	
6th December 1965	4½
7th April 1967	4
20th November 1967	4½
22nd March 1968	*5*
19th April 1968	*5½*
30th August 1968	*5¼*
18th December 1968	*5½*
4th April 1969	*6*

Up to May, a shift towards credit restraint had occurred in Belgium, Denmark, Germany, the Netherlands, Sweden and, from an earlier date, France. Some countries — Belgium, Denmark, France, Italy and, in early 1969, Germany — had also taken selective measures aimed at reducing or limiting the outflow of capital and the drain on official reserves. In themselves, however, these measures did not involve a tightening of domestic credit conditions.

Domestic capital issues.

The strain on capital markets in the United States, Canada and the United Kingdom was due not so much to private financing requirements as to public-sector needs and monetary restraint. Total issues rose moderately in the United States, declined in Canada and dropped sharply in the United Kingdom. Public-sector flotations were larger in the United States, where Federal

Government borrowing increased markedly and State and local government issues continued to rise. At the same time, bond flotations by the private sector showed a decline, but this was offset to some extent by larger share issues. In Canada, apart from a small increase in central-government borrowing, other types of issues dropped off. This was coupled, however, with an increase in both public and private-sector issues abroad. In the United Kingdom share issues expanded considerably, more than offsetting a decline

Domestic capital markets: 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 net issues
		in milliards of national currency units						as percentages of GNP	
Belgium	1966	12.97	12.17	14.82	15.07	0.46	55.49	3.3	6.1
	1967	12.17	24.67	14.47	21.13	0.17	72.61	3.7	7.4
	1968	18.19	25.64	21.52	31.76	.	97.11	5.1	9.2
Denmark.	1966	−0.16	—	0.23	4.20	—	4.27	5.7	5.5
	1967	−0.16	—	0.29	4.37	—	4.50	5.5	5.3
	1968	−0.12	—	0.13	6.85	—	6.86	7.5	7.4
France	1966	0.56	0.87	3.66	7.11	0.20	12.40	2.1	2.3
	1967	0.21	0.87	3.46	7.00	0.20	11.74	1.9	2.1
	1968	−1.00	0.81	5.56	5.86	—	11.23	1.8	1.8
Germany.	1966	0.36[2]	0.06	2.71	5.10	1.38[3]	9.61	1.9	2.0
	1967	2.11[2]	2.98	1.91	10.23	0.87[3]	18.09	2.7	3.7
	1968	1.13[2]	2.57	3.15	14.10	5.42[3]	26.36	4.3	5.0
Italy	1966	735	853[4]	470	1,178	81	3,317	4.3	8.3
	1967	457	562[4]	396	1,389	22	2,826	4.1	6.5
	1968	831	513[4]	473	1,705	44	3,566	4.8	7.6
Netherlands . . .	1966	−0.02	0.66	0.06	0.80	−0.07	1.43	1.1	1.9
	1967	0.32	0.76	0.04	0.26	−0.04	1.35	0.3	1.6
	1968	0.26	0.71	−0.01	0.33	0.01	1.31	0.4	1.4
Sweden	1966	−0.14	0.37	0.65	4.60	—	5.48	4.6	4.8
	1967	1.20	0.53	0.55	5.61	—	7.89	5.0	6.5
	1968	2.15	0.40	0.49	6.28	—	9.33	5.2	7.2
Switzerland[5] . . .	1966	0.00	0.90	1.26	1.59	0.43[3]	4.17	5.1	6.5
	1967	0.06	0.89	1.33	1.60	0.71[3]	4.59	5.3	6.7
	1968	0.16	0.60	1.92	2.05	0.82[3]	5.56	6.5	7.6
United Kingdom .	1966	0.23[6]	0.19	0.19	0.51	−0.02	1.11	1.8	2.9
	1967	0.53[6]	0.22	0.08	0.41	0.11	1.33	1.5	3.4
	1968	−0.51[6]	0.12	0.36	0.27	0.23	0.49	2.1	1.2
United States[7] . .	1966	6.30[8]	5.50	4.90	11.10	1.50[9]	29.30	2.3	3.9
	1967	12.70[8]	8.80	5.00	15.90	1.90[9]	44.30	2.9	5.6
	1968	16.90[8]	10.10	6.00	13.70	1.90[9]	48.60	2.5	5.6
Canada	1966	0.42	1.59	0.59	0.55	0.04[9]	3.18	2.0	5.5
	1967	0.82	1.84	0.50	0.81	—	3.97	2.1	6.4
	1968	0.91	1.40	0.50	0.39	0.01[9]	3.22	1.3	4.8
Japan	1966	797	206	433	1,576[10]	—	3,011	5.7	8.6
	1967	645	245	384	1,702[10]	—	2,976	5.0	7.2
	1968	581	163	530	1,531[10]	—	2,804	4.2	5.7

[1] Includes issues of semi-public credit institutions and nationalised industries. [2] Change in market holdings of bonded loans and medium-term notes. [3] Includes parts of international issues handled by domestic banks. [4] Includes indirect Treasury borrowing. [5] Includes privately-placed issues. [6] Change in marketable debt (excluding Treasury bills) in public hands. [7] Based on Federal Reserve flow-of-funds data, excluding mortgage loans. [8] Direct issues, including agency issues and participation certificates. [9] Gross. [10] Includes public corporation bonds.

in private bond issues. The gilt-edged market was, however, under great pressure during the year, and the public's holdings of government stock declined sharply. In Japan total issues went down in 1968 for the second year in succession, reflecting a further reduction in public-sector borrowing.

In most continental countries, with France the major exception, easy monetary conditions and buoyant share markets led to a strong increase in new-issue activity in 1968. Bond issues by the private sector (including semi-public credit institutions) usually increased quite sharply, this being attributable in some countries, such as Sweden and Denmark, to an acceleration in mortgage bond issues. Share issues rose appreciably in Germany, Switzerland and France.

In the case of public-sector borrowing, the pattern was less uniform. In Germany both the central and local governments reduced their recourse to the market, thereby facilitating not only a rise in private issues but also a remarkable increase in foreign issues. In Italy and Belgium, on the other hand, the government's larger deficit led to a marked increase in new public-sector issues, which were placed mainly with the banking system. In Sweden government issues also rose sharply, but they were mostly placed outside the banking system. Budget deficits also raised the government's financing requirement in Denmark and France, but these needs were met primarily by direct recourse to the banking system rather than by new issues.

Foreign and international bond issues.

New issues of foreign and international bonds rose in 1968 to $6.4 milliard, or to a level 50 per cent. above that of the preceding year. Once again, international ("Euro") bond issues, i.e. those placed on several markets simultaneously, recorded a sharp rise: from $1.9 milliard in 1967 to $3.4 milliard in 1968. Thus, for the first time, they exceeded the placement of conventional foreign issues on single national markets, which went up from $2.3 to 3.0 milliard. Of this total, $1.9 milliard represented flotations in the United States, largely by Canada and international institutions, while the remainder consisted almost entirely of issues on European — mainly continental — markets.

As to the supply of capital, there has been a marked shift in the relative positions of the United States and western Europe over recent years. In this context one may view the market for international bonds as being essentially a European market in that the funds supplied to the market come directly or indirectly from European countries. Adding these issues to conventional foreign issues in Europe, one finds that placements in western Europe amounted to $4.4 milliard, accounting for 70 per cent. of total foreign and international issues, against only 30 per cent. in 1963. For the United States these percentages were just the reverse.

The shift along these lines continued in the early months of 1969. In the first four months international issues amounted to $1,330 million, against

Foreign and international bond issues: Public offerings and private placements, 1965-68, according to borrowing countries and issue markets.[1]

Borrowing countries or areas	Years	Foreign issues: markets of issue						Inter-national issues[2]	Total issues abroad
		Europe				United States	Total		
		Germany[2]	Switzer-land	Other countries	Total				
		in millions of US dollars							
Continental Europe	1965	—	40	38	79	25	104	456	559
	1966	—	71	33	104	—	104	426	531
	1967	—	54	5	59	—	59	886	945
	1968	99	89	14	202	—	202	658	860
United Kingdom. .	1965	—	23	—	23	80	103	25	128
	1966	—	12	—	12	—	12	40	52
	1967	—	23	—	23	—	23	51	74
	1968	—	15	—	15	—	15	134	149
Canada	1965	—	—	—	—	1,034	1,034	—	1,034
	1966	—	—	—	—	1,070	1,070	—	1,070
	1967	—	—	—	—	1,172	1,172	—	1,172
	1968	63	—	—	63	1,155[3]	1,217	38	1,255
United States . . .	1965	—	10	—	10	—	10	331	341
	1966	180[4]	10	—	190	—	190	439	629
	1967	22	49	—	71	—	71	527	598
	1968	35	139	—	174	—	174	2,059	2,232
Japan.	1965	10	—	—	10	63	73	25	98
	1966	—	—	—	—	—	—	—	—
	1967	—	—	—	—	15	15	—	15
	1968	—	14	—	14	—	14	180	194
Rest of the world .	1965	—	—	59	59	215	275	83	357
	1966	—	—	42	42	204	246	101	347
	1967	—	17	116	133	237	370	305	675
	1968	101	25	31	158	280	438	259	698
International institutions . . .	1965	—	14	56	70	200	293[5]	128	421
	1966	—	12	171	182	175	394[5]	101	495
	1967	—	14	100	114	510	624	120	744
	1968	218	50	138	405	470	931[5]	40	971
Total issues placed	1965	10	88	154	251	1,617	1,892[5]	1,046	2,938
	1966	180	105	246	530	1,448	2,015[5]	1,107	3,123
	1967	22	157	221	400	1,933	2,333	1,889	4,222
	1968	515	331	184	1,030	1,905	2,991[5]	3,368	6,359

[1] Issues with an average maturity of five years or more. Company borrowing through foreign subsidiaries is normally treated as borrowing by the country of the parent company. [2] Non-resident issues in Germany between March 1964 and the end of 1967 are generally treated as international issues. In March 1964 the 25 per cent. withholding tax (coupon tax) on interest payments on German bonds held by non-residents was announced. As a result, non-resident issues, which are not subject to that tax, were sold during this period mainly to foreigners, at interest rates below those prevailing on the domestic market. Excluded from foreign issues in Germany are "Schuldscheindarlehen" (loans secured by certificates of indebtedness) placed privately with German banks. [3] Excluding a $500 million Canadian issue (Churchill Falls) offered in the United States in 1968 but with payments spread over the period 1969–73. [4] Issue in exchange for shares of a German company (Texaco/Deutsche Erdöl). [5] Including small amounts placed in other areas.

$950 million in the corresponding period of 1968, while foreign issues on the Continent rose to $350 million from $175 million a year earlier. In the United States, on the other hand, incomplete data suggest that flotations by foreign borrowers were running at a lower level than in 1968.

Foreign issues. The fact that conventional foreign issues are subject to official approval in almost all countries has been a major impediment to their growth. In the United States the interest equalisation tax has much the same effect as far as borrowing by developed countries is concerned. The levelling-off of foreign issues in the United States last year (by countries and institutions not subject to that tax) was ascribable largely to unfavourable capital-market conditions. Foreign issues in sterling on the London market dropped from an already low figure of $100 million to less than $40 million owing to market tightness as well as to the voluntary programme to curb investment in the developed countries of the sterling area.

On the other hand, in Germany, where foreign borrowers in 1968 continued to have unrestricted access to the market, easy monetary conditions made the capital market very receptive to foreign issues. Increasing to $515 million from only $20 million in 1967, they accounted for a large part of the growth in conventional foreign issues last year. In Switzerland, too, where such issues were liberally approved in 1968, they increased sharply from $160 to 330 million. Foreign issues in other continental countries, though higher in 1968 than in 1967, remained comparatively small and consisted almost entirely of issues by international institutions.

In the first quarter of 1969 foreign issues in Germany continued on a particularly large scale, as did international issues denominated in Deutsche Mark. In consequence, the banks agreed in April to exercise some informal issue control, the immediate aim being to keep the monthly average over the rest of the year below that of the first quarter. Another recent development was the reduction in the US interest equalisation tax at the beginning of April from an interest rate equivalent of 1¼ per cent. to one of ¾ per cent.

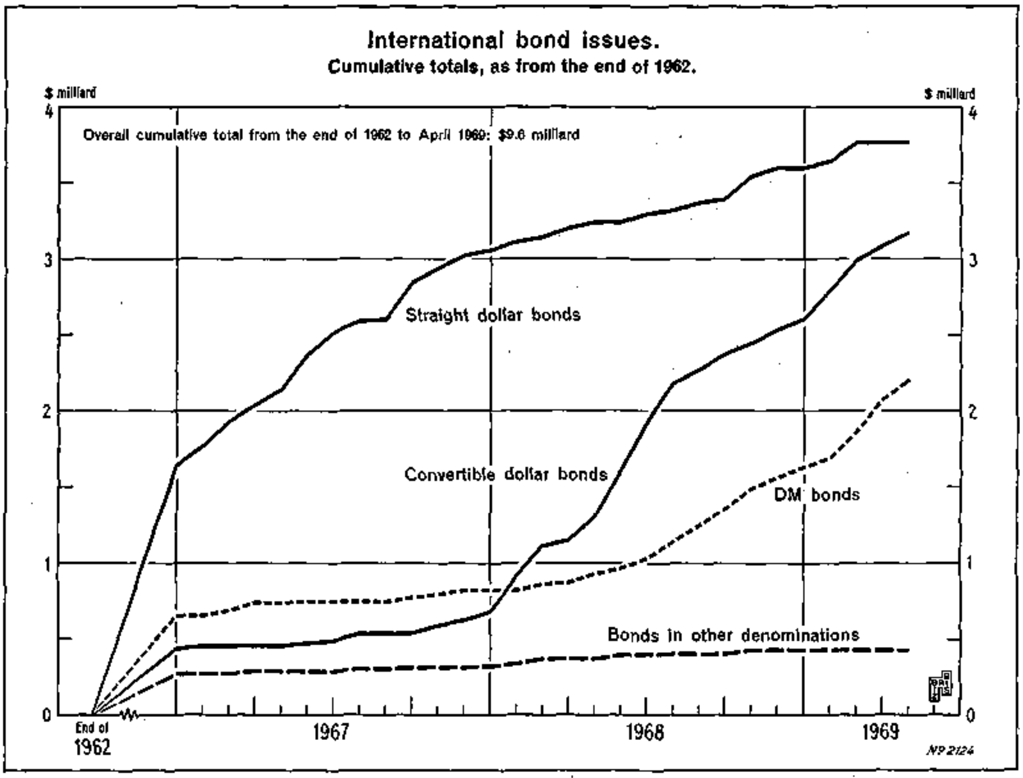
International issues. On the demand side, the strong impetus to international issues in 1968 came from US corporations and their financial subsidiaries. Largely as a result of the stringent US balance-of-payments programme introduced at the beginning of the year, these companies raised their international issues to $2,060 million from $525 million in 1967. Thus, their borrowing accounted for slightly more than the whole of the increase in such issues, and it brought the US share of the total from 28 per cent. in 1967 to 61 per cent. last year.

European borrowing in 1968 amounted to only $790 million, compared with $935 million the year before. This decline was mainly due to a holding-back early in the year, when US corporations were tapping the market for unusually large amounts. For the year as a whole, there was a moderate increase in issues by Austria and Italy, a quite substantial one in those by Finland and the United Kingdom, and above all a steep rise in Dutch placements from $33 million in 1967 to $184 million in 1968. On the other hand, Denmark, France, Norway, Portugal and various European corporations (such as Eurofima, Transalpine and Shell) took up much less than in 1967, while Belgium, Germany and Sweden had no recourse to the market.

Canada entered the international bond market for the first time in August 1968, when a province made a DM issue equivalent to $38 million. Borrowing by the "rest of the world" rose by $135 million to $440 million, mainly reflecting a return of Japanese borrowers to the market after an interval of three years. Finally, international institutions, having turned more to conventional foreign issues, reduced their international issues from $120 million in 1967 to $40 million last year.

On the supply side, the increased flow of funds in 1968 was largely due to widespread monetary ease on the Continent. The most important source continued to be Switzerland, which in the past has probably accounted for between one-third and one-half of new-issue acquisitions, the greater part being taken up by Swiss banks on behalf of non-resident clients, both European and non-European. Furthermore, balance-of-payments data suggest that residents of Germany, Italy, Belgium and the Netherlands substantially stepped up their purchases of international issues last year. On the other hand, participation is virtually excluded for US citizens by the interest equalisation tax and for UK subjects by the high investment dollar premium. Purchases by residents of the Scandinavian countries and, as from last year, by French residents are circumscribed by exchange controls. It should be added that in April 1969 Italy introduced regulations limiting the scope for its banks to participate in international underwriting syndicates.

In the circumstances of 1968 the large growth of the international bond market testifies to its adaptability. The first half of the year was marked by a continuation of uncertainties concerning gold and the dollar and by an intensification of inflationary pressures in the United States. With interest

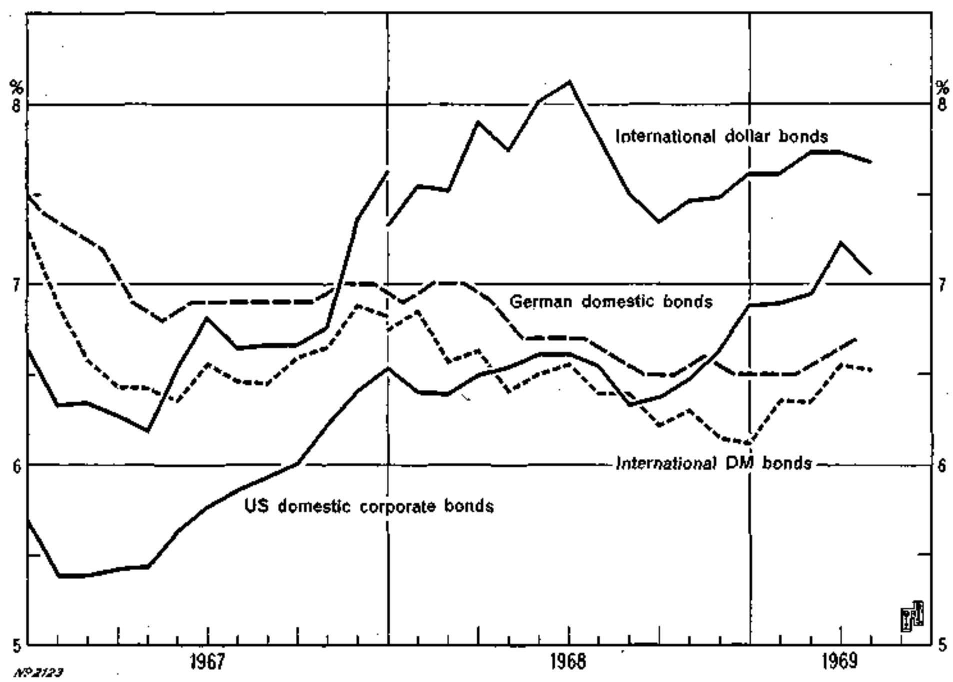


rates on straight dollar bonds rising sharply, but with the US equities market buoyant from the spring onwards, there was a pronounced shift from straight dollar to convertible dollar issues. For the investor, convertible issues provided a hedge against both US inflation and exchange risks. Yields on such issues actually declined up to the summer, but issue conditions had to be made more attractive again from about August onwards, coincident with a certain shift back to straight bonds and a marked increase in DM issues. Over 1968 as a whole convertible dollar issues totalled $1.9 milliard, against only $245 million in 1967, whereas issues of straight dollar bonds declined from $1.4 milliard in 1967 to $535 million.

The pace of DM issues was stepped up from the spring of 1968 onwards, but the acceleration was particularly marked after mid-year, when rumours concerning a possible revaluation of the Deutsche Mark began to take hold. As interest rates on DM issues were relatively low, borrowers did not seem to be deterred by a possible revaluation loss. International DM issues rose from only $170 million in 1967 to $805 million in 1968, or from 9 to 24 per cent. of total international issues.

A significant development since late 1967 has been the different movement of yields on outstanding international dollar and DM bonds and the emergence of a wide gap between them. In the autumn of 1967 yields on both types stood at about 6¾ per cent. However, yields on dollar bonds thereafter rose sharply, reaching 8.1 per cent. in June 1968, while those on

Yields on US dollar and DM bonds, international and domestic.*



* US domestic bond yields are calculated to final maturity, the others to average maturity.

DM bonds edged downwards to about 6½ per cent. by the same date. After the middle of the year dollar bond yields fell rather sharply — to 7.3 per cent. in September — but the gap did not narrow much, as DM yields continued to decline. By the end of the year the gap had widened again, dollar yields having risen to 7.6 per cent. and DM yields having fallen to 6.1 per cent. — their lowest point so far. Early in 1969 yields on DM bonds moved up substantially, reaching nearly 6.6 per cent. at the end of April, at which time dollar yields stood at 7.7 per cent.

It is noteworthy that the yields on international and domestic dollar bonds have tended to fluctuate closely in line with each other, as have also those on international and domestic DM bonds. This suggests that arbitrage between international and domestic bonds of the same denomination has been stronger than that between international bonds of different denominations. The market for international bonds expressed in a given currency is, of course, marginal to the domestic market, and hence international yields in that currency tend to adapt themselves to the domestic ones. Currency preferences and risks help to explain, on the other hand, how it is possible for the yields on international bonds of different denominations to diverge so widely.

From a structural point of view, the development of the international bond market still has some way to go. Problems have been evidenced at times with regard to quotations, transfer procedures and security deliveries. However, efforts have been and are being made to ameliorate the conditions. Moreover, the secondary market, though still fairly narrow, may be expected to become broader and more efficient as time goes on.

Without any question, the performance of the international bond market in recent years has been impressive. It is necessary to ask, however, how far growth, in itself, serves useful ends of policy. The underlying movements of capital, it is true, have generally helped to alleviate existing current-account imbalances. But to a considerable extent these movements have been induced by selective measures rather than by adaptations of relative levels of demand, costs and interest rates. For this reason the market may often serve as a means by which more fundamental adjustment to present imbalances is unduly postponed. As a longer-term aim, therefore, countries should seek, through appropriate domestic adaptations, to eliminate the need for selective incentives to capital imports and exports.

Developments in individual countries.

Canada. After nearly two years of restrained advance, output accelerated considerably from the beginning of 1968, as a sharp upturn in exports was reinforced by a strengthening of domestic demand, led by housing, government expenditure and fixed investment. Monetary policy was at first restrictive, mainly because of the pressures on the Canadian dollar which developed after the sterling devaluation. The Bank of Canada's discount rate was increased from 6 to 7 per cent. in January and, following a series of temporary measures to stem capital outflows, to 7½ per cent. in March, somewhat prior to the discount rate increase in the United States. New fiscal restraints introduced in the spring, principally a 3 per cent. surcharge on personal and corporate income taxes and a speeding-up of corporation-tax collection, were designed to limit the unexpectedly large expansion in the central government's budget deficit.

As the year progressed, a swing back to stock accumulation and a quickening of expenditure on durable consumer goods helped to sustain expansion, while rising exports brought a marked improvement in the trade balance. However, business fixed investment, though continuing to advance, remained below its previous peak in early 1967. Moreover, the labour force increased very rapidly and unemployment edged steadily upwards from an adjusted rate of 4½ per cent. at the end of 1967 to a disturbing 5½ per cent. in the summer. In these circumstances, and in view of developments in the United States, monetary policy was eased rather sharply. The Bank of Canada's discount rate was reduced in three stages between July and September from 7½ per cent., which had been unusually high in relation to US interest rates, to 6 per cent.

The central government's budget deficit in the calendar year 1968 was substantial. It was to a large extent financed by chartered banks, whose liquid assets and holdings of government securities rose sharply during the summer. The expansion of bank liquidity was slowed down in the autumn by a renewed tightening of monetary policy, and the official discount rate was raised to 6½ per cent. in December, simultaneously with the discount rate increase in the United States. Financial markets were brought under strain at the end of the year, by which time expansionary forces had gained considerable momentum. For the year as a whole, the currency circulation plus chartered-bank deposits grew by 13½ per cent., or by not much less than the exceptionally large increase of 14 per cent. in 1967. Banks' loans expanded by 12.4 per cent. in 1968, compared with 14.2 per cent. in 1967, and their holdings of government securities rose by almost $1 milliard, following an increase of about $750 million in 1967.

Severe capital-market pressures and sharp rises in interest rates in early 1968 and again at the end of the year were due mainly to the heavy reliance placed on monetary restraint. With provincial and local governments and corporations increasingly borrowing at short term or resorting to foreign markets, total security issues in Canadian dollars fell by some 20 per cent. in 1968, largely reversing the rise in 1967.

Despite the persistently higher average level of unemployment, the difficulty of controlling price inflation increased during 1968. Wage costs in manufacturing industry rose more slowly than in 1967 but nevertheless faster than productivity. Moreover, as a result of inflation in the United States, less restraint was imposed by competition from abroad, so that consumer prices went up by about 4 per cent. — even more than in 1967 — and inflationary expectations increasingly took hold.

To deal with this situation, fiscal policy was made more restrictive towards the end of the year. The government announced a series of economies in spending and its budget provided, as from January 1969, for an additional 2 per cent. surcharge on personal income tax, a further speeding-up of corporation-tax collection and reductions in tax concessions for financial institutions. Altogether, these measures were designed to reduce the estimated deficit for the fiscal year ending March 1969 from Can. $730 to 675 million and to produce a small surplus in the following fiscal year.

At the beginning of 1969 a prospective recovery of private investment seemed likely to support the upswing and monetary restraint was intensified. As from January the method of calculating chartered-bank reserves was amended with a view to accelerating the response of bank lending to reserve changes. The Bank of Canada raised its discount rate to 7 per cent. in early March, and in April announced an increase in the banks' secondary reserve ratio from 7 to 8 per cent., to take effect in June. In May further fiscal restrictions were adumbrated.

Japan. Under the influence of monetary restraint, which included an increase in the Bank of Japan's discount rate from 5.840 to 6.205 per cent. in January, the pace of output growth eased somewhat in early 1968 in conjunction with an inventory adjustment. But, led by a strong advance in exports, particularly to the United States, rapid general expansion was soon resumed, with private equipment investment, consumption and housing construction all increasing quite fast. Imports, however, after receding in the first quarter, increased only moderately, while exports continued to rise steeply. Though consumer prices moved up at a 5.3 per cent. annual rate, this was little faster than in previous years, and in the typically large-scale export industries rising costs were offset by a rapid advance in productivity.

In these circumstances the Bank of Japan lowered its discount rate to 5.840 per cent. in August and abolished the guide-lines for bank lending, which had been in force for about twelve months, at the end of September. As a precaution, the large city banks were now requested not to permit their reserve positions to deteriorate. During the year the banks' liquidity benefited from substantial net sales of foreign exchange to the monetary authorities. Another important source of liquidity was the government's increased purchases, outside its budget, of grain stocks, which were financed by the issue of short-term securities mobilisable with the Bank of Japan. Thus, the banks' liquidity position became easier during 1968, though by the end of the year market interest rates were generally about as high as at the beginning.

Against this background, the banking system's monetary and quasi-monetary liabilities rose by 14.8 per cent., against 15.5 per cent. in 1967, whereas the gross national product grew by 17½ per cent. in current prices and 14 per cent. in real terms. Demand for bank credit remained generally strong and, despite monetary restraint in the first part of the year, lending to the private sector rose by some 14 per cent. following an increase of 16 per cent. in 1967. Moreover, the banks were also able to accelerate their lending to the

Japan: Changes in financial assets and liabilities, by sectors.[1]

Items	Years	Corporations	Personal sector	Central government	Public enterprises and local authorities	Banking system	Other financial institutions	Rest of the world[2]
		in milliards of yen						
Financial surplus or deficit (—)	1966	—1,418	3,316	— 254	—1,194	.	.	450
	1967	—2,829	4,109	— 292	—1,057	.	.	— 69
	1968	—2,911	4,668	77	—1,457	.	.	377
Net changes in financial assets and liabilities (increase —)								
Money and time deposits	1966	1,780	3,611	— 605	140	—3,209	—1,717	
	1967	1,723	4,333	— 803	210	—3,279	—2,184	
	1968	1,992	4,869	— 992	156	—4,324	—1,700	
Insurance and trust claims	1966	51	1,148	— 166	6	— 25	—1,014	
	1967	76	1,273	— 164	6	— 28	—1,163	
	1968	131	1,514	— 235	4	1	—1,415	
Securities (net)	1966	— 454	472	— 579	— 902	456	958	
	1967	— 421	477	— 478	— 923	698	606	
	1968	— 369	621	— 382	— 890	599	563	
Loans	1966	—3,915	—1,583	1,027	— 404	2,906	1,970	
	1967	—5,135	—1,834	1,128	— 317	3,235	2,923	
	1968	—5,612	—1,867	1,504	— 636	3,649	2,962	
Official reserves	1966							— 12
	1967							— 25
	1968							319
Other foreign claims (net)	1966	353		80	— 37	56		447
	1967	— 115		107	— 30	— 38		— 71
	1968	— 56		91	— 52	113		89
Miscellaneous transactions[3]	1966	767	— 332	— 11	3	— 184	— 197	15
	1967	1,043	— 140	— 82	— 3	— 588	— 182	27
	1968	1,003	— 469	91	— 39	— 38	— 410	— 31

[1] Provisional estimates. [2] A positive figure signifies an increase in claims (or a reduction in liabilities) vis-à-vis the rest of the world. [3] Including trade credit and statistical discrepancies.

public sector. Total lending by non-bank financial institutions, on the other hand, grew about as fast as before.

The total net financing requirement of the public sector remained almost unchanged in 1968, but the government's budget deficit proper declined considerably as a result of the rapid expansion of fiscal revenue, leading to a reduction from Yen 640 to 460 milliard in planned issues of long-term bonds for the fiscal year 1968–69.

With both internal and external demand strong, corporate saving rose substantially in 1968, and although there was a further marked increase in its investment, the corporate sector's total net financial deficit was only a little higher than in 1967. Despite this, companies' recourse to domestic credit institutions continued to increase at about the same rate as before, with the proceeds being used partly for reconstituting their liquidity. At the same time, company issues of new securities fell back slightly from the 1967 level. Investment by the personal sector, especially in housing, rose sharply, but a remarkable growth of savings enabled this sector to increase its holdings of liquid assets and insurance claims while keeping its borrowing at about the same level as in 1967.

Although there was little evidence of a deterioration in the trade balance or of a faster increase in prices in early 1969, policy remained cautious. The Bank of Japan continued its supervision of bank reserve positions and the government's 1969–70 budget envisaged a reduction in bond issues to Yen 490 milliard. Central government budgetary spending is to rise somewhat faster than in 1968–69, but the rate of increase in total public expenditure is to be kept below the forecast growth rate of gross national product.

Italy. Up to the late summer of 1968 output moved ahead at a fairly good, though somewhat disappointing pace, propelled mainly by the continued rapid growth of exports. Domestic demand, particularly for consumer goods, showed signs of weakness, evidently because budgetary developments, viewed in terms of the growth of revenue relative to expenditure, had proved to be too restrictive. The reason was largely that planned expenditure, particularly for public investment, was slow to be carried out. The slower growth of consumption, which was evident more in money than in real terms, was also attributable partly to a shift in expenditure towards housing.

A new programme to stimulate the economy was introduced in the late summer. The measures, mainly fiscal and budgetary, included a tax credit on new investment, a partial taking-over by the government of southern Italian firms' social security charges, the abolition of a surcharge on electricity consumption, new credit facilities for small and medium-sized enterprises and additional funds for railway development. From about this time onwards economic activity gathered momentum, mainly because of a new spurt in exports but also because public expenditure began to accelerate.

Industrial production rose from December to December by 7.2 per cent., compared with 6.3 per cent. in 1967. Real gross national product went up by 5.7 per cent., compared with 6.4 per cent. in the previous year, with exports accounting for about 45 per cent. of the growth in demand. Private investment in plant and equipment grew less quickly than in 1967, though house-building made a good recovery. Consumption advanced only moderately, partly because wages were rising more slowly than in 1967, and the rate of stock-building fell back quite sharply. These developments, together with the carry-over of the good harvest of 1967, were reflected in a reduced flow of imports, particularly during the first half of the year.

The shift in budget policy from restraint to stimulus is clearly revealed in the deficit on the public sector's combined accounts, which increased from Lit. 695 milliard in 1967 to Lit. 1,165 milliard in 1968. Current expenditure (including transfer payments) rose by 11 per cent., compared with 8.7 per cent. in the preceding year, while public investment advanced by 23 per cent. after a decline of 5 per cent. in 1967. These changes were coupled with a growth in the Treasury's cash borrowing requirement from Lit. 1,225 milliard in 1967 to Lit. 2,070 milliard in 1968, which was met chiefly by recourse to the banking system. Thus, the credit institutions took up securities issued by or for the Treasury in the amount of Lit. 850 milliard, against Lit. 305

milliard in 1967. In addition, the Treasury's borrowing from the central bank aggregated Lit. 500 milliard, following a net repayment of Lit. 140 milliard in the previous year. Government security sales to the public, though still considerable, were appreciably smaller than in 1967.

Liquidity creation via the balance of payments, though much less than that deriving from the Treasury's deficit, was appreciably greater than in 1967. It would have been even larger, however, had it not been for an unprecedented outflow of long-term capital. Given the relative ease of domestic monetary conditions and the attractiveness of investment abroad, Italian residents moved funds out on a scale that went far to offset the unusually large current-account surplus.

With domestic demand relatively weak, bank credit expansion moderated in 1968. The increase in the credit institutions' lending to the economy, which in 1967 had risen by over 15 per cent., fell back to about 10 per cent. Deposit liabilities, on the other hand, advanced by over 13 per cent., or almost as much as in the preceding year. In these circumstances the banks' security purchases (excluding Treasury bills), which in 1967 had amounted to Lit. 1,010 milliard, rose to Lit. 1,535 milliard, of which over half consisted of issues on Treasury account. In addition, taking advantage of high interest rates abroad, the banks moved from approximate balance to a strongly positive net foreign position.

In contrast to bank lending, medium and long-term credit-granting by the special credit institutions accelerated last year, expanding by 17.6 per cent.

Net security issues in 1968 came to Lit. 3,565 milliard, or fully one-quarter more than in 1967. Besides the larger issues on Treasury account, those of the special credit institutions and public organisations (such as ENI and IRI) increased considerably. While bank purchases lent substantial support to the market, the public also acquired securities on an appreciably larger scale. In line with policy objectives, long-term interest rates remained quite stable for the fourth year in succession.

In recent years Italy has found itself in an increasingly paradoxical situation. Though it is a country needing rapid growth, its relatively high saving, instead of being absorbed fully in domestic productive and social investment, has been partly exported via the balance of payments. In fact, the external current surplus in 1968 was equivalent to well over 20 per cent. of net national saving and to nearly 4½ per cent. of national income. The problem is being dealt with on two fronts. Stimulatory budget policy is expected to provide the necessary impetus to domestic demand. But, in addition, direct action has been taken to curb the outflow of capital. In late March the banks were requested to reduce gradually their net foreign assets so as to balance their position by 30th June 1969. Shortly after, at the beginning of April, the Bank of Italy suspended the general authorisation allowing banks to participate in consortia for the taking-over and placing of foreign security issues. At the same time, the sale of shares in Italy by foreign investment funds was made subject to official approval, and this will be granted only if at least 50 per cent. of the funds' portfolios consists of Italian securities.

Switzerland. A new expansion has marked the economic trend in Switzerland since the autumn of 1967. The growth of real gross national product, after slowing down over a period of three years, picked up again and reached 3½ per cent. in 1968, against 1.9 per cent. the year before. The main force leading to this acceleration was foreign demand, but from about the middle of the year onwards fixed investment, too, showed a certain recovery. Consumption, on the other hand, remained rather weak and its growth again fell short of the preceding year's results. In view of this development, labour markets remained fairly easy and prices kept stable.

In the monetary field conditions of ease prevailed throughout the year. A subdued domestic demand for credit and a remarkable increase in savings contributed to this, but the rise in the current-account surplus and, especially, the inflow of foreign funds were also very important. The banks, whose liquidity was already high at the beginning of the year, received substantial amounts from abroad during the gold crisis in the spring and at the time of the political events in France during May and June. A new wave came in November, when the currency speculation was at its height. But, with the assistance at times of swap facilities offered by the National Bank, the banks used these foreign funds to augment their foreign investments. In addition, attracted by the high interest rates obtainable abroad, they employed substantial domestic resources to increase their net foreign assets. The call-money rate fluctuated widely, but over the year as a whole it moved upwards in conjunction with developments in other centres.

Total bank lending increased in 1968 by almost 10 per cent., or at much the same rate as in 1967. The growth of net new lending to the domestic sector, however, fell short of this and according to newly available statistics came to only Sw.fr. 5.1 milliard, or 8.4 per cent. If mortgage lending, which accounted for more than half the expansion, is excluded, the growth rate goes down to 7.6 per cent. On the liabilities side, in contrast, deposits and other funds increased substantially. The rise was related partly to the inflow of foreign funds and partly to the growth of domestic savings. Under these circumstances interest conditions remained largely unchanged. As regards lending rates, however, a significant development was a renewed tendency for mortgage rates to increase. This was attributable essentially to the progressive replacement of maturing 5 to 8-year cash certificates (Kassenobligationen) by new issues bearing the higher rates prevailing since 1967.

Demand for bonds increased in 1968 and from the middle of the year onwards all resident applications for new issues were approved by the bank committee supervising the market. Reflecting a strong rise in private-sector flotations — partly offset by lower government borrowing — net bond issues by domestic borrowers came to Sw.fr. 2,820 million, against Sw.fr. 2,545 million in 1967. Non-resident issues, comprising both traditional foreign issues and tranches of international issues placed by domestic banks, also went up on a net basis, from Sw.fr. 712 to 818 million. However, as much as half of this amount was subscribed by non-residents and therefore did not directly burden the Swiss capital market. In spite of the increase in total flotations, yields came down over the year. The average yield on outstanding bonds of the Confederation decreased from 4.59 per cent. in January to 4.33 per cent. in December and that on cantonal bonds from 5.03 to 4.66 per cent. However, recent new cantonal bond issues have borne the same 5 per cent. nominal interest rate as early in 1968. High long-term yields abroad probably kept Swiss rates from falling as much last year as they might have done in view of the considerable increase in savings.

The overall development allowed the authorities to pursue a generally passive policy. The Confederation's budget, originally expected to be slightly in deficit, turned out a small surplus. The principal aim of monetary policy was to prevent foreign funds from exercising an expansionary effect on the domestic money supply. In the short-term market, the National Bank's active use of swap arrangements, together with high rates abroad, helped towards this end. In addition, in order to facilitate the outflow of capital the Bank approved all applications for foreign issues in Switzerland and for credit transactions abroad that are subject to authorisation. Moreover, the amount below which foreign loans can be issued without approval was raised from Sw.fr. 5 to 10 million and permission was granted for the first time to place foreign medium-term debt certificates denominated in Swiss francs on the domestic market.

Austria. After remaining fairly level for about two years, industrial production rose steeply in late 1967 and throughout 1968. This development appears to have been linked largely to a turn-round in the stock cycle, which occurred in conjunction with an acceleration in exports and a continuing steady rise in private consumption. Fixed investment, on the other hand, showed another decline over the year. The real gross national product increased by 4.1 per cent. in 1968, against 3.1 per cent. in 1967. In spite of this expansion, labour-market conditions remained easy and consumer prices rose relatively little, apart from certain administrative and fiscal adjustments.

Economic policy played a significant part in the revival of business activity. For the second year in succession fiscal policy was expansionary, providing for tax reliefs, an anti-cyclical increase in expenditure and additional outlays under an emergency budget. As a result, the budget deficit rose from Sch. 3.7 milliard in 1966 to Sch. 8.4 milliard in 1968. Monetary policy also remained generally easy, following the reduction of the official discount rate in two stages in 1967 from 4½ to 3¾ per cent.

Commercial-bank lending (including security purchases) expanded in 1968 by Sch. 14.9 milliard, against Sch. 12.0 milliard in 1967. By far the greater part of this increase was attributable to private-sector borrowing and to some extent reflected a shift from foreign to domestic sources of funds. With interest rates abroad comparatively high, the private sector scaled down its net foreign borrowing to Sch. 1.9 milliard from Sch. 3.8 milliard in 1967. On the other hand, the central government, partly in order to keep domestic monetary conditions easy, covered much of its financial requirements by net borrowing abroad; for the public sector as a whole such borrowing from foreign sources came to Sch. 4.9 milliard, thus substantially exceeding the current-account deficit of Sch. 2.2 milliard. The resulting net inflow of foreign exchange, combined with a high rate of deposit formation, enabled the banks to improve their net foreign position substantially. At the same time, their domestic liquid assets declined by an amount almost equal to their repayment of indebtedness to the central bank.

In the budget sphere, forward projections showed that deficits would grow still larger in the coming years, even assuming continued economic expansion. As a first step towards containing this tendency, indirect taxes on alcoholic drinks, tobacco and new cars were raised in September 1968. In January 1969 taxes on income and property, social security contributions and railway tariffs were increased and social subsidies reduced. In addition, expenditure economies were introduced and certain commitments were shifted to other public organisations. As a result, the budget deficit for 1969 is expected to be kept down to Sch. 8.0 milliard, although expenditure is to increase by 8.9 per cent. In view of the continuing weakness of fixed investment and the remaining margins of productive capacity, a deficit of this size does not appear at present to be inappropriate. Its financing abroad, however, should probably be kept more in line with the requirements of external basic balance.

Belgium. The upswing that had begun in the early autumn of 1967 continued, though with some hesitation during the summer, throughout 1968. Rather more than elsewhere, however, it depended on the stimulus of rising exports. For most of the year domestic demand remained relatively subdued and unemployment went on rising up to the summer, stayed on a plateau for some months and began to decline only late in the year. Wages advanced appreciably less than in 1967, thereby tending to moderate the recovery of private consumption and to retard further the rise in prices. Re-stocking took place on a large scale, but this expressed itself primarily in a rise in imports, which about matched that in exports. With productive capacity under-utilised, investment in plant and equipment was restrained and house-building declined in real terms for the third year in succession. As a deliberate policy stimulus, however, public investment was considerably increased, thus reinforcing the contribution of exports to raising aggregate demand. Gross national product rose in real terms by 4 per cent., compared with 3½ per cent. in 1967.

Against this background monetary policy was kept relatively easy over most of 1968. In March the official discount rate was brought down from 4 to 3¾ per cent., after having been as high as 5¼ per cent. at the beginning of 1967. Long-term bond yields also edged downwards over the twelve months to the middle of 1968. This situation, however, together with the financial tensions prevailing in certain markets abroad, led to an outflow of capital at both short and long term. The 1967 gain in official reserves was more than reversed. Money-market rates were the first to come under pressure, though partly also for domestic reasons, and the National Bank ceased from the autumn onwards to counteract their upward movement. Subsequently, on 19th December, following the rise in the US discount rate and when economic recovery had become more robust, the Belgian rate was raised from its low level of 3¾ per cent. to 4½ per cent.

Despite the drain on domestic liquidity associated with the external deficit, the money supply plus quasi-money rose by B.fr. 44.3 milliard, compared with B.fr. 32.6 milliard in 1967. This acceleration was not connected with the behaviour of credit to the private sector, which, on the contrary, rose slightly less fast than in the preceding year. Rather, it was ascribable to the central government's budget and debt-management policies. Owing largely to a speeding-up of public investment, the Treasury's net financing requirement rose from B.fr. 23.0 milliard in 1967 to B.fr. 34.1 milliard in 1968. Moreover, whereas the Treasury's recourse to the banking system had been negligible in 1967, its borrowing needs last year were covered to the extent of over two-thirds by monetary financing. This pattern of borrowing was concentrated largely in the first half of the year. Later, when more normal channels were used, money and quasi-money expanded less rapidly and long-term interest rates rose.

In the early months of 1969 economic activity grew vigorously as exports continued to rise and domestic demand accelerated. House-building had begun to recover in the latter part of 1968, and plant and equipment outlays were starting to rise sharply. Expenditure on durable consumer goods picked up, and consumer prices also rose somewhat faster — both developments reflecting in part the early anticipatory effects of the value added tax to be introduced at the beginning of 1970. Unemployment continued to decline.

Over these months the downward trend in official reserves also persisted. For this reason a principal aim of monetary policy was to keep domestic interest rates in line with those abroad, particularly those in international markets. The timing of increases in domestic rates, however, had to depend largely on the progress of domestic recovery. Domestic developments provided the basis in March for an increase in the discount rate from 4½ to 5 per cent., and in early April, following the upward adjustment in the United States, the Belgian rate was raised further to 5½ per cent. Prior to the latter increase, also to help restrain the outflow of funds, a ceiling was imposed on banks' spot positions in foreign currency drawn from the controlled exchange market plus their advances in convertible franc accounts.

The strained international situation, the rapid revival of the domestic economy and the large-scale public-sector expenditure programme led to the adoption of new credit measures at the end of April. The National Bank fixed ceilings for rediscounting by individual banks at 16 per cent. of the average total over the preceding twelve months of deposits in Belgian francs, proceeds of medium and long-term bond issues and the banks' own funds. In addition, the banks were asked to limit their total credit-granting in 1969 to 14 per cent. of the end-1968 total, as such an increase would be sufficient to meet all credit demand compatible with an ordered growth of the economy.

With economic activity expected to go on rising buoyantly, an objective of policy is to keep public expenditure under selective restraint. Thus, in early May it was decided to suspend the contingency tranche (B.fr. 7.5 milliard) of the extraordinary budget and to curtail ordinary budget expenditure. In addition, the public credit institutions were asked to be more selective in granting credits, but without prejudice to investment plans for restructuring the economy. It was also announced that consumer-credit terms were to be tightened. In late May the discount rate was put up to 6 per cent.

Netherlands. Economic activity quickened considerably in the latter half of 1967 and continued at a fast pace during 1968. As a result, the real gross national product increased by 6.3 per cent., against 5.6 per cent. in 1967. More pronounced was the growth of industrial production, which in the last quarter of 1968 reached a level 12½ per cent. above that a year earlier. The main stimulus came from exports and fixed investment, which expanded in real terms by 13 and 10 per cent. respectively. On the other hand, household consumption increased only a little more than in 1967 and the expansion of public consumption even slowed down. However, reflecting earlier action to stimulate recovery, total government expenditure was again expansionary, as evidenced in a widening of the budget deficit from Fl. 2.2 milliard in 1967 to Fl. 2.8 milliard in 1968. In the principal industrial areas there was full or even over-employment. Combined with a considerable improvement in productivity, wages rose by 7 per cent. in 1968 and consumer prices went up over the year by a further 4.2 per cent.

With monetary policy still easy over most of the year, commercial banks increased their short and medium-term lending to the private sector in 1968 by about 20 per cent. for the second year in succession. The increase in their long-term lending was also substantial, reaching almost Fl. 1 milliard, against Fl. 0.4 milliard in 1967. Their credit-granting to the public sector was lower, but this was because the government, in order to help avoid strains on financial markets, covered a substantial part of its requirements by recourse to the Nederlandsche Bank. Almost equal to the commercial banks' total new lending was the growth in their deposits, which rose by Fl. 3.2 milliard, against Fl. 2.5 milliard the year before. But, since high interest rates abroad led the banks to increase their net foreign assets, they not only drew down their liquid domestic reserves but also stepped up their borrowing from the central bank. Such borrowing came to Fl. 345 million, or nearly the same as the increase in the banks' net foreign assets of Fl. 365 million. Domestic money-market conditions gradually tightened over the year, with call-money rates rising from just over 3 per cent. to almost 5 per cent.

Net domestic borrowing on the capital market (including direct loans) amounted in 1968 to Fl. 8.9 milliard, which was roughly 12 per cent. above that in 1967. The private sector took up Fl. 6.1 milliard, or 30 per cent. more than in the preceding year. Public-sector fund-raising, on the other hand, decreased from Fl. 3.3 to 2.8 milliard. This was in line with the government's aim of increasing the scope for private-sector borrowing by having recourse to short-term funds and by continuing the practice of centralised financing of the local authorities through official credit institutions. Security transactions with non-residents, finally, involved a considerable increase in the net outflow of funds. Nevertheless, market conditions were relatively stable, except for a temporary weakness in the summer, and yields on most types of government bonds remained generally below 6½ per cent. This picture changed, however, towards the end of the year, when domestic and international developments set off a rise in interest rates which brought the yield on state loans up to more than 7 per cent. in March 1969.

Towards the end of 1968 pressures on costs and prices had become quite pronounced and they were aggravated by the introduction of a 12 per cent. value added tax at the beginning of 1969. In addition, credit-granting accelerated and the external accounts weakened. As a first step towards policy restraint, intended also to curb the outflow of funds, the discount rate was raised from 4½ to 5 per cent. in December. Subsequently, a ceiling equivalent to an annual growth rate of 10 per cent. was imposed on short-term bank lending to the private sector and excess credit-granting was made subject to the holding of non-interest-bearing deposits with the Nederlandsche Bank. The banks were also required to restrict the rise in their long-term lending to the accrual of long-term resources. These measures were supplemented in January by a tightening of hire-purchase terms and by a halving of the special tax relief on investment in 1969, granted in connection with the changeover to the value added tax. New measures were taken in April, when inflationary symptoms had become more evident. The discount rate was raised to 5½ per cent. and the investment credit was abolished altogether. In the same month a general price freeze on goods and services was imposed after consumer prices had increased in the first quarter by 4½ per cent., which was considerably more than could be explained by the value added tax alone. Further tax measures are scheduled for July, when the duty on beer, alcoholic beverages and petrol is to be raised by about 10 per cent.

The budget for 1969, as presented last autumn, was designed to be less expansionary than that for 1968. None the less, drawn up before the economy had reached a stage of overheating, it provided for an 8 per cent. rise in expenditure and an overall deficit of Fl. 2.5 milliard. The fiscal measures taken since that time will tend to reduce this deficit, as may also certain envisaged expenditure economies. In addition, the government has declared its intention to shift its financing more to the capital market.

Denmark. Demand pressures had eased somewhat during 1967, as consumption slowed down after the introduction of the value added tax and private investment weakened under credit restraint. However, little progress was made towards ending the severe cost inflation which had been continuing for several years. But it was primarily the UK devaluation that occasioned the change in the parity of the Danish krone by 7.9 per cent., or by slightly more than half as much as sterling. Trade margins were frozen immediately, and in December the Nationalbank increased its official discount rate from 6½ to 7½ per cent. and terminated its support of the bond market. But a stabilisation programme did not emerge until February 1968; under this the scope of price and profit controls was broadened and the value added tax increased from 10 to 12½ per cent. from the beginning of the new fiscal year in April. This change, together with expenditure economies, was designed to bring about a budget surplus in 1968–69 of D.kr. 445 million following a deficit of D.kr. 350 million in 1967–68.

Consumption remained level during the first half of 1968 and unemployment rose somewhat. With fiscal policy tighter, it was considered that investment recovery could be assisted by an easing of credit conditions. The Nationalbank reduced its discount rate from 7½ to 6 per cent. in three stages in March, June and August. In February twelve-month deposits were exempted from the provision introduced in 1965 that 20 per cent. of any increase in deposits with commercial and savings banks should be placed on special deposit with the Nationalbank or used to improve net foreign positions, and in August this ratio was reduced to 10 per cent. in respect of other deposits. Danish enterprises were permitted to borrow abroad as from July, and most of the restrictions on domestic bond issues were lifted in stages between March and September.

Industrial exports benefited substantially from devaluation, and in the latter part of 1968 private investment and house-building began to speed up. The advance in activity was also stimulated by a substantial increase in public expenditure, especially by local governments, which took advantage of easier credit conditions. Furthermore, revised estimates of the central government's budgetary outcome showed that, instead of a large cash surplus as originally expected, a considerable deficit would be realised. Prices were brought progressively under control during the year and in November price and profit controls were extended, though in a modified form, until July 1969.

Long-term interest rates eased until the late summer but then began to come under pressure owing to the rapid increase in new issues following the relaxation of controls over them. In these circumstances the Nationalbank again intervened on the bond market, taking up about half of the issues offered in the last four months of 1968. Part of the resulting rise in bank liquidity was offset by securing the agreement of commercial and savings banks to deposit D.kr. 1,000 million with the central bank for between one and five years. Of this, some D.kr. 700 million had been lodged by the end of 1968, but the rise in the Nationalbank's total security holdings for the year as a whole came to D.kr. 2,150 million. Another source of bank liquidity was a deterioration in the government's net position with the central bank. As an outcome, facilitated by the public's high liquidity preference, commercial-bank deposits grew by 17 per cent. in 1968, compared with 11 per cent. in 1967. And, as their advances went up by 9½ per cent., or at about the same rate as in 1967, commercial banks were able to increase their investments. Furthermore, their primary liquidity rose substantially over the year.

Around the turn of the year domestic production and imports accelerated and, in conjunction with an outflow of capital, official reserves began to decline sharply. In February the banks were requested to reduce their foreign exchange holdings by about one-fifth, and were given increased interest incentives to place funds with the central bank. The 1969–70 budget aimed at a surplus of D.kr. 180 million, to be achieved by a reduction in the rate of growth of expenditure. But the government still wished to assist investment selectively by avoiding a rise in long-term interest rates. Thus, after a renewed upsurge in its support purchases of bonds, the Nationalbank concluded agreements with the banks and mortgage institutions, under which bank lending was to replace mortgage financing of building during the construction stage. In addition, restrictions on local-government borrowing were reintroduced.

At the end of March, along with a rise in bank lending rates, the official discount rate was increased to 7 per cent. Although the immediate objective was to restore an incentive to bring in short-term capital following rises in interest rates abroad, this move appeared to be consistent with domestic considerations. On 12th May, after further heavy losses in external currency reserves, the discount rate was put up to 9 per cent. In addition, the government announced selective tax increases and public expenditure economies designed to yield in total about D.kr. 800 million in 1969–70. Shortly afterwards, the Nationalbank concluded agreements with the commercial and savings banks whereby the August 1968 measure reducing their special reserve requirements was reversed with retroactive effect. For any increase in deposits after April 1969, moreover, the reserve ratio was raised temporarily to 30 per cent. At the same time, the scope for meeting the requirements by placing funds abroad was restricted and bonds with up to thirty years to maturity were made eligible.

Norway. In 1968, after several years of sustained rapid advance, the growth of output slowed down considerably. Exports continued to rise but domestic demand weakened, mainly on account of a fall in fixed investment, together with an adjustment in stocks and a slowing-down of consumption.

The monetary and fiscal policies formulated at the beginning of 1968 were designed to promote some reduction in demand pressures. The government budget provided for slower growth of expenditure, although lending to the state banks, principally for housing, was to be increased. Credit policy was aimed at limiting the expansion in commercial and savings-bank lending in 1968 to the same rate as in 1967. To make the limit effective, the authorities no longer relied on formal agreements with the banks, applying instead the higher minimum liquidity ratios established at the end of 1967.

With growth slackening considerably during the year, the normal working week was reduced from 45 to 42½ hours in July without bringing the labour market under strain. Investment fell progressively as a number of major projects were completed, inducing the government in the autumn to provide some stimulus to demand. Additional finance was provided for special employment schemes, the quotas for mortgage lending and bond issues were increased, the granting of credits from state banks for new investment projects was accelerated and some N.kr. 200 million of investment funds held in blocked accounts at Norges Bank were released. Owing largely to additional expenditure, the government's total financing requirement in 1968 proved considerably greater than originally forecast. The 1969 budget, presented in October, provided for a continuation of this stimulus, to come mainly from rising expenditure, an increase in loans to state banks and some easing of income tax, though certain indirect taxes were raised.

Commercial and savings-bank lending to the private sector in 1968 at first expanded slowly, then quickened a little in the final quarter, and for the year as a whole the growth came to about 9 per cent., broadly in line with the increase envisaged at the beginning of the year and that recorded in 1967. On the other hand, with the large external surplus and a run-down of the government's balances at Norges Bank contributing to liquidity, commercial and savings-bank deposits rose by 13.6 per cent. in 1968, compared with 10 per cent. in 1967. Thus the banks were able substantially to improve their foreign positions and, especially towards the end of the year, to augment their liquid assets. Their holdings of domestic bonds, which bear relatively low interest rates, showed little increase.

In the course of 1968 an improved balance in the economy was evidenced by a smaller rise in prices, less pressure on the labour market and a strengthening of the foreign trade balance. Towards the end of the year there were some indications of a moderate upturn in activity. Reflecting a preference for expansion based on large-scale investment projects requiring long-term financing, credit policy for 1969 was designed to avoid an acceleration in the growth of bank lending, and the recommended ceiling for the increase in commercial and savings-bank credit was set at N.kr. 1,800 million, or about 8 per cent.

Sweden. Retarded by the weakness of private investment, output continued to advance rather slowly in early 1968. With demand and price pressures considerably reduced, the government provided some selective support for demand through its budget and housing policy, but carefully sought to avoid renewed general overheating. Monetary policy, too, became less restrictive once the exchange-market difficulties of late 1967 had been overcome, and in February the Riksbank reduced its discount rate from 6 to 5½ per cent. On the other hand, the regulations imposing penal interest rates on commercial-bank indebtedness to the central bank in excess of certain limits remained in force.

Although it envisaged increases in employment-creating and infrastructure expenditures, the government's budget, as presented in January for the year beginning July 1968, called for a reduction in the overall deficit. It provided for the replacement of the turnover tax by a value added tax, supplemented by a 1 per cent. tax on pay-rolls as from January 1969. But the new tax was to be refunded on capital goods and, as an interim incentive to investment, tax-free amortisation of 10 per cent. on machinery purchases in 1968 was permitted.

Recovery was at first slow. Faced with a further rise in unemployment, the government introduced selective stimulatory measures in the spring, including an advancing of the timing of certain government orders, an acceleration of public housing construction, further releases of funds held by industry in blocked Riksbank accounts and incentives for increased private construction. The easier labour-market conditions prevailing in 1968 did, however, contribute to a significant stabilisation of wages and prices, and in October the Riksbank lowered its discount rate to 5 per cent.

Assisted by a rise in exports, demand strengthened progressively in the latter part of the year. An acceleration of private consumption and public investment and some further advance in housing more than offset the fall in private investment for the year as a whole, so that in 1968 real gross national product rose by 3½ per cent., compared with 2½ per cent. in 1967.

The net increase in lending by the credit system came to S.kr. 19.9 milliard, compared with S.kr. 17.3 milliard in 1967 and S.kr. 12.7 milliard in 1966. Borrowing by both the housing and the business sectors rose substantially. The business sector had less recourse to the capital market, while issues of housing bonds expanded sharply. At the same time, reflecting mainly demand from the business sector, the growth of commercial-bank advances accelerated from 12 per cent. in 1967 to 17 per cent. in 1968. The commercial banks achieved this large increase in advances by limiting their acquisition of liquid assets to S.kr. 816 million in 1968, compared with S.kr. 3,246 million

Sweden: Net credit flows.

Lenders	Years	Borrowers				
		Government	Local authorities	Housing sector	Business sector	Total
		in millions of Swedish kronor				
Riksbank	1967	330	20	140	160	656
	1968	1,230	10	110	30	1,380
Commercial banks	1967	1,325	180	2,520	1,910	5,930
	1968	255	70	2,060	3,345	5,735
Other banks	1967	290	835	1,920	785	3,825
	1968	510	600	2,280	830	4,215
Public insurance institutions	1967	240	460	1,665	1,805	4,170
	1968	535	495	2,785	1,880	5,690
Private insurance institutions	1967	− 30	95	680	670	1,415
	1968	190	115	890	600	1,795
Others	1967	850	55	− 95	545	1,360
	1968	650	75	− 20	390	1,095
Total	1967	3,010	1,645	6,830	5,875	17,355
	1968	3,370	1,365	8,105	7,070	19,905

in 1967. The government's borrowing requirement was higher in 1968 and, compared with 1967, was financed less by the commercial banks and more by the central bank and other financial institutions. With the banks' bond purchases reduced, the considerable increase in new issues by the government and the housing sector was financed largely via the National Pension Fund.

By early 1969 the expansion of output had gained momentum and an accelerated rise in imports was becoming a matter for increasing concern. Partly in view, too, of renewed capital outflows, monetary policy became more restrictive, and in February the Riksbank increased its discount rate to 6 per cent. Moreover, to bring bank liquidity under effective control, as well as to strengthen the market for housing bonds, the banks' obligation to meet hitherto informal liquidity ratios was made legally binding and subject to an interest rate penalty of 4 per cent. of any deficiency. The ratios were defined broadly as before and remained at 30 per cent. for large banks; but they were tightened in certain respects, principally by restricting the eligibility as liquid assets of banks' net foreign currency claims on banks abroad to 1½ per cent. of their total liabilities. Furthermore, savings and insurance institutions and the National Pension Fund undertook, in agreement with the Riksbank, to invest two-thirds of the increase in their total assets in government and housing bonds. To leave room for a desired recovery of private investment, the 1969–70 budget proposals envisage a number of economies in spending and a reduction in the overall deficit.

Finland. A contraction in productive investment had caused growth to slacken in 1967, but the external balance remained unsatisfactory until the devaluation of the Finnish markka in October. Measures taken at that time successfully curbed consumption and, with credit policy still restrictive, domestic demand remained subdued in early 1968. Nevertheless, prices rose steeply in the aftermath of devaluation until the implementation of an extensive programme in April 1968.

This programme provided for the abolition of indexation arrangements in respect of wages, bank deposits, government bond issues and most other contracts. It also called for a limit on increases in wages and agricultural prices and a freeze on other prices and on rents and bank lending rates up to the end of 1969. The government undertook to curb increases in its own spending and in loan issues and to avoid tax changes before the end of 1969.

Throughout 1968 monetary policy sought to avoid a sharp increase in bank liquidity. However, as other stabilisation measures helped to slow the growth of demand, some easing was permitted during the year. Foreign import credits of up to six months were authorised as from the beginning of the year, and in order to check rising unemployment the Bank of Finland provided F.mk. 170 million to finance industrial investment and housing. The banks' obligation under a 1966 agreement to make special deposits with the Bank of Finland related to the increase in their deposits was terminated in June, and a quarter of such deposits was released in the latter part of the year. On the other hand, the government repaid F.mk. 100 million of the special loan received from the Bank of Finland in 1966. Although the average export levy imposed after devaluation was reduced in three stages from 11 to 4 per cent. during 1968 and terminated at the end of April 1969, the gradual accrual of unspent proceeds of the levy on a special government account at the Bank of Finland significantly limited the contribution of the external surplus to bank liquidity.

Under these policies a high degree of balance and stability was achieved in 1968. Price increases levelled off substantially; the consumer-price index, after rising by 4.4 per cent. in the first four months of 1968, went up by only 1.2 per cent. over the rest of the year. Private consumption and public investment were held in check, the balance of payments improved and private investment showed signs of revival towards the end of the year. The banking system's sight deposits rose sharply, but lending to the private sector went up by less than 6.6 per cent., compared with more than 12 per cent. in both 1966 and 1967. Bills rediscounted at the central bank fell by F.mk. 250 million to F.mk. 618 million during the year.

In early 1969 output was advancing more quickly. The government's 1969 budget envisaged a reduction in total outlays and a lower borrowing requirement than had actually arisen in 1968. This is partly attributable to removal of certain expenditure and lending items from the budget proper, but significant expenditure economies are also involved. According to recent estimates, however, the government's borrowing requirement is expected to be not significantly below that of 1968.

Spain. Following earlier restraint measures, output growth had slowed down considerably in 1967, principally as a result of a fall in productive investment. The devaluation of the Spanish peseta in line with sterling was accompanied by measures designed to check consumption growth and the unabated upward spiral of wages and prices, whilst providing selective stimulus to investment. Hire-purchase terms were tightened, and a pending increase in public salaries and pensions was postponed. Moreover, with the assistance of import subsidies, customs-duty adjustments and levies on certain exports, prices were frozen until the end of 1968, as were personal incomes. A temporary 10 per cent. surtax was imposed on part of enterprise profits in 1968, but depreciation allowances and special tax benefits for investment were increased and the government-supported house-building programme was expanded. The Bank of Spain's discount rate for commercial paper was raised from 5 to $5^5/_8$ per cent. and for financial paper from $5^3/_4$ to $6^3/_8$ per cent. Concurrently, there were rises of $1/2$ per cent. in bank lending rates and of a full 1 per cent. in interest rates on time deposits.

Led by rising exports, industrial production resumed an upward course in early 1968, but productive investment remained weak and in the autumn the government announced further incentives, in the form of cash grants, official credits and tax rebates, for investment in industrial growth centres.

With public expenditure and dwelling construction rising strongly, the expansion of domestic output and imports accelerated in the second half of the year. Private consumption, too, seems to have recovered. In November taxes on tobacco and luxury goods were increased by an average of 20 per cent.

However, with recovery still in the early stages, the labour market remained easy. With the help of price controls, the rise in the cost-of-living index during 1968 was kept down to less than 3 per cent., compared with an average of 6 per cent. in the years 1966–67. The general wage freeze was lifted ahead of schedule at the beginning of October but ceilings were fixed for wage increases in 1968 and 1969, whilst price control was extended until the end of 1969. The national minimum daily wage, which had been raised by 14 per cent. in 1967, remained unchanged in 1968 but was increased by 6.25 per cent. to Pesetas 102 as from January 1969. At the same time, however, the tax on labour income was to be extended to cover manual workers.

The external surplus contributed part of the substantial increase in the liquidity of the economy in 1968. But credit to the domestic sectors also played a major rôle. The central government's expenditure accelerated in 1968, particularly for lending and transfers, while its revenue slowed down. The budget deficit of Pesetas 42.7 milliard, up from Pesetas 29.9 milliard in 1967, was financed to an increased extent by sales of securities, principally to banks, while recourse to the central bank was reduced. On the other hand, autonomous public-sector organisations again relied heavily on central-bank credit, and there was a sharp rise in the granting of types of credit enjoying guaranteed rediscount facilities at the Bank of Spain.

Demand for credit strengthened in the second half of the year and the credit system's lending to the private sector rose by almost 20 per cent. in 1968, following an increase of 18 per cent. in 1967. Credit institutions' ordinary lending to the public sector expanded, mainly in the form of security purchases, by about 20 per cent., as against 14 per cent. in the preceding year. The proportion of their deposits which banks must invest in government securities was raised by 2 per cent. in two stages in 1968, as in 1967, and is to be increased by a further 1 per cent. to 22 per cent. with effect from end-June 1969. Reflecting the changed structure of interest rates, time and savings deposits increased at the expense of a slower growth of demand deposits in 1968, but towards the end of the year the expansion of demand deposits also accelerated and over the year as a whole money and quasi-money rose by nearly 19 per cent., compared with about 15 per cent. in 1967.

By early 1969 the previous mild recession had been overcome and overall output growth had probably returned approximately to its pre-1967 rate.

Portugal. The recovery in the growth of domestic production, which had commenced in 1967 with an upturn in agricultural output, became somewhat more broadly based in 1968. The main impetus appears to have come from consumption and the rebuilding of stocks. Fixed investment seems to have remained generally weak and the growth of exports and tourism slackened. A somewhat faster rise of consumer prices was related to developments in food supplies and in construction, but it also reflected substantial wage adjustments in certain key sectors.

The central administration's ordinary and extraordinary expenditure is estimated to have increased in 1968 by approximately 10 per cent., compared with about 18 per cent. in 1967. This slower expansion was the result partly of a stabilisation of public-sector labour remuneration following increases in 1966 and partly of a deceleration in public investment. Taxes on profits of commercial and industrial firms were raised in April 1968. On the other hand, tax concessions benefiting investment and agriculture were increased for 1968. Total ordinary and extraordinary revenue (which includes certain borrowing) grew more slowly and the overall surplus was a little smaller than in 1967.

Although a rise in official reserves and central-bank credit contributed slightly less to bank liquidity in 1968, money and quasi-money grew by some 13 per cent., compared with about 11 per cent. in 1967. This was mostly due to a sharp rise in quasi-money, which appears to have been associated with a levelling-off in the growth of long-term funds, other than mortgage finance, directly placed on the capital market in 1968. In conjunction with this shift, credit granted by the banking system to the private sector, which mainly takes the form of discounts of commercial bills, expanded in 1968 by some 16 per cent., compared with only 7 per cent. in 1967. Commercial banks were also able to improve their net foreign positions and to increase their free liquid balances.

Certain measures to improve the efficiency of the credit system were taken in April 1969. Facilities for longer-term credits were enlarged by allowing the banks to grant credits at between two and five years in excess of their own capital and by reorganising the General Deposits, Credit and Pension Fund so as to broaden the field of its lending.

The government's 1969 budget is designed to give a selective stimulus to investment. The budget total is expected to go up by 13.4 per cent. On the expenditure side, public investment will show a relatively large increase; moreover, further tax incentives to private investment are provided. To offset a rise in public-sector salaries and benefits, the rates of certain taxes, including the complementary tax on personal income and the tobacco tax, have been increased.

Eastern Europe.

Money has long played the rôle of a dependent variable in the economic system of eastern Europe. The essential policy instrument has been the centrally-formulated annual economic plan, conceived largely in volume terms, and disaggregated into detailed, mandatory instructions for each producing enterprise. The primary function of the banking system has been to supervise the carrying-out of such instructions on the basis of corresponding financial plans, exercising its influence through control over credit. Capital resources have been allocated principally through the budget. With the economic reforms now being implemented throughout the area, which have as a common characteristic greater autonomy for the enterprises, significant changes are necessarily being introduced into the credit systems.

The process has gone furthest in Yugoslavia, where credit policy — operated through control over bank liquidity and through interest rates — is now perhaps the major weapon for controlling the level of economic activity. And in both Czechoslovakia and Hungary, where emphasis is shifting more towards macro-economic management than elsewhere, it seems that credit policy, including more flexible use of interest rates, will eventually be used both to help influence aggregate demand and also to allocate financial resources more on the basis of rates of return than in the past. In other countries, where the reforms at present seem less radical, interest charges and repayment obligations are being increasingly attached to the provision of long-term capital and more generally the rôle of bank credit is being extended. These changes are related to the increased emphasis being placed upon financial performance as an indicator of enterprise efficiency. If this is to be allowed to influence the pattern of development, it seems that more extensive changes in the monetary system are to be expected, although the main problem remains that of rationalising the price-fixing mechanism. The situation is still too fluid to trace the lines of possible future development with regard to monetary systems in eastern Europe, and it will be some time before the impact of the economic reforms becomes clear.

As to productive activity last year, there was a general tendency for the rate of growth of total output to ease off further following the slow-down noted in 1967. During the early 1960s the pace of economic expansion in the area had declined considerably, but it had recovered strongly by 1966. Then, in 1967, progress slackened, essentially because of the stabilisation of agricultural production at the record level achieved the year before. In 1968, on the other hand, while results in the farming sector were again not particularly good, the retardation of output was more closely related to a slackening of industrial expansion.

In some of the larger countries the slower growth of output was accompanied by an unplanned acceleration in money incomes, and significant imbalance arose in consumer markets. This was the case in the *Soviet Union*, where a fall in the rate of productivity increase to 5 per cent. caused the industrial growth rate to drop back to 8 per cent. from the 10 per cent. figure recorded in 1967. At the same time, partly because of large wage rate increases for low-paid workers, average money earnings went up by as much as 7½ per cent., compared with an average increase of around 4 per cent. over the previous four years. Coupled with a 3½ per cent. rise in employment, the strong growth of earnings seems to have generated demand pressure in the consumer market, despite the increasing attention given to consumer goods. In a planned economy the usual market reactions in terms of rising

Eastern European economies:
National income and industrial and agricultural production.

Country	Net material product			Global industrial output			Global agricultural output		
	1966	1967	1968	1966	1967	1968	1966	1967	1968
	real annual increases, in percentages								
Albania	9.0	7.5	11.0	12.0	12.8	19.0	12.5	12.0	2.5
Bulgaria	11.1	9.0	6.5	12.4	13.4	11.8	14.3	3.5	— 8.7
Czechoslovakia. .	10.2	6.9	7.0	7.4	7.1	5.2	11.1	5.5	3.6
Eastern Germany.	5.3	5.8	5.3	6.3[1]	6.5[1]	6.1[1]	.	.	.
Hungary	8.4	8.7	5.0	6.7	8.7	4.9	8.0	1.0	1.0
Poland	7.2	5.6	8.0	7.4	7.7	9.3	5.4	2.3	4.4
Rumania	10.0	7.0	7.0	11.7	13.5	11.6	14.0	1.8	— 3.6
USSR	7.5[2]	7.0[2]	7.2[2]	8.7	10.0	8.3	8.9	1.6	3.5
Yugoslavia . . .	6.6[3]	1.0[3]	4.0[3]	4.0	0.5	6.6	16.6	— 1.4	— 3.0

[1] Commodity production (i.e. excludes work in progress). [2] Distributed net material product. [3] Gross material product.

Source: UN Economic Commission for Europe, *Economic Survey of Europe in 1968*.

prices or increased imports can be suppressed to a considerable extent. However, in the Soviet Union last year demand pressures seem to have expressed themselves partly in an unplanned rise in prices, since for the first time for many years real earnings rose less than nominal earnings. Policy adjustment to short-run disturbances of this kind is made in the next annual plan: in 1969, therefore, the rise in average earnings is to be cut back to 3 per cent., employment is to increase by under 1½ per cent. and productivity is projected to rise by nearly 6 per cent. Moreover, consumer goods production is to increase somewhat more than producer goods output for the second year running.

Similar tensions in consumer markets developed last year, too, in Czechoslovakia and perhaps also, on a smaller scale, in Hungary. In *Czechoslovakia* production was dislocated during the political crisis in August, and this helps to explain a fall in productivity growth to 4 per cent. in 1968, as well as the decline in the rate of industrial expansion to little over 5 per cent. The rise in average money wages, on the other hand, accelerated to over 8 per cent., perhaps as a result of increased enterprise autonomy under the reforms. The effect of higher wages on consumer spending was accentuated both by an unusually rapid rise in agricultural sector incomes and by substantial dissaving during the political crisis. Despite the sharp rise in demand, the cost-of-living index rose by only 1.2 per cent. in 1968, and pressure was relieved mainly through a run-down of stocks and by allowing the foreign trade surplus to deteriorate. Excess demand continued into 1969, however, and in May more substantial price increases were announced. In *Hungary* the rise in per capita output in industry dropped to only 1 per cent. last year — partly because of a reduction in working hours — and the 5 per cent. increase in total output came mostly from a large rise in employment. Although, therefore, average wages rose by only 2 per cent., the total industrial wage bill went up substantially. Moreover, price adjustments in the agricultural sector brought an increase of about 20 per cent. in peasant incomes. At the same time, the growth of output in the food-processing and light industries in 1968 slowed down to 4 per cent. and under 3 per cent. respectively.

In the other planned economies consumer-market tensions may have moderated in 1968, perhaps not so much because of improved supply conditions, but rather because real incomes and total employment were under better control than at times in the past. On the other hand, real consumption standards everywhere improved much less than in the Soviet Union and Czechoslovakia. In *eastern Germany*, where economic progress has recently been generally somewhat slower but more stable than in other countries of the area, there was again very little rise in employment. Although higher wages for low-paid workers since mid-1967 and substantially increased bonus payments brought a faster rise in average earnings in 1968, the increase was still somewhat less than that of per capita output. In both *Rumania* and *Bulgaria* industrial expansion slowed from about 13½ per cent in 1967 to 11½ per cent. in 1968, and both countries suffered a considerable set-back in agricultural production, being most affected by drought. The rise in total employment was more moderate than in the past, and consumer demand was apparently held back also by very limited wage increases accompanied by a sizable advance in prices. These developments were especially marked in Bulgaria, where the cost-of-living index rose by 5 per cent., causing average real wages to fall by 3 per cent. in 1968.

Quite in contrast to the trend in other countries, there was an acceleration of economic growth in Albania and Poland. In *Albania* this was due to a 19 per cent. increase in industrial output. In *Poland*, too, industrial production rose by more than in 1967, expanding by nearly 9½ per cent., and there was, in addition, a considerable improvement in the agricultural sector. However, although total net output rose by 8 per cent. in 1968, compared with 5½ per cent. the year before, real wages were allowed to increase by only 1½ per cent., against 2½ per cent. in 1967. The cost of living in Poland rose by 2½ per cent. last year.

Despite a set-back in the agricultural sector in *Yugoslavia* last year, there was a considerable recovery in the rate of growth of total output, to 4 per cent. after virtual stagnation in 1967. Once excessive wage and price pressures — originating in the sweeping economic reforms introduced in 1965 — had been brought under reasonable control, monetary policy shifted from severe restraint to expansion late in 1967. The result was a marked improvement in enterprises' liquidity, which brought an upsurge in fixed investment. And, as employment increased from the middle of the year, consumer demand also accelerated. For the year as a whole industrial output rose by 6½ per cent., after a slight decline in 1967, and by the end of 1968 production was running more than 10½ per cent. above the year-earlier level. This rate of expansion caused industrial producer prices to start to move up again in the second half of 1968, after a year and a half of stability, and monetary policy, therefore, shifted back to moderate restraint in the autumn.

Stabilisation had not brought an improvement in Yugoslavia's trade deficit in 1967, and it increased further, to \$535 million, in 1968. Most of this deterioration was, however, again covered by a growth in net invisible receipts (mainly tourism and workers' remittances), so that the current-account deficit rose substantially less, to some \$110 million. As a result of a somewhat larger net capital inflow, however, the overall external position was in approximate balance, and Yugoslavia's gold and convertible foreign exchange reserves rose by \$50 million.

III. WORLD TRADE AND PAYMENTS.

In 1968 the value of world exports for the first time exceeded $200 milliard. This was more than twice the figure ten years previously. The rate of increase, after averaging 10 per cent. in the years 1963–66, had slowed down to only 5 per cent. in 1967, but last year, in response to expansionary conditions in the main industrial countries, in particular the United States and Germany, it went up to 11 per cent. The rise accelerated in the course of the year, from 8 per cent. in the first half to 18 per cent. in the second. The volume of exports increased by 12 per cent. in 1968, with unit values declining by 1 per cent.

International trade.

Areas	Exports			Imports			Increases in volume of	
	1966	1967	1968	1966	1967	1968	exports 1968	imports 1968
	in milliards of US dollars						in percentages	
Developed areas								
Western Europe								
EEC	52.7	56.1	64.2	53.7	55.0	62.0	*16.0*	*14.0*
EFTA	28.5	29.2	31.6	33.9	35.8	38.1	*11.0*	*8.5*
Other countries	5.7	6.1	6.3	10.0	10.0	10.4	*7.0*	*5.5*
Total for western Europe	86.9	91.4	102.1	97.6	100.8	110.5	*14.0*	*11.0*
United States	30.4	31.6	34.7	27.7	29.1	36.0	*8.0*	*22.0*
Canada	10.0	11.0	13.1	10.2	11.0	12.5	*15.0*	*9.0*
Japan	9.8	10.5	13.0	9.5	11.7	13.0	*23.5*	*12.5*
Other areas[1]	6.0	6.4	6.7	7.3	7.8	8.2	*6.0*	*7.0*
Total for developed areas	143.1	150.9	169.6	152.3	160.4	180.2	*13.0*	*13.0*
Developing areas								
Latin America	11.0	11.0	11.5	9.7	10.3	11.2	*3.0*	*7.0*
Other areas	27.3	28.6	31.5	30.2	31.5	33.7	*10.0*	*8.0*
Total for developing areas	38.3	39.6	43.0	39.9	41.8	44.9	*8.0*	*8.0*
Grand total[2]	181.4	190.5	212.6	192.2	202.2	225.1	*12.0*	*12.0*

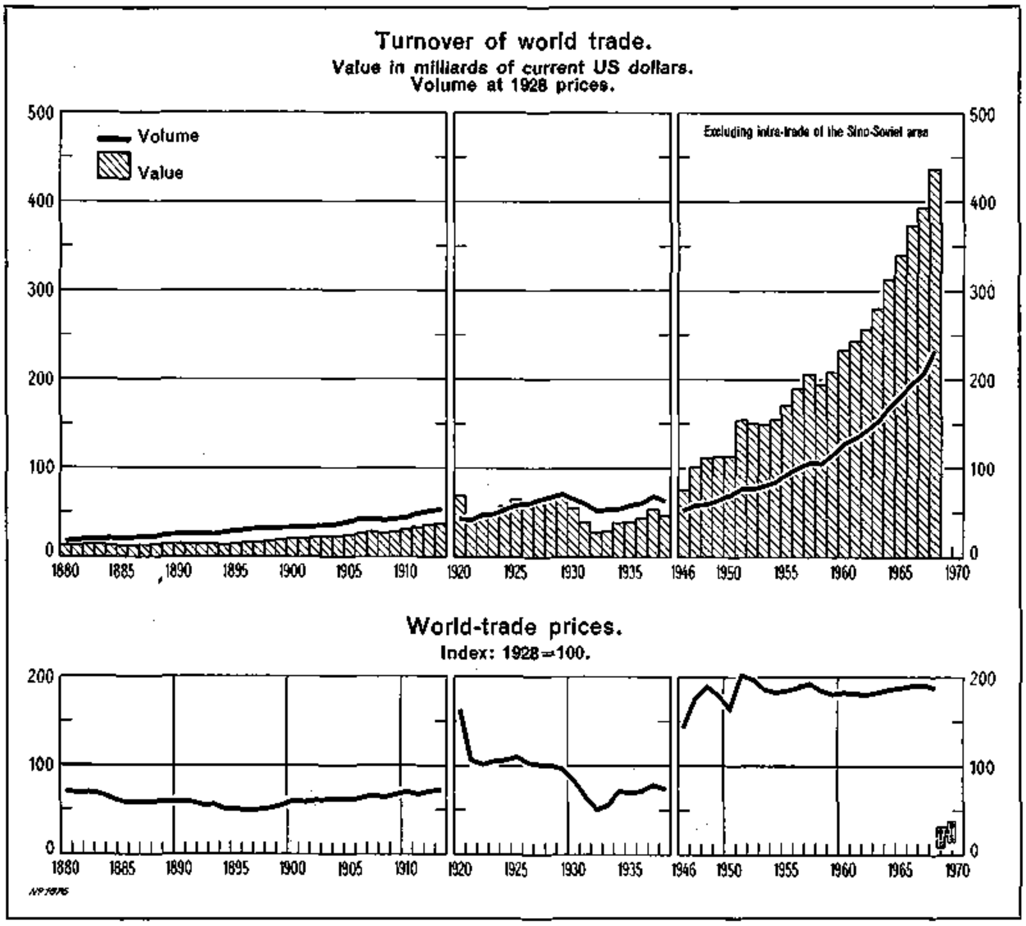
[1] Australia, New Zealand and South Africa. [2] Represents roughly 90 per cent. of world trade, as the trade of centrally-planned economies is included only to the extent that it is reflected in the imports and exports of their trade partners in the West.

In 1967 the volume of exports from both developed and developing countries had grown at the same modest rate, but last year the former went up by 13 per cent. (nearly three times as fast as the increase in real output) and the latter by 8 per cent. Unit values, on the other hand, moved somewhat more favourably for developing than for developed countries. In the first case they went up by 1 per cent., owing to a 6 per cent. rise in prices of exports of non-ferrous base metals, chiefly copper, and a small increase in food prices. In the second case they dropped by 1 per cent. as a result of a slight fall in prices of exports of manufactured goods and of primary commodities, above all food.

Last year's increase in world trade was rather exceptional in comparison with other recent years; it was even more so when looked at in a longer historical perspective. The accompanying graph shows developments since 1880, the earliest year for which at all reliable data are available. Three main phases can be distinguished, separated by the two world wars.

From 1880 to 1913 the volume of world trade, expressed in 1928 prices, grew slowly, the average annual increase being 3.5 per cent. Prices showed a slight downward trend from 1880 to 1896, but afterwards this tendency was reversed, so that the value of trade rose faster in the second half of the period than in the first.

After the disruptions caused by the first world war the volume of trade in 1920 was 20 per cent. less than in 1913, even though, mainly because of the break-up of the Austro-Hungarian empire, more countries were involved. The value of world trade, which had been pushed up by inflated prices in the short-lived boom of 1920, came down in 1921 when prices broke. From then onwards it increased parallel with the volume, as prices



remained practically stable. The latter fell sharply after the crash of 1929, however, so that in the years of the great depression the decline in value was more pronounced than that in volume. The value contracted from $70 milliard in 1929 to $27 milliard in 1932, or by nearly 60 per cent., the volume by 25 per cent. In 1932 the volume had fallen back to the 1913 figure and the value to the 1908 figure. The subsequent recovery in both volume and prices was fairly moderate, and on the eve of the second world war both the volume and the value of world trade were only 20 per cent. above their level in 1913.

A renewed expansion got under way after 1946 and this was due almost entirely to a growth in the volume of transactions, since prices, apart from a sharp rise in the earlier years, due to post-war scarcities and to the 1951 Korea crisis, remained remarkably stable. The annual growth rate from 1946 to 1968 amounted to 7 per cent. (exactly twice that in the period 1880–1913). It was somewhat less (6.7 per cent.) in the first ten years and a little more (7.3 per cent.) after the 1958 recession. While world trade prices in 1968 were about 30 per cent. higher than in 1946 (and about 2½ times higher than in 1938), the turnover had risen nearly sixfold at current dollar prices and 4½ times in real terms.

An important factor in the general expansion of trade in 1968 was the high import demand in the United States and Germany, which registered increases of 23 and 17 per cent. respectively over the previous year. The rises of $6.9 and 2.9 milliard in these two countries' imports accounted for nearly half the total growth in world imports. The impact of this demand was felt in all areas, but particularly in the main industrial countries.

**Main industrial countries:
Growth of exports to different areas in 1968**
(based on dollar values).

Exporting countries	Exports to: United States	EEC: Germany	EEC: Other countries	EEC: Total	United Kingdom	Other countries	All countries
	in percentages over previous year						
BLEU	31	23	17	18	7	6	16
France	16	20	14	16	4	8	12
Germany	38	—	17	17	16	8	14
Italy	26	24	19	21	7	13	17
Netherlands	27	22	18	20	11	5	14
Total EEC	30	22	16	18	10	8	14
Sweden	15	15	7	10	20	5	9
Switzerland	14	22	11	15	15	15	15
United Kingdom*	25	15	6	8	—	3	7
United States	—	0	11	7	9	10	9
Canada	25	28	10	11	4	8	19
Japan	36	34	20	26	23	19	24
Total	28	18	14	15	11	9	13

* UK produce and manufactures.

Exports to the United States from Germany, Japan and the Belgium-Luxemburg Economic Union went up by 38, 36 and 31 per cent. respectively, and those from Canada, Italy, the Netherlands and the United Kingdom by some 25 per cent. Resumption of expansion in Germany exerted its greatest pull on Japan, Canada, Switzerland and the EEC partners. Exports to Germany from Japan and Canada expanded by 34 and 28 per cent. respectively, and those from Germany's EEC partners and Switzerland by 22 per cent. each. The United States, despite an overall export rise of 9 per cent., did not increase its sales to Germany at all.

In all, EEC exports went up by 14 per cent., compared with 7 per cent. in the previous year, Italy and the BLEU recording the highest rates with 17 and 16 per cent. respectively and France the lowest with 12 per cent. Exports from EFTA countries rose by 8 per cent. in 1968, compared with 2 per cent. the year before. In 1967 UK exports had actually declined, but they recovered last year with a 7 per cent. gain. The leaders among the EFTA countries in 1968 were Switzerland, Norway and Austria with export rises of 15, 12 and 10 per cent. respectively, while Denmark lagged behind with 4 per cent.

Exports from the United States, Canada and Japan all grew at an accelerated rate in 1968, viz. by 9, 19 and 24 per cent. respectively (compared with 4, 10 and 7 per cent. in the previous year). But whereas in the United States the growth of exports in 1968 was far exceeded by that of imports, the reverse was the case in Canada and Japan. Indeed, the increase in the latter's imports slowed down from 22 to 11 per cent.

The exports of Australia, New Zealand and South Africa combined went up by 4.5 per cent., compared with a rise of 7.5 per cent. in 1967. The main reason for this change was that Australia's wheat sales, which had nearly doubled in value in 1967, fell back sharply last year. Sales of mineral products and manufactures increased, however, so that the Australian export total rose slightly. New Zealand's exports recovered from their previous decline, since the continuous price fall for its staple products was more than compensated by a growing volume of sales. South African exports, despite the reduction of gold sales, increased by 11.5 per cent., nearly as much as in 1967.

The divergent growth rates of exports and imports in the different countries caused significant changes in the pattern of trade balances. On an f.o.b. basis, the traditional US export surplus, which had been shrinking continuously since 1964, was practically wiped out. It fell from $3.5 milliard in 1967 to $0.1 milliard last year. Conversely, Japan's export surplus increased by $1.3 milliard and the export surpluses of Canada and the EEC countries both went up by $0.7 milliard. The deficit of EFTA countries was reduced by $0.2 milliard despite a rise in the UK deficit.

The deterioration in the US trade account and the improvement in Canada's and Japan's trade balances were partly offset by inverse movements in the balance of invisible items. Consequently, the US surplus on current account shrank from some $3.5 to 0.8 milliard, Japan's current balance swung

Balances of payments: Actual positions and changes in 1967 and 1968.

Items	Years	United States	Canada	Japan	EFTA	EEC[1]
		in milliards of US dollars				
Trade balance	1967	3.5	0.6	1.2	− 4.7	4.7
	1968	0.1	1.3	2.5	− 4.5	5.4
Change		*− 3.4*	*+ 0.7*	*+ 1.3*	*+ 0.2*	*+ 0.7*
Services	1967	—	− 1.1	− 1.4	3.3	− 0.3
	1968	0.7	− 1.5	− 1.5	3.7	− 1.2
Change		*+ 0.7*	*− 0.4*	*− 0.1*	*+ 0.4*	*− 0.9*
Current balance	1967	3.5	− 0.5	− 0.2	− 1.4	4.4
	1968	0.8	− 0.2	1.0	− 0.8	4.2
Change		*− 2.7*	*+ 0.3*	*+ 1.2*	*+ 0.6*	*− 0.2*
Net capital movements	1967	− 7.1	0.8	− 0.4	1.2	− 2.5
	1968	− 0.6	0.6	0.1	1.0	− 6.1
Change		*+ 6.5*	*− 0.2*	*+ 0.5*	*− 0.2*	*− 3.6*
Overall balance	1967	− 3.6[2]	0.3	− 0.6	− 0.2	1.9
	1968	0.2[2]	0.4	1.1	0.2	− 1.9
Change		*+ 3.8*[2]	*+ 0.1*	*+ 1.7*	*+ 0.4*	*− 3.8*

[1] Including BIS provisional estimates for France. [2] On a liquidity basis.

round from a deficit of $0.2 milliard to a surplus of over $1 milliard and Canada's current deficit was reduced from $0.5 milliard to less than $0.2 milliard. For the EEC countries as a group, the current surplus declined from $4.4 to 4.2 milliard, as a rise in the export surplus was not sufficient to offset a $0.9 milliard increase in net outpayments on services account. In the EFTA countries, on the other hand, net receipts from invisible items increased by $0.4 milliard and the current deficit was reduced from $1.4 to 0.8 milliard.

Changes in capital movements (long and short-term and errors and omissions taken together) more than compensated the deterioration in the US current balance and partly offset the improvement in that of Canada and the EFTA group. In Japan and the EEC countries, on the other hand, the changes in the capital account were added to those in the current account.

Changes in the pattern of capital movements.

One of the most striking developments in the international balance-of-payments position last year was the change in the pattern of capital movements. Its most obvious manifestation was the turn-round in the position of the United States, hitherto the world's biggest exporter of private capital, to being a capital-importing country. This development was accompanied by opposite changes in the capital accounts of a number of European countries, notably the emergence of sizable capital outflows from France, Germany and Italy.

United States: Balance of private capital movements.

Items	1964	1965	1966	1967	1968
	in millions of dollars				
US capital					
Long-term					
Direct investment	– 2,330	– 3,465	– 3,625	– 3,020	– 2,745
Portfolio	– 675	– 760	– 480	– 1,265	– 1,290
Claims reported by US non-banks	– 485	– 90	– 110	– 290	– 115
Claims reported by US banks	– 940	– 230	335	285	355
Total	– 4,430	– 4,545	– 3,880	– 4,290	– 3,795
Short-term					
Claims reported by US non-banks	– 625	425	– 335	– 470	– 965
Claims reported by US banks	– 1,525	325	– 85	– 745	– 100
Total	– 2,150	750	– 420	– 1,215	– 1,065
Total outflow	– 6,580	– 3,795	– 4,300	– 5,505	– 4,860
Foreign capital					
Long-term					
Direct investment	– 5	55	85	250	365
Portfolio	– 85	165*	1,010*	1,470*	4,175
Liabilities reported by US non-banks	– 40	30	180	90	685
Liabilities reported by US banks	90	165	190	150	45
Total	– 40	415	1,465	1,960	5,270
Short-term					
Liabilities reported by US non-banks	115	150	295	390	665
Liabilities reported by US banks	1,555	130	2,385	1,455	3,835
Total	1,670	280	2,680	1,845	4,500
Total inflow	1,630	695	4,145	3,805	9,770
Balances					
Long-term	– 4,470	– 4,130	– 2,415	– 2,330	1,475
Short-term	– 480	1,030	2,260	630	3,435
Errors and omissions	– 860	– 315	– 210	– 530	– 200
Total	– 5,810	– 3,415	– 365	– 2,230	4,710
Total excluding liquid liabilities	– 7,365	– 3,545	– 2,750	– 3,695	875

* Excluding UK Treasury sales of US securities.

The US private long-term capital account moved from a net outflow of $2.3 milliard in 1967 to a net inflow of $1.5 milliard in 1968. In addition, the outflow of short-term funds (including errors and omissions but excluding changes in US liquid liabilities to non-official foreigners) declined from $1.4 to 0.6 milliard. The overall private capital account, therefore, turned round from a net outflow of $3.7 milliard in 1967 to a net inflow of $0.9 milliard in 1968. And if the changes in US liquid liabilities to non-official foreigners are taken into account, then the shift would be from a net outflow of $2.2 milliard to a net inflow of $4.7 milliard.

Three main factors were responsible for this dramatic change in the US capital account last year: the reinforcement of direct controls on capital outflows; the tight domestic monetary situation and the consequent rise in US interest rates; and the much greater demand in the rest of the world for US securities.

Measures to limit the outflow by means of direct controls had been taken by the United States on a number of occasions during recent years. The origins of these measures are to be found in the large increase in net capital outflows that got under way at the end of the 1950s. This increase arose out of the favourable investment opportunities available in Europe, which was experiencing rapid economic growth at a time when there existed a certain amount of slack in the US economy. Between 1959 and 1964 the net outflow of long-term capital from the United States went up from \$1.6 to 4.5 milliard and the short-term capital account shifted from a net inflow of \$0.4 milliard to a net outflow of \$2.9 milliard. As a result the US current external account was no longer adequate to provide fully for the transfer of capital abroad.

The US authorities then began to take measures to slow down the capital outflow. In July 1963 the interest equalisation tax was imposed on all purchases by US citizens of long-term foreign securities originating in any industrial country. This was followed up in February 1965 by the so-called voluntary restraint programme on direct investment outflows, the extension of the interest equalisation tax to foreign lending for periods of more than one year by both banks and non-banks and a ceiling of 5 per cent. of the end-1964 figure on new bank credits to be granted to foreigners during 1965. The February 1965 programme was subsequently strengthened twice, in December 1965 and December 1966, and then in January 1968 the controls over direct investment outflows were made mandatory.

These various controls over capital outflows were supported by the subsequent development of the domestic economy, which by the middle of 1966, in the absence of fiscal restraint, led to the implementation of a very tight monetary policy. The combination of credit shortage and the restraint programme brought about a marked slow-down in the capital outflow, the net deficit on private capital account contracting between 1964 and 1966 from \$7.4 to 2.8 milliard. In 1967, when there was a short-lived pause in domestic economic growth coupled with easier credit conditions, the outflow increased again, and then in 1968 the renewed emergence of boom conditions at a time when the credit climate in some European countries was fairly relaxed, together with the mandatory restraints on direct investment outflows, led to the very sharp turn-round in the private capital account already described.

The change between 1965 and 1968 in the overall private long-term capital account was due to the extent of only \$750 million to a decline in the net outflow of US long-term capital, whereas over the same period the net inflow of foreign long-term capital went up by \$4.9 milliard. An important reason for this was that the controls on US direct investment had the effect of shifting the financing to foreign capital markets rather than of reducing very greatly its actual level. And the offshore financing of direct investment shows up in an inflow of foreign long-term capital.

The total of US direct investment abroad actually went up from \$2.3 milliard in 1964 to \$3.6 milliard in 1966. Much of this increase was vis-à-vis Canada, which was exempted from the voluntary restraint programme; however, direct investment in Europe also rose, from $1,390 to 1,810 million. In 1967, when there was an economic slow-down both in Canada and in several continental countries, the total of direct investment declined to $3 milliard. And in 1968 the imposition of controls may have contributed to the further decline in the total to $2.7 milliard.

The mandatory restraint programme introduced at the beginning of 1968 placed an absolute ban on the employment of US funds for investment in the developed countries and limited the use of foreign earnings for that purpose to 35 per cent. of the total average 1965–66 investment outflow (essentially in the case of continental Europe), to 65 per cent. in the case of other developed countries and to 110 per cent. in the case of the less-developed countries. Direct investment in continental western Europe, which had already declined by $330 to 1,100 million in 1967, shrank to $500 million in 1968, and its share in total US direct investment fell from over 50 per cent. in 1964 to less than 20 per cent. Direct investment in Australia, New Zealand and South Africa, which had shown a rapid advance in 1967, contracted from $360 to 160 million. On the other hand, direct investment in Latin America expanded from $220 million in 1967 to $610 million in 1968.

Because of the exemption from the ceilings of direct investment financed out of long-term borrowing abroad, full appreciation of the impact of the restraint programme requires a look also at the change in the external liabilities of US residents. In 1966, for example, when direct investment reached a $3,625 million peak, about $450 million was financed out of capital issues abroad and other long-term borrowing abroad amounted to $180 million. In 1968, with total direct investment down to $2,745 million, somewhat over $700 million of the $2,190 million of new security issues abroad (the bulk of which were made through the Euro-bond market) was used for financing direct investment; and the greater part of the $690 million rise in US non-banks' long-term liabilities was probably employed for the same purpose.

US portfolio investment abroad declined considerably in the three years following the introduction of the interest equalisation tax. From a peak of $1,105 million in 1963 it had fallen away by 1966 to only $480 million. In 1967 and 1968, however, portfolio investment recovered sharply to $1,265 and 1,290 million respectively. In fact, the impact of the interest equalisation tax on foreign bond issues in the United States was limited, since the countries affected by the tax accounted for only 35 per cent. of total foreign bond issues in 1963, the year when the tax was introduced. Although new issues by developed countries (excluding Canada) tapered off completely, total new bond issues remained fairly stable at about $1.2 milliard until 1966, subsequently rising to $1.6 milliard in 1967 and 1968. Canadian issues on the US market rose from $695 million in 1963 to $1,005 million in 1967, falling to $865 million in 1968. Between 1963 and 1968 issues by less-developed countries rose from $100 to 320 million and those by international organisations from nil to $390 million.

The introduction of the interest equalisation tax tended to shift certain types of foreign borrowing in the United States away from the security markets over to the commercial banks. Partly for this reason, and partly as a result of tightening credit conditions abroad, the US banks' external long and short-term lending rose from $450 million in 1962 to $2,465 million in 1964. The programme announced in February 1965 extended the interest equalisation tax to bank credits at over one year and put a ceiling (changed over time) on the increase in bank lending to non-residents. The 1968 mandatory restraint programme specified that the banks had to keep their foreign assets within 103 per cent. of the amount outstanding at the end of 1964. The banks have on the whole remained well within the ceiling. Their net new long-term lending, after falling from $940 million in 1964 to $230 million in 1965, was replaced by net borrowing to the extent of over $300 million in 1966, and this trend was maintained throughout 1967 and 1968. Short-term US bank lending abroad, after its $1,525 million increase in 1964, was reduced by $325 million in 1965; large leeways under the ceiling permitted the banks to build up their short-term assets by $745 million in 1967, but this outflow of funds slowed down to $100 million in 1968.

Long-term foreign lending by US non-banks, if deduction is made of a $255 million outflow in connection with the Columbia River Treaty in 1964, has shown relatively little change in recent years. The restraint programme was, however, reflected in the movement of the non-bank sector's short-term assets; as a result of an official request to reduce surplus cash holdings abroad, an outflow of $625 million in 1964 was followed by a $425 million inflow in 1965. Since then corporate short-term foreign assets have been going up again; their $965 million rise in 1968 reflected, however, mainly the depositing in the Euro-dollar market of proceeds from Euro-bond issues.

As already mentioned, the main factor in the turn-round on the private capital account of the US balance of payments was the increase in the inflow of foreign capital, by far the most important item being foreign transactions in US securities. These shifted from net sales of $85 million in 1964 to net purchases of $1,470 million in 1967 and of $4,175 million in 1968. Up to 1966 the increase in this item was partly due to the appearance of US firms as borrowers on the Euro-bond market. In 1967 an even more important development occurred. According to US Treasury sources, foreign investors, who had been net sellers of US shares to the extent of $335 million in 1966, purchased a net amount of $755 million in 1967 and increased their acquisitions to $2,270 million in 1968 (the figures for 1966 and 1967, however, would seem to include sales by the UK Treasury out of its US security portfolio). But even this $2.6 milliard turn-round since 1966 understates the change in attitude of foreign investors in respect of US shares, since it does not take into account foreign purchases of US convertible bonds. After remaining about constant in 1967, US bond issues abroad, in response both to the mandatory restraints and to rising interest rates at home — in the course of 1968 the cost of domestic issues for the first time began to equal or even exceed that of foreign issues — expanded by $1,630 to 2,230 million in 1968; over 75 per cent. of these issues were in the form of convertible bonds.

The rise in foreign demand for US equity capital cannot easily be explained on purely economic grounds. Nevertheless, an important factor was the acceleration since 1965 of economic growth in the United States and its reflection in profits, and this particularly at a time when European firms had been reportedly suffering from declining profit margins. Moreover, the rôle of the strongly intensified activity of American investment funds in Europe should not be understated either. In addition to these more or less economic influences, political factors, too, were undoubtedly of some importance.

As regards other forms of capital flows to the United States, the increase in foreign direct investment from about nil in 1964 to $365 million in 1968 would seem to have been induced mainly by the improved growth performance of the US economy. On the other hand, the expansion in the foreign long and short-term lending to US non-banks from $75 million in 1964 to $1,350 million was related both to the restraint programme and to the credit tightening in the United States.

Balances of payments.

In western Europe as a whole the overall balance shifted from a surplus of $1.4 milliard in 1967 to a deficit of $1.5 milliard last year, owing entirely to a turn-about of $3.8 milliard in the combined balance of the EEC countries.

The moderate decline from $4.4 to 4.2 milliard in the current surplus of the EEC area was the net outcome of an estimated deterioration of $1.5 milliard in France's current account, largely offset by increases of $1.0 and 0.4 milliard in the current surpluses of Italy and Germany. About half of the worsening in France's current account was due to a shift from surplus to deficit in the trade balance, while in the case of Italy and Germany the whole of the increase in the current surplus was on trade account. In Italy exports expanded faster than imports and the negligible import surplus of 1967 was followed by an export surplus of over $1.0 milliard, while in Germany, despite the strong domestic recovery, the export surplus rose from $5.2 to 5.7 milliard. On capital account, taking long and short-term movements together, all the EEC member countries recorded a net outflow, and a larger one than in 1967. The total capital outflow for the group rose from $2.5 to 6.1 milliard, France being estimated to have accounted for nearly half of the increase. The net capital outflow went up by roughly $0.8 milliard in Germany and Italy and by less than $0.2 milliard in both the BLEU and the Netherlands. Whereas for France the capital outflow had a severely destabilising effect, in Italy it largely offset the surplus on current account, while in Germany the long-term capital outflow — a result of the easy monetary policy of the Bundesbank — alone sufficed to offset the current surplus, so

Western European 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. . .	1967	− 125	+ 330	+ 205	+ 50	− 95	+ 160
	1968	− 275	+ 295	+ 20	− 90	− 150	− 220
France	1967	+ 150	− 140	+ 10	+ 265	− 310[4]	− 35
	1968[5]	− 650	− 800	− 1,450	− 300	− 1,400[4]	− 3,150
Germany	1967	+ 5,160	− 2,695	+ 2,465	− 795	− 365	+ 1,305
	1968	+ 5,705	− 2,830	+ 2,875	− 2,835	+ 910	+ 950
Italy	1967	− 20	+ 1,620	+ 1,600	− 1,225		+ 375
	1968	+ 1,050	+ 1,590	+ 2,640	− 2,055[6]		+ 585
Netherlands	1967	− 505	+ 580	+ 75	− 170	+ 155	+ 60
	1968	− 450	+ 525	+ 75	− 145[6]	− 30	− 100
Total EEC	1967	+ 4,660	− 305	+ 4,355	− 2,490		+ 1,865
	1968	+ 5,380	− 1,220	+ 4,160	− 6,095		− 1,935
Austria.	1967	− 545[7]	+ 435	− 110	+ 265	+ 55	+ 210
	1968	− 540[7]	+ 455	− 85	+ 185	+ 15	+ 115
Denmark	1967	− 300	+ 140	− 160	+ 95		− 65
	1968	− 300	+ 185	− 115	+ 115		—
Norway.	1967	− 1,035[7]	+ 835	− 200	+ 350	+ 15	+ 165
	1968	− 785[7]	+ 950	+ 165	+ 25	− 40	+ 150
Portugal	1967	− 335	+ 365	+ 30	+ 120	+ 30[8]	+ 180
	1968	− 305	+ 350	+ 45	+ 85	+ 10[8]	+ 140
Sweden	1967	− 175[7]	+ 25	− 150	+ 105	+ 20	− 25
	1968	− 215[7]	− 45	− 260	+ 50	+ 165	− 45
Switzerland.	1967	− 605[7]	+ 845	+ 240	− 125		+ 115
	1968	− 480[7]	+ 920	+ 440	+ 710		+ 1,150
United Kingdom	1967	− 1,675	+ 645	− 1,030	− 325	+ 545	− 810
	1968	− 1,910	+ 905	− 1,005	− 95	− 210	− 1,310
Total EFTA . . .	1967	− 4,670	+ 3,290	− 1,380	+ 1,150		− 230
	1968	− 4,535	+ 3,720	− 815	+ 1,015		+ 200
Finland	1967	− 180[7]	+ 40	− 140	+ 95	− 30	− 75
	1968	+ 25[7]	+ 50	+ 75	+ 90	+ 75	+ 240
Greece	1967	− 675[7]	+ 490	− 185	+ 170	+ 30	+ 15
	1968	− 765[7]	+ 530	− 235	+ 210	+ 60	+ 35
Iceland	1967	− 55	—	− 55	+ 20	+ 10	− 25
	1968	− 60	—	− 50	+ 40		− 10
Ireland	1967	− 295[7]	+ 325	+ 30	− 10		+ 20
	1968	− 375[7]	+ 325	− 50	+ 20		− 30
Spain	1967	− 1,900	+ 1,320	− 580	+ 460	− 35	− 155
	1968	− 1,730	+ 1,425	− 305	+ 530	− 180	+ 45
Turkey	1967	− 160[7]	+ 45	− 115	+ 130		+ 15[9]
	1968	− 270[7]	+ 45	− 225	+ 200		− 25[9]
Total "other" . .	1967	− 3,265	+ 2,220	− 1,045	+ 840		− 205
	1968	− 3,165	+ 2,375	− 790	+ 1,045		+ 255
Grand total. . . .	1967	− 3,275	+ 5,205	+ 1,930	− 500		+ 1,430
	1968	− 2,320	+ 4,875	+ 2,555	− 4,035		− 1,480

[1] Including unilateral transfers. [2] Difference between current and overall balances. Includes errors and omissions. [3] Equal to changes in net official assets and the net foreign position of commercial banks. [4] Including multilateral settlements and adjustments. [5] BIS provisional estimates. [6] Including official debt prepayments. [7] Imports c.i.f. [8] Including the balance of Portuguese overseas territories vis-à-vis the non-escudo area. [9] Net official assets only.

that the overall payments surplus of \$0.9 milliard corresponded to the net inflow of short-term capital. This largely took the form of an improvement in the terms of payment, which reflected expectations of a revaluation of the Deutsche Mark and uncertainty concerning other currencies.

EFTA countries as a group reduced their current-account deficit from \$1.4 to 0.8 milliard in 1968. Two-thirds of this improvement was due to a rise in net receipts from invisible transactions, particularly in the United Kingdom, Norway and Switzerland. In each of these countries net receipts exceeded \$0.9 milliard last year. In the United Kingdom a rise of \$0.3 milliard reflected an increase in earnings on most private invisible transactions. In Norway and Switzerland rising receipts from shipping and capital income respectively were the chief causes of the improvement. In Sweden and Portugal, on the other hand, the invisible account deteriorated. In the latter country the import surplus was reduced by \$30 to 305 million in 1968 and the current surplus increased from \$30 to 45 million. The net capital inflow amounted to \$95 million and was somewhat smaller than in 1967, so that the overall surplus declined from \$180 to 140 million.

For the EFTA countries as a group the net capital inflow, at \$1 milliard, was roughly the same as in 1967. A turn-about of over \$800 million in Switzerland, from a net outflow to a net inflow, was practically offset by changes in the opposite direction in Norway and the United Kingdom.

As regards the six other western European countries, the overall balance shifted from deficit to surplus in Finland and Spain. Finland's foreign trade balance moved from substantial deficit into moderate surplus, while in Spain there was a contraction of the import surplus and a rise in receipts from services. In both countries there were devaluations in late 1967. Ireland also devalued at the same time but, as it pursued a reflationary policy, its imports rose by 9 per cent. in dollar terms, whereas its exports — 70 per cent. of which go to the United Kingdom — remained stationary. The import surplus increased from \$295 to 375 million and, despite a small net capital inflow, the overall balance shifted from a surplus of \$20 million to a deficit of \$30 million. In Turkey, too, the overall balance moved from a surplus of \$15 million to a deficit of \$25 million, as a substantially larger capital inflow was not sufficient to cover the widening trade gap. Most of the deterioration in the trade account was due to rising imports and only about a quarter to a decline in exports (chiefly of tobacco). In Greece growing receipts from services and a larger capital inflow more than offset the bigger import surplus.

Italy. In 1968 Italy recorded the fifth successive surplus in its current and overall balance of payments. In the five-year period 1964–68 the current surpluses totalled \$9.2 milliard and the overall surpluses \$4 milliard. Over this period, therefore, capital exports (excluding changes in the banks' external positions) totalled \$5.2 milliard; if net exports of funds by the banks are included they came to over \$7 milliard.

Italy: Balance of payments.*

Items	1967	1968 Year	1968 1st quarter	1968 2nd quarter	1968 3rd quarter	1968 4th quarter	1969 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Imports	8,630	9,050	2,110	2,200	2,210	2,530	.
Exports	8,610	10,100	2,350	2,480	2,470	2,800	.
Trade balance	− 20	+ 1,050	+ 240	+ 280	+ 260	+ 270	+ 190
Services							
Travel	+ 1,130	+ 1,110	+ 150	+ 290	+ 460	+ 210	.
Workers' remittances	+ 760	+ 850	+ 170	+ 210	+ 220	+ 250	.
Transport and insurance	− 230	− 200	− 90	− 50	− 10	− 50	.
Other	− 40	− 170	− 30	− 100	− 30	− 10	.
Total	+ 1,620	+ 1,590	+ 200	+ 350	+ 640	+ 400	+ 290
Current balance	+ 1,600	+ 2,640	+ 440	+ 630	+ 900	+ 670	+ 480
Capital movements							
Residents	− 1,630	− 2,180	− 520	− 580	− 360	− 720	} − 750
Non-residents	+ 610	+ 450	− 30	+ 260	+ 40	+ 180	
Errors and omissions	− 200	− 320	− 60	− 150	+ 20	− 130	− 90
Total	− 1,220	− 2,050	− 610	− 470	− 300	− 670	− 840
Total balance (= changes in monetary items)	+ 380	+ 590	− 170	+ 160	+ 600	—	− 360

* On a transactions basis.

As regards the 1968 results, both the current surplus, at \$2.6 milliard, and the capital-account deficit, at \$2 milliard (\$2.7 milliard if the banks' exports of funds are included), reached record levels. The whole of the increase in the current surplus was due to changes in the trade account, which from equilibrium in 1967 moved into a surplus (on a transactions and f.o.b. basis) of over \$1 milliard. Imports increased by only 5 per cent. owing to the general weakness of domestic demand, particularly during the first part of the year. There was actually a decline in imports of foodstuffs (partly because of the carry-over from the previous year's bumper crops); imports of raw materials and semi-manufactures showed a modest rise, while those of finished products expanded at an above-average rate. Over one-half of the import total was accounted for by three commodity groups — foodstuffs, fuels and engineering products — each of which recorded import values of between \$1.7 and 2.2 milliard.

Exports were again a strong growth factor last year. Given the relatively large unused domestic productive capacity and expanding foreign demand — from the United Kingdom early in the year, from Germany and France at a later stage and from the United States throughout the year — Italian sales abroad increased by \$1.5 milliard (17 per cent.) to \$10.1 milliard. Exports of industrial goods were nearly one-fifth higher. The best performance was that of synthetic hosiery and leather footwear, with increases of 38 and 33 per cent. respectively; exports of footwear totalled 140 million pairs. The export earnings of these two groups together came to some

$700 million, almost $200 million more than in 1967. Exports of cars and spare parts also rose by $200 million to a total of $900 million.

At some $1.6 milliard, net receipts from services and unilateral transfers were practically the same as in 1967, an increase in workers' remittances, particularly from Germany, having been offset by a slight decline in net receipts from tourism owing to increased Italian travel expenditure abroad. By and large, however, the various components of the services group did not show any significant change. Tourism and workers' remittances remained the most important sources of income, with yields of $1,100 and 850 million respectively.

The outward movement of capital persisted and in 1968 net capital exports — mostly long-term, but also short-term and in the form of leads and lags — exceeded $2 milliard, compared with $1.2 milliard the year before. Higher interest rates abroad, ample domestic liquidity and also some other factors not entirely of an economic nature were responsible for the outflow, which continued during the first quarter of 1969, when it reached an annual rate of some $3.4 milliard, inducing the authorities to adopt the set of measures described on page 57.

Apart from these higher capital exports, the main features of the first quarter of 1969 were the continued strength of commodity exports, particularly to EEC countries, and a renewed growth of net receipts from services. Estimates for the whole of 1969 point to a current-account surplus of between $1.7 and 2.2 milliard on the assumption that imports will rise much faster than exports.

In this perspective, the question of the structure of Italy's external accounts deserves consideration. Assuming as a reasonable external payments aim for Italy a more or less balanced capital account, with outflows to developing areas broadly offset by inflows from technologically more advanced countries, the problem is that of re-equilibrating the current account in view of the predominant part played in it by services, which respond slowly and but little to policy actions. This leaves trade. And in this field, if direct action to check the rise in exports is ruled out, for one thing because it would hit precisely those industries which show the most dynamism and, normally, the biggest productivity gains, the bulk of the adjustment has to come from commodity imports and thus from the expansion of domestic demand — particularly investment demand.

Belgium-Luxemburg Economic Union. The overall balance of payments deteriorated substantially between 1967 and 1968, from a surplus of $160 million to a deficit of $220 million. The surplus on current account almost disappeared and there was a large net outflow of capital, including errors and omissions.

A cyclical recovery set in during the spring of last year, induced partly by growing foreign demand and partly by government policy. On a customs basis, the 1968 trade deficit, at $170 million, was about the same as the

Belgium-Luxemburg Economic Union: Balance of payments.

Items	1967	1968 Year	1st quarter	2nd quarter	3rd quarter	4th quarter
	in millions of US dollars					
Merchandise trade						
Imports	5,800	6,665	1,595	1,615	1,625	1,830
Exports	5,675	6,390	1,500	1,545	1,560	1,785
Trade balance	− 125	− 275	− 95	− 70	− 65	− 45
Services						
Merchanting and processing	+ 265	+ 240	+ 65	+ 95	+ 40	+ 40
Travel	− 130	− 130	− 15	− 40	− 70	− 5
Transport	+ 45	+ 35	+ 10	+ 10	+ 15	—
Government transactions	+ 75	+ 60	+ 20	+ 25	—	+ 15
Other	+ 75	+ 90	+ 25	+ 10	+ 40	+ 15
Total	+ 330	+ 295	+ 105	+ 100	+ 25	+ 65
Current balance	+ 205	+ 20	+ 10	+ 30	− 40	+ 20
Capital movements						
Public authorities	− 135	− 60	− 10	− 20	− 15	− 15
Semi-official*	+ 20	− 10	− 10	—	− 25	+ 25
Private						
Foreign investment in the BLEU	+ 300	+ 240	+ 60	+ 60	+ 20	+ 100
BLEU investment abroad	− 165	− 295	− 65	− 55	− 60	− 115
Other	+ 5	—	—	—	—	—
Total	+ 25	− 125	− 25	− 15	− 80	− 5
Errors and omissions	− 70	− 115	− 40	+ 40	− 10	− 105
Total balance (= changes in monetary items)	+ 160	− 220	− 55	+ 55	− 130	− 90

* Public enterprises and non-monetary financial institutions of the public sector.

year before. Both exports and imports, which had remained practically stable in 1967, expanded by 16 per cent. last year, all of the rise being due to a growth in volume. In the first quarter of 1969 exports rose somewhat faster and imports somewhat more slowly, so that there was a surplus of $35 million, compared with a deficit of the same size in the corresponding quarter of 1968. Last year exports to the United States went up by 31 per cent. in value and those to the EEC by over 18 per cent., sales to Germany rising by 23 per cent. Nearly all groups of products participated in the rise. The increase in imports was largely accounted for by additional purchases of producer goods and was most marked in relation to the United Kingdom (20 per cent.), France (18 per cent.) and the United States (16 per cent.). The trade deficit measured on the basis of payments and receipts grew from $125 to 275 million between 1967 and 1968, the deterioration being entirely attributable to a lengthening of the payments terms for exports in the latter year. Total net receipts from services decreased from $330 to 295 million, including a $25 million reduction in net receipts from merchanting and processing.

On capital account, the total net inflow of $25 million in 1967 was followed by a net outflow of $125 million in 1968. Public and semi-public capital outflows declined from $115 to 70 million, whilst on private capital account there was a much larger opposite movement, from a net inflow of $140 million to a net outflow of $55 million. The change on private capital account was due chiefly to larger net purchases of foreign securities (mainly Euro-bonds and US securities) by Belgian residents, which increased from $105 to 265 million. At the same time, transactions in Belgian securities by non-residents shifted from net purchases of $55 million in 1967 to net sales of $10 million last year. The reduction in the net outflow of official capital in 1968 was associated with the absence of non-contractual repayments on the government's foreign debt, which in 1967 had been quite substantial. In addition to the increase in total net capital outflows, the deficit on the errors and omissions item went up from $70 to 115 million.

Netherlands. The overall balance of payments of the Netherlands, which in 1967 had shifted from a deficit of $40 million to a surplus of $60 million, moved back to a deficit of $100 million last year. There was no change between 1967 and 1968 in the current balance and total long-term capital outflows declined slightly; the deterioration in the overall balance in 1968, therefore, corresponded broadly to the change in the short-term capital account.

The small reduction in total long-term capital outflows, from $170 to 145 million, was the net outcome of larger opposite changes in private and official capital movements. On private account, net long-term capital exports fell from $150 million in 1967 to $50 million in 1968. Long-term lending by the Dutch banks declined from $65 to 15 million and the balance of security transactions shifted from a net outflow of $5 million to a net inflow of $35 million. Net purchases of foreign securities by Dutch residents rose sharply from $45 to 265 million, owing to the large increase during 1968 in purchases of US securities. But this was more than offset by the rise from $40 to 300 million in sales of Dutch securities to non-residents. This rise was chiefly in the form of new issues abroad, which were $165 million higher than in 1967. Dutch issues on the Euro-bond market during 1968 totalled $185 million, including an issue of $100 million by Philips in the third quarter. Net direct investment abroad declined from $105 to 15 million, while other private capital (mainly credit-granting), which in 1967 had shown a net inflow of $25 million, turned to a net outflow of $55 million. On official long-term capital account, the net outflow rose from $20 to 95 million, essentially as the result of a $65 million debt prepayment to the United States. On short-term capital account there was a shift between 1967 and 1968, from an inflow of $155 million to an outflow of $30 million. This was connected partly with the fact that Dutch companies, which in 1967 had received net repayments from their subsidiaries abroad, last year granted them new credits.

Measured on a cash basis, the surplus on current account remained at $75 million last year, a contraction in the trade deficit being offset by a decline in net receipts from invisible items. Net income from investment

Netherlands: Balance of payments.[1]

Items	1967	1968					1969
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Imports	7,380	8,235	1,950	1,990	2,015	2,280	2,115
Exports	6,875	7,785	1,860	1,855	1,915	2,155	2,095
Trade balance	− 505	− 450	− 90	− 135	− 100	− 125	− 20
Services							
Investment income	+ 250	+ 195	+ 25	—	+ 85	+ 85	+ 20
Other	+ 330	+ 330	+ 60	+ 100	+ 75	+ 95	+ 55
Total	+ 580	+ 525	+ 85	+ 100	+ 160	+ 180	+ 75
Current balance	+ 75	+ 75	− 5	− 35	+ 60	+ 55	+ 55
Capital movements							
Dutch securities	+ 40	+ 300	+ 5	+ 50	+ 185	+ 60	+ 70
Foreign securities	− 45	− 265	− 30	− 80	− 65	− 90	− 65
Direct investments	− 105	− 15	+ 25	− 35	− 35	+ 30	—[2]
Banks	− 65	− 15	− 15	+ 5	+ 15	− 20	− 5
Other private capital	+ 25	− 55	− 10	+ 20	− 50	− 15	+ 50
Official	− 20	− 95[3]	− 5	− 5	− 5	− 80[3]	+ 5
Total long-term	− 170	− 145	− 30	− 45	+ 45	− 115	+ 55
Short-term	+ 155	− 30	− 10	—	− 30	+ 10	− 20
Total	− 15	− 175	− 40	− 45	+ 15	− 105	+ 35
Total balance (= changes in monetary items)	+ 60	− 100	− 45	− 80	+ 75	− 50	+ 90

[1] On a cash basis. [2] Included under "Other private capital". [3] Including a debt prepayment of $65 million to the United States.

decreased by $55 to 195 million, as outpayments in respect of interest and dividends went up more than receipts from abroad. As regards other services, net expenditure on travel, which had fallen somewhat in 1967, rose again last year, while on the receipts side net income from freight and insurance also increased. In the first quarter of 1969 both the current and the capital accounts improved substantially, and there was an overall surplus of $90 million, compared with a deficit of half that size in the first quarter of 1968.

In volume terms, exports rose by 15.5 per cent. in 1968, as against an increase of 8.5 per cent. in the previous year, sales of chemical products and textiles showing the highest rates of growth. Exports to Germany alone rose in value terms by $415 million, which was nearly half of the total increase. The volume of imports went up by 12.5 per cent., as compared with a rise of 6 per cent. in 1967. Imports of capital goods, which had fallen slightly in that year, expanded by 20 per cent., and the growth of consumer goods imports also accelerated, from 6 to 16 per cent. Export prices fell by 1 per cent. in 1968 but, as prices of imported goods declined by 3 per cent., the terms of trade improved.

Spain. For the first time since 1964 Spain's basic balance of payments showed a surplus last year. This was the result of several factors. The sluggishness of domestic demand and the buoyant demand abroad, together with the effects of the devaluation and the stabilisation programme adopted in support of it, reduced the import surplus from $1,900 to 1,730 million. With net receipts from invisibles increasing by $100 million and the net long-term capital inflow by not quite as much, the basic balance shifted from a deficit of $120 million to a surplus of $225 million and the overall balance from a deficit of $155 million to a surplus of $45 million.

Imports, on a customs basis and expressed in dollars, which had fallen by 3 per cent. in 1967, rose by 1 per cent. last year. They actually declined in the first part of 1968, but gathered momentum after mid-year, particularly in the fourth quarter, when, with domestic activity quickening and stocks of raw materials being rebuilt, they rose by 14 per cent. This growth rate fell back to 7 per cent. in the first quarter of 1969. In value, imports totalled $3,520 million in 1968. Food imports fell by $65 million, reflecting a record crop in fodder grains, and those of capital goods by $80 million, as domestic investment remained rather depressed throughout most of the year. Imports of fuel, mainly petroleum products, rose by $115 million (or nearly 30 per cent.). Fuel exports, on the other hand, increased by $55 million (70 per cent.) and accounted for more than a quarter of the total rise in exports. In all, exports went up by $205 to 1,590 million, or by 15 per cent. While food sales declined, those of manufactured goods increased by 30 per cent. In the first quarter of 1969 total exports rose by 22 per cent.

Net receipts from services went up from $1,320 to 1,425 million. Net earnings from travel, which had been falling since 1965, rose by $40 million. The number of foreign tourists increased by 10 per cent., while dollar earnings went up by only 3 per cent., owing to the devaluation and possibly also to a change in the structure of foreign travel. Workers' remittances remained practically the same as in 1967. The combined improvement in the balance of trade and on services account brought the current-account deficit down from $580 to 305 million.

The total long-term capital inflow increased by $70 to 530 million in 1968. The net inflow of official capital went up by $90 million, about half being accounted for by borrowing abroad by the Treasury and the Instituto Nacional de Industria. The net inflow of private capital declined slightly as a reduction in net direct investment and security transactions was only partly offset by a rise in investment in real estate. A substantial increase in new loans and credits was counterbalanced by larger repayments of about the same size. On short-term account (including errors and omissions) there was a net outflow of $180 million, compared with one of $35 million in 1967.

Greece. In 1968, as in previous years, the net capital inflow into Greece more than offset the current deficit. The latter increased by $50 to 235 million, as the growth in invisible receipts did not keep pace with the rising import surplus. Imports went up from $1,160 to 1,250 million, half of the increase being due to the growth of imports financed by suppliers' credits — chiefly consumer goods. Exports stagnated, amounting to $485 million in each of the last two years. In 1968 a fall in tobacco sales was compensated by an improvement in exports of ores and minerals and manufactured products (exports of aluminium, non-existent four years ago, amounted to $30 million). The share of exports to EEC countries increased from 35 to 39 per cent. of the total, while that of exports to eastern European countries declined from 18 to 16 per cent. (in 1965 they had accounted for nearly a quarter of all exports). Net receipts from invisibles rose by $40 to 530 million, most of the increase being due to larger shipping receipts. Earnings on travel account, which had grown rapidly in the early 1960s, have fallen in the last two years.

The net inflow of long-term capital went up from $170 to 210 million, more than half of the increase being accounted for by new suppliers' credits and the remainder by loan funds and direct investments. On short-term account the net inflow doubled from $30 to 60 million and the overall balance of payments showed a surplus of $35 million, compared with $15 million in 1967.

Austria. Despite some reduction in the current-account deficit and a marked increase in foreign borrowing by the public authorities, Austria's overall balance-of-payments surplus declined from $210 million in 1967 to $115 million last year owing to a very sharp reduction in the inflow on private capital account.

The deficit on current account was reduced from $110 to 85 million last year. While the deficit in the balance of trade remained practically unchanged at $540 million — imports rising by 7 per cent. and exports by 10 per cent. — net receipts from services went up by $20 million. Tourist receipts rose from $395 to 430 million, after falling somewhat in 1967. On the other hand, Austria's growing external indebtedness and rising interest rates abroad pushed up net outpayments on investment-income account from $35 to 55 million. The trade deficit was reduced to $115 million in the first quarter of 1969 from $165 million a year earlier, as exports rose much faster than imports.

The net inflow of private long-term capital declined from $145 million in 1967 to only $5 million last year. Capital exports by Austria rose by $75 million, chiefly owing to larger purchases of foreign securities and an increase in longer-term bank lending. At the same time the inflow of long-term capital into Austria fell by $65 million, domestic enterprises (mainly transport firms) reducing their foreign borrowing from $145 to 75 million. In addition, the short-term capital inflow, including errors and omissions, declined from $55 to 15 million. In the public sector, the net inflow of long-term capital went up from $115 to 180 million.

Switzerland. After a period of slackening activity the Swiss economy has been expanding at an accelerated pace since the autumn of 1967, mainly in response to foreign demand. Exports grew faster than imports in 1968 and the deficit on trade account was reduced from $605 to 480 million. At the same time net receipts from services rose by about $75 million, so that the current-account surplus increased from \$240 to 440 million. As the net outflow of identified long-term capital rose between 1967 and 1968 from \$440 to 650 million, the deficit in the basic balance amounted to roughly \$200 million in 1968 — about the same as the year before. A very large inflow of unidentified capital, however, pushed the overall surplus for 1968 up to \$1,150 million, as compared with \$115 million in 1967.

Imports, which had risen by only 5 per cent, in 1967, increased by 9 per cent. last year, those of capital goods going up by nearly a fifth. Exports expanded by 15 per cent., or twice as fast as in 1967. Sales to the EEC and the EFTA groups of countries rose at about the same rate as total exports (of which they represented nearly 60 per cent. last year). In the first group, exports to Germany, which had fallen by 5.5 per cent. in 1967, went up by 22 per cent. and those to other EEC member countries by an average of 11 per cent. In the second group, exports to Sweden and the United Kingdom went up by 17 and 15 per cent. respectively, while those to Norway declined very slightly. Exports to the United States increased by 14 per cent. after showing very little growth in 1967. In the first quarter of 1969 total imports and exports continued to grow at the same rates as in 1968 as a whole.

Net receipts from services increased from \$845 to 920 million in 1968, owing chiefly to a rise of \$45 million in net income from capital. In all, this item amounted to \$400 million last year, nearly as much as net receipts from travel.

The increase in the identified net outflow of capital resulted from a sharp rise in Swiss purchases of shares in foreign companies. Such purchases, including those made through investment trusts, rose from \$40 million in 1967 to \$335 million in 1968. The value of foreign issues on the Swiss market also increased in 1968, from \$210 to 250 million. At the same time repayments by foreigners of Swiss loans and credits went up from \$100 to 235 million. Total net receipts from unidentified transactions, which had amounted to over \$300 million in 1967, came to close on \$1.4 milliard last year — to a large extent reflecting the flight of funds from France.

Denmark. In 1968 Denmark was well placed to respond without strain to the revival of demand abroad. The devaluation of the Danish krone in November 1967 had strengthened the country's competitiveness, while the slow-down in domestic activity, induced by policy measures, had set manpower and capacities free to produce for export markets. Exports as recorded in customs statistics and expressed in Danish kroner increased by 12 per cent. last year, of which 10 per cent. was due to a rise in volume and 2 per cent. to a rise in prices. At the same time, however, imports went up by 10 per cent., 6 per cent. representing higher prices — owing chiefly to the devaluation and rising oil prices — and 4 per cent. a larger volume of purchases abroad. It has been calculated that the deterioration in the terms of trade which occurred in the first three quarters of 1968 enlarged the trade deficit by D.kr. 1 milliard, or \$135 million. As this deterioration was almost offset by the expansion in the volume of exports, chiefly those of industrial products, which went up by 17 per cent., the trade deficit on the customs basis was little bigger than in 1967. As shown in the balance-of-payments statistics, the trade deficit, in fact, amounted to $300 million in both years. In the first quarter of 1969, however, the deficit widened by $30 million over the year to $170 million, as imports rose faster than exports.

Net receipts from shipping increased from $125 to 140 million in 1968 and other net invisible receipts from $15 to 45 million. While net outpayments on interest and dividends went up in line with Denmark's growing indebtedness to foreign countries, there was a shift from deficit to surplus on travel account and also in the item "Inheritances, gifts, grants, etc.". This item chiefly includes aid to developing countries and usually shows a deficit. In 1967 and 1968 it also included gains on forward exchange dealings with other countries, which amounted to $5 and 30 million respectively. Owing to the improvement on services account, the current-account deficit was reduced from $160 to 115 million last year. As this was exactly the same size as the net capital inflow, the overall balance, which had shown a deficit of $65 million in 1967, moved into equilibrium. Net direct investment in Denmark went up by $35 to 100 million. The whole of this increase was due to long-term loans granted by foreign companies to their subsidiaries, in particular in the oil industry. New bond issues abroad by the public sector totalled $125 million last year — $40 million more than in 1967. Central-government borrowing represented about 40 per cent. of the new issues, local-authority borrowing 30 per cent. and borrowing by mortgage banks over one-fifth.

Finland. Owing almost entirely to a turn-round in the trade account in 1968, Finland achieved a surplus on current account for the first time since 1959. The devaluation of the markka in October 1967 and a comprehensive stabilisation programme adopted in April 1968 provided the background for a revival of exports. In fact, exports were the only strong demand factor in the Finnish economy last year. They increased by 11 per cent. in volume and by nearly 7 per cent. in terms of dollars. Exports of engineering and metal goods showed the sharpest rate of growth, followed by products of the wood and paper industry. Sales to western markets, mainly to OECD countries, increased by about 9.5 per cent. in terms of dollars, while those to eastern European countries — which account for a fifth of the total — fell somewhat. Imports declined by some 5 per cent. in volume, reflecting the sluggishness of domestic demand and also some import substitution, notably in the consumer goods sector, where prices of domestic products had become lower than those of their imported counterparts. The volume of imports of finished investment goods and consumer goods fell by 16 and 13 per cent. respectively, with a particularly sharp decline in those of motor-cars. On a year-to-year comparison the terms of trade deteriorated by 3 per cent. in 1968. In the course of the year, however, they improved, as unit values of exports rose while those of imports remained stable.

On a balance-of-payments basis, the trade balance shifted from a deficit of $180 million in 1967 to a surplus of $25 million in 1968 and net invisible receipts rose from $40 to 50 million as a result of the elimination of the deficit on travel. The net long-term capital inflow amounted to $90 million, slightly less than in 1967. Drawings on long-term loans totalled $300 million but these were offset to a considerable extent by bigger amortisation payments and a substantial increase in export credits. On short-term account there was a turn-round from a net outflow of $30 million to a net inflow of $75 million.

Sweden. The overall balance-of-payments deficit increased slightly in 1968, to $45 million, a deterioration on current account from a deficit of only $5 million to one of $100 million having been largely offset by a switch on capital account from a net outflow of $20 million to a net inflow of $55 million.

The deterioration on current account reversed the trend of the two preceding years. The strength of internal demand had pushed the trade deficit up to $400 million in 1965. As the domestic economy cooled off and demand for Swedish exports was well maintained, the trade deficit had fallen by 1967 to $175 million. In 1968 it rose to $215 million, but principally as a result of changes in the method of recording exports.

In 1968 imports and exports increased by 9 per cent. each, against 3 and 5 per cent. respectively in the previous year. A quarter of the rise in imports was attributable last year to mineral fuels, in particular crude

Sweden: Balance of payments.

Items	1965	1966	1967	1968
	in millions of US dollars			
Imports (c.i.f.)	4,375	4,580	4,700	5,120
Exports (f.o.b.)	3,970	4,265	4,525	4,905[1]
Trade balance	− 405	− 315	− 175	− 215
Services	+ 150	+ 65	+ 25	− 45
Current balance of recorded transactions	− 255	− 250	− 150	− 260
Errors and omissions in respect of current items[2]	+ 115	+ 130	+ 145	+ 160
Current balance	− 140	− 120	− 5	− 100
Long-term capital	+ 50	+ 145	+ 105	+ 50
Short-term capital[3]	+ 115	+ 70	− 125	+ 5
Total capital	+ 165	+ 215	− 20	+ 55
Total balance (= changes in monetary items)	+ 25	+ 95	− 25	− 45

[1] Excluding $30 million on account of changes in the method of compiling customs statistics. [2] Official estimate. [3] Chiefly trade credits and errors and omissions in respect of capital movements.

Note: The balances on current and short-term capital account indicated above differ from those shown in the consolidated balance-of-payments table for western European countries because of the different treatment of the "errors and omissions" item. Whereas in the above table this item is split according to the nature of the transactions involved (see footnotes 2 and 3), in the consolidated table it is included entirely in the short-term capital account.

petroleum, purchases of which increased by 50 per cent. in volume owing to demand from the newly-built refineries. Imports also reflected the growing demand for consumer goods, especially motor-cars, and the need to rebuild stocks which had been run down earlier. Excluding sales of ships, which are subject to considerable year-to-year fluctuations and which declined in 1968, exports rose by 10 per cent. in value. Those of iron ore, newsprint and telephone equipment went up by some 20 per cent. each, while those of motor-cars and paper increased by 13 and 9 per cent. respectively. Exports to EEC countries, the United Kingdom and North America expanded substantially, while those to the Nordic countries, which account for roughly a quarter of the total, stagnated. According to an official Swedish study, it appears that in the years 1963–67 the annual growth rate of Sweden's exports was nearly 1 per cent. below that of the OECD countries taken as a whole. This difference was due for the most part to a reduction in Sweden's share of foreign markets for raw materials and ships. Sales of manufactured products, on the other hand, grew faster than the OECD average.

The main factor behind the deterioration of the current account in 1968 was a further erosion of the invisible balance. In 1968, for the first time, there was a deficit amounting to \$45 million, compared with a surplus of \$25 million in the previous year. With the exception of shipping, receipts from which went up by \$15 million, all other invisible items deteriorated. Net expenditure on travel increased by \$20 million and transfer payments — chiefly aid to developing countries — rose by \$15 million. The "errors and omissions" item in respect of current transactions, which corresponds largely to the undervaluation of receipts from trade and services, has shown a tendency to grow in recent years. In 1967 it practically offset the deficit on recorded current transactions, but last year, as this increased from \$150 to 260 million, there remained a current deficit of \$100 million. Roughly one-half of this was offset by a net capital inflow. The net inflow of long-term funds decreased from \$105 million in 1967 to \$50 million in 1968, owing mainly to large repayments of private loans. The net short-term capital outflow, including unidentified movements and trade credits, which had amounted to \$125 million in 1967, disappeared last year. In the first quarter of 1969 the deficit on current account amounted to \$130 million. This was exactly the same as the deficit in the first quarter of 1968. The structure of the current account, however, was different. In the first quarter of 1968 there had been a trade deficit of \$125 million and a deficit on invisible items of \$5 million. In the first three months of 1969 the import surplus declined to \$80 million but, on the other hand, the deficit on invisibles rose to \$50 million.

Norway. In 1968 the structure of Norway's balance of payments was markedly different from what it had been in other recent years. The overall surplus, at \$150 million, was about the same as in 1967, but the current account improved by \$365 million to show a surplus of \$165 million — the first in any year since 1957 — while on capital account the total net inflow of \$365 million recorded in 1967 gave way to a small net outflow of \$15 million. The big changes on both current and capital account were to a large extent due to developments in the shipping sector.

The trade deficit declined by $250 million, from $1,035 to 785 million. The deficit in the shipping sector alone was reduced from $310 to 110 million owing to exceptionally large sales of second-hand tonnage and to smaller purchases of new ships. In addition, the merchandise trade deficit (which excludes ships) declined by $50 million. On the basis of customs statistics, the growth rate of merchandise imports slowed down from 7.5 to 4 per cent. partly as a result of a decline in industrial investment and partly also owing to some easing of consumption demand. Imports of machinery fell by 5.5 per cent., and those of other manufactured goods, in particular iron and steel products and textiles, also declined. Merchandise exports, on the other hand, expanded by 9 per cent. (against 5.5 per cent. in the previous year), half of this rise being accounted for by larger sales of non-ferrous metals (chiefly aluminium).

Net receipts from services increased by $115 million. Freight rates, which had moved up in 1967 because of the Middle East war, fell somewhat last year, but, despite this, net earnings from shipping rose from $800 to 900 million in response to the fast growth of world trade.

In 1967 the net long-term capital inflow had nearly trebled, to $350 million, owing essentially to large-scale borrowing by shipping companies. Last year the inflow dwindled to a mere $25 million. With the decline in purchases of new ships, net borrowing by shipping companies fell from $230 to 20 million. In addition, net direct investment in Norway was reduced from $70 to 30 million, while net private Norwegian loans to foreigners went up from $40 to 50 million. On the other hand, the public authorities' capital account was in equilibrium, chiefly because official debt repayments were only half as large as in 1967. On short-term capital account there was a turn-round from a small net inflow to a net outflow of $40 million.

Canada. A considerable rise in exports to the United States and a sizable increase in the long-term capital inflow pushed the Canadian basic surplus up from $740 million in 1967 (already a post-war record) to $1,260 million last year and the overall surplus, at $440 million, was $100 million larger than in 1967.

Exports went up by $2 to 12.7 milliard and imports (f.o.b.) by $1.3 to 11.4 milliard, so that the export surplus increased by $750 million. Exports of motor-cars, engines and spare parts rose by $840 million (52 per cent.) and imports by $765 million (38 per cent.), and their share of total exports and imports rose to as much as a fifth and a quarter respectively. Sales of all other products went up by 13.5 per cent. Exports of copper, nickel, aluminium and steel, boosted by the shortages created by the strikes in the United States, expanded by over $250 million. Shipments of raw and processed timber increased by about the same amount, whereas wheat deliveries fell by nearly $50 million, despite a sharp rise in those to mainland China. Imports, again excluding the motor-car sector, went up by 6 per cent. But in the

Canada: Balance of payments.

Items	1967	1968[1] Year	1968[1] 1st quarter	1968[1] 2nd quarter	1968[1] 3rd quarter	1968[1] 4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	10,635	12,680	3,065	3,150	3,130	3,335
Imports	10,085	11,380	2,785	2,735	2,815	3,045
Trade balance	+ 550	+ 1,300	+ 280	+ 415	+ 315	+ 290
Services						
Investment income	— 830	— 900	— 220	— 235	— 230	— 215
Travel	+ 395	— 5	—	+ 30	— 20	— 15
Other	— 615	— 560	— 145	— 135	— 135	— 145
Total	— 1,050	— 1,465	— 365	— 340	— 385	— 375
Current balance	— 500	— 165	— 85	+ 75	— 70	— 85
Long-term capital						
Net new Canadian issues abroad	+ 890	+ 1,450	+ 270	+ 545	+ 415	+ 220
Transactions in outstanding Canadian securities	— 40	+ 35	— 35	+ 20	— 5	+ 55
Transactions in foreign securities	— 385	— 430	— 80	— 115	— 125	— 110
Direct investment	+ 490	+ 385	— 70	+ 200	+ 160	+ 95
Other	+ 285	— 15	+ 20	+ 15	— 85	+ 35
Total	+ 1,240	+ 1,425	+ 105	+ 665	+ 360	+ 295
Balance on current and long-term capital account	+ 740	+ 1,260	+ 20	+ 740	+ 290	+ 210
Short-term capital[2]	— 395	— 820	— 830	— 130	+ 10	+ 130
Total balance (= changes in monetary items)	+ 345	+ 440	— 810	+ 610	+ 300	+ 340

[1] Quarterly data in the current balance are seasonally adjusted. [2] Including adjustment factors.

course of the year they accelerated in line with the growth of domestic demand. In the first quarter of 1969 total exports and imports rose by 15 and 16 per cent. respectively and the export surplus was about the same as in the first quarter of 1968.

As regards invisible items, the travel account was in equilibrium, after the $400 million surplus in 1967 connected with the centenary celebrations. Net outpayments of investment income increased further, to $900 million, while net expenditure on other items declined somewhat, partly owing to a reduction in economic aid to developing countries. In all, the deficit on services amounted to $1.5 milliard. The reduction of the deficit on current account from $500 to 165 million finds its counterpart in the improvement of some $400 million in the balance with the United States and the deterioration of $100 million vis-à-vis European OECD countries.

Capital movements were most erratic last year. The tightening of the US Government's direct controls on foreign investment and lending, announced on 1st January 1968, caused the Canadian dollar to come under sharp attack and a net outflow of $830 million of short-term funds occurred in the first quarter. Following the US Government's decision on 7th March to exempt

US investment in Canada from its controls, confidence was restored and short-term movements in the following three quarters balanced out. A net inflow of long-term capital in the second quarter compensated most of the earlier short-term losses, the Canadian Government having borrowed a total of \$235 million in Germany, Italy and the United States, and another \$420 million having been obtained through issues abroad by the private sector and a number of provinces and local authorities, while repayments totalled \$110 million. In addition, direct investment from abroad was resumed. In all, the net inflow of long-term funds amounted to \$665 million. In the third and fourth quarters it came down to \$360 and 300 million respectively, mainly because of a reduction in new bond issues abroad. For the whole of 1968 the net long-term capital inflow amounted to \$1,425 million, some \$200 million more than in the previous year. New bond issues placed abroad yielded \$1,450 million net, of which some \$450 million came from continental European markets. The rise of \$560 million in this item over the year was, however, to a great extent offset by a swing of \$300 million in "other" long-term capital movements (bank loans and export credits) from a sizable net inflow to a small net outflow. The net inflow on account of direct investment declined by \$100 million, largely because of a rise in Canadian investment abroad. Changes in outstanding security transactions tended to offset each other, there having been a rise of \$80 million in net sales of Canadian bonds and shares to foreigners and one of \$45 million in net purchases of foreign securities by Canadians.

Japan. In 1968 the Japanese economy continued to expand rapidly (gross national product rose by nearly 14 per cent. in real terms), while at the same time a very large improvement was achieved in the country's balance of payments. The overall balance, which had changed from a surplus of more than \$300 million in 1966 to a deficit of nearly \$600 million in 1967, switched again last year to a surplus of \$1,100 million. Whereas in 1967 boom conditions in Japan had coincided with a slowing-down in most other industrial countries, last year expanding demand abroad pushed Japanese exports up, while the growth rate of imports decelerated, partly as a result of the restrictive monetary and fiscal measures adopted earlier. These were relaxed in the late summer of 1968 after the balance had swung back into surplus in the second quarter of the year.

Imports, as recorded in the balance of payments, rose by nearly 13 per cent. in 1968, against 23 per cent. in the previous year. This slow-down was mainly caused by inventory adjustments in the first half of the year and by a decline in imports of iron and steel due to an increase in the productive capacity of the steel industry. In the first quarter of 1968 imports were 18 per cent. higher than in the corresponding period of 1967 and in the remaining three quarters they showed an 11 per cent. increase. Exports expanded by nearly 25 per cent. over the year as a whole (compared with 6 per cent. in 1967), their growth rate doubling from 15 per cent. in the first quarter to 32 per cent. in the fourth. In absolute figures the export

Japan: Balance of payments.[1]

Items	1967	1968					1969
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	10,230	12,750	2,570	3,110	3,325	3,745	3,280
Imports	9,070	10,220	2,450	2,565	2,480	2,725	2,670
Trade balance	+ 1,160	+ 2,530	+ 120	+ 545	+ 845	+ 1,020	+ 610
Services							
Transport	− 815	− 860	− 230	− 215	− 195	− 220	.
Investment income	− 180	− 255	− 60	− 50	− 65	− 80	.
Government[2]	+ 475	+ 550	+ 120	+ 135	+ 135	+ 160	.
Other	− 830	− 915	− 245	− 225	− 215	− 230	.
Total	− 1,350	− 1,480	− 415	− 355	− 340	− 370	− 425
Current balance	− 190	+ 1,050	− 295	+ 190	+ 505	+ 650	+ 185
Long-term capital	− 815	− 250	− 110	− 20	+ 5	− 125	
Balance on current and long-term capital account	− 1,005	+ 800	− 405	+ 170	+ 510	+ 525	+ 95
Short-term capital[3]	+ 435	+ 300	+ 160	+ 50	+ 30	+ 60	
Total balance (= changes in monetary items)	− 570	+ 1,100	− 245	+ 220	+ 540	+ 585	+ 280

[1] On a transactions basis. [2] Mainly military transactions. [3] Including the balancing item.

surplus went up from \$120 million in the first quarter to over \$1 milliard in the fourth and totalled \$2.5 milliard for the whole of 1968.

On a customs basis, sales to the United States and Germany soared by 36 and 34 per cent. respectively, while those to the United Kingdom grew by 23 per cent. Together these three countries accounted for nearly half of the increase in Japanese exports. Sales to South-East Asia, which in 1967 were nearly as large as those to the United States, went up by 24 per cent. While exports of machinery and equipment rose by 29 per cent. — within this group sales of motor vehicles increased by 64 per cent. — those of textile products grew by only 16 per cent.

The structural deficit on invisible items increased by \$130 to 1,480 million. The largest single rise, of \$75 million, was in respect of outpayments of interest and dividends. Net expenditure on transportation rose by only \$45 million (compared with an increase of \$200 million in 1967), reflecting the more moderate import rise last year. The current balance switched from a deficit of \$190 million to a surplus of \$1,050 million, i.e. \$200 million less than in the peak year 1966. In the first quarter of 1969, as compared with the corresponding period of 1968, there was also a turn-round in the current balance, which shifted from a deficit of \$300 million to a surplus of nearly \$200 million, entirely owing to a larger export surplus.

The net outflow of long-term capital, which had amounted to over \$800 million in the previous two years, contracted sharply to \$250 million in

1968 as the result of a substantial rise in the inflow of foreign capital to Japan. Longer-term borrowing by Japanese corporations from financial institutions in other countries went up from \$60 to 480 million and foreign purchases of Japanese securities — the prices of which had fallen to rather low levels in 1967 — from \$70 to 230 million. The net inflow of short-term capital was reduced from \$435 to 300 million. While the inflow of identified short-term capital, chiefly trade credits, contracted by roughly \$300 million, the balance of unidentified transactions improved by \$170 million from a net outflow to a net inflow.

IV. GOLD, RESERVES AND FOREIGN EXCHANGE.

Gold production, markets and reserves.

After a noticeable decline in 1967, world gold production (excluding the USSR, other eastern European countries, mainland China and North Korea) recovered moderately in 1968, by 250,000 ounces, to 40.4 million ounces. The expansion in production came essentially from the South African mines, as the combined output of the rest of the western world continued to contract.

World gold production.

Countries	1929	1940	1946	1953	1964	1965	1966	1967	1968
	weight, in thousands of fine ounces								
South Africa . . .	10,412	14,046	11,927	11,941	29,137	30,540	30,869	30,535	31,169
Canada	1,928	5,333	2,849	4,056	3,835	3,606	3,319	2,962	2,688
United States . . .	2,059	4,870	1,575	1,958	1,456	1,705	1,803	1,585	1,533
Australia	427	1,644	824	1,075	964	878	917	801	815
Ghana	208	886	586	731	865	755	684	763	727
Japan.	335	867	40	258	460	519	555	678	614
Philippines	163	1,121	1	481	426	437	454	491	500
Colombia	137	632	437	437	365	319	281	258	240
Mexico	655	883	420	483	210	216	214	183	145
Total listed .	16,324	30,282	18,659	21,420	37,718	38,975	39,096	38,256	38,431
Other countries[1] .	2,016	7,178	2,771	2,840	2,452	2,165	2,104	1,914	1,989
Estimated world total[1] .	18,340	37,460	21,430	24,260	40,170	41,140	41,200	40,170	40,420
	in millions of US dollars								
Value of estimated world total at $35 per fine ounce .	640[2]	1,310	750	850	1,405	1,440	1,440	1,405	1,415

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

Following upon a decline of 330,000 ounces in 1967, South African output rose by 630,000 ounces in 1968 to a new peak of almost 31.2 million ounces. The increase would have been somewhat larger but for the temporary drop-out in the last two months of the year of West Driefontein, South Africa's largest gold-producing mine. Three new mines opened up during the year, adding 860,000 ounces to total production, and in addition output from the other mines in the newer goldfields went up by 440,000 ounces. Production in the older areas, on the other hand, fell by 670,000 ounces.

As in the preceding years, profits per ounce of gold continued to fall. In the newer goldfields, whose share in total South African production expanded from 82 to 85 per cent., the decline was from $15.45 to 14.95 per ounce (excluding profits from uranium). Owing to the expansion in output, however, total profits edged up from $388 to 395 million. In the older mines average profits per ounce of gold fell from $3.55 to 2.60 and total profits from over $16 million to less than $11 million; seven of the seventeen mines in this group were operating at a loss. In 1968 the South African Government introduced a new scheme under which mines that otherwise would have to cease operations within eight years may qualify for state assistance, either in the form of tax reductions or through government grants.

Gold output in Canada, the second largest western producer, declined by another 275,000 ounces in 1968 and amounted to only about 60 per cent. of its 1961 peak. US production, about one-third of which is derived as a by-product of copper, suffered in the earlier part of the year from strikes in the copper-mining industry and was down 50,000 ounces from its 1967 level. The combined output of the other gold-producing countries also declined on balance, by 60,000 ounces.

As regards the uses of gold, the situation was abruptly changed by the suspension of the gold pool arrangements in March 1968. During the six months from October 1967 to March 1968, official sales on the gold market, to keep the price from rising above $35.20 an ounce, had entailed a decline in western official gold holdings of $2,720 million (valued at $35 an ounce). Since new production may be estimated at about $700 million over this period, this means that, after allowing for estimated purchases by non-western countries of about $300 million, non-monetary absorption of gold amounted to $3.1 milliard during these six months. Not more than about $650 million of this would have been accounted for by current industrial uses and traditional saving, so that the remaining $2.5 milliard would seem to have represented speculative and protective purchases. These exceptional holdings by the public were an important factor in the market situation during the remaining months of 1968, when market supply and demand were no longer equated by sales from official gold stocks.

From the second quarter of 1968 on, the situation has been the reverse of what it was between October 1967 and March 1968. Owing mainly to the small amount of South African production that was offered on the market after March 1968, world gold reserves went up by $655 million in the last three quarters of 1968. It may be estimated that total new supplies of gold

Estimated sources and uses of gold.

	1965	1966	1967 January to September	October 1967 to March 1968	1968 April to December
	in millions of US dollars				
Gold production	1,440	1,440	1,060	705	1,060
Sales by USSR	550	—	—	—	—
Total	1,990	1,440	1,060	705	1060
Changes in western official gold stocks	220	− 45	− 230	− 2,720	655
Other uses	1,770[1]	1,485[2]	1,290	3,425[3]	405

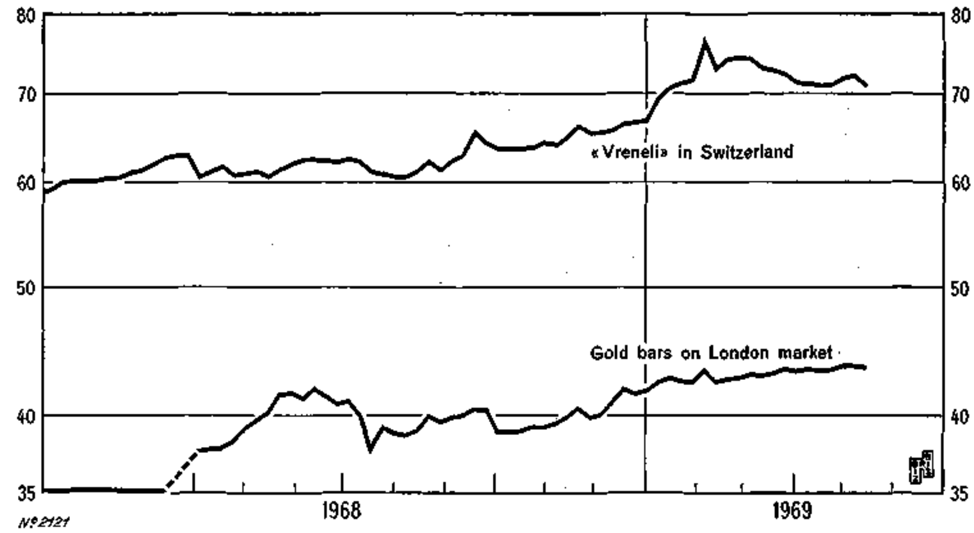
[1] Including estimated purchases by China of $150 million. [2] Including estimated purchases by China of $75 million. [3] Including estimated purchases by non-western countries of $300 million.

that reached the market during the last nine months of 1968 amounted to no more than about $400 million's worth, valued at the official price of $35 per fine ounce, including about $170 million's worth from South Africa. Since this was far less than was required to meet current industrial uses, there must have been considerable dishoarding of gold. In addition, it appears that a substantial part of the speculative holdings of gold built up by the public between October 1967 and March 1968 has been resold to more permanent investors.

As to the gold market's behaviour since the price peg was removed, two main periods may be roughly distinguished. During the first of these, which lasted from mid-March until the end of October 1968, there were pronounced fluctuations in the market price of gold but no clear trend. In the second period, which lasted from about October 1968 to March 1969, the price tended to go up rather persistently while at the same time the amplitude of its fluctuations was considerably smaller.

After Zurich quotations of nearly $45 per ounce in the days immediately following the suspension of official selling, the London gold market reopened on 1st April 1968 at around $37.80. And with prospects of peace talks about Vietnam, there were signs of a further decline. However, a South African Government statement that it would not sell gold to the market for the time being caused prices to become firmer in the second week of April. The upward movement was subsequently maintained by weakness of the dollar and by the outbreak of the French crisis. In the second half of May the London fixing price reached a peak of over $42 an ounce, and, although the introduction of exchange controls in France helped to insulate the market

Gold market prices.*
In US dollars per fine ounce.



* Wednesday figures (semi-logarithmic scale).

somewhat from the developments in that country, the continuing weakness of sterling helped to keep the price relatively high until early July. The announcement at that point that new support arrangements for sterling were being negotiated led, however, to a sharp decline in the gold price, which fell to a low of $37.80 on 17th July. Hopes of a resumption of South African sales also seem to have contributed to the change in market sentiment, but denials by the South African Finance Minister on 18th July led to a renewed strengthening of the price. Under the impact of the events in Czechoslovakia, quotations at one point reached $40 in the second half of August, and they continued to edge up throughout the earlier part of September, partly as a result of the abolition of the French exchange controls. Renewed hopes of a change in South Africa's gold policy at the time of the IMF annual meeting led subsequently to some easing and the price hovered around $39 throughout October.

From November on, however, the gold price again began to show a fairly steady upward trend, caused not so much by the size of demand as by the lack of sellers. At first the renewed buoyancy was partly a reflection of the growing unrest in the exchange market but, owing perhaps to sales by South Africa, even at the height of the exchange crisis in the second half of November market quotations did not get anywhere near to the level reached in May. Conjectures about a possible change in US gold policy under the new Administration contributed to the continued upward movement of the price in December, and by the middle of January it began to exceed $42.50, its highest level since the suspension of the gold pool arrangements. And in the second week of March 1969 quotations reached a new peak of $43.82, demand being stimulated by uncertainties about the French franc. Subsequently the price eased somewhat but, although the renewal of disturbances in the exchange market in early May had little effect on quotations, in mid-May the London market fixing price stood at about $43.50, more than $5.50 above the level at which the market had reopened in April 1968.

Since April 1968 the prices of gold coins have behaved in somewhat the same way as that of bars, though in most cases they have risen more sharply. At the time of the reopening of the London gold market in April 1968, quotations for the Swiss 20-franc piece, expressed in dollars per ounce, stood at just over $60, having risen by about $5 per fine ounce over the preceding twelve months. During the first few months of the two-tier system, however, and despite the French crisis, the price of the Vreneli increased, relatively speaking, less than that of gold bars. Then in August 1968 an upward trend began which carried quotations to a peak equivalent to about $76 per fine ounce in early February 1969. There then followed some decline and in mid-May 1969 the price was equivalent to about $71 per fine ounce.

After a first-quarter decline from about $41.6 to 40.2 milliard, official gold reserves recovered to about $40.9 milliard at the end of 1968 and then stood just below their end-1961 level.

World gold reserves.

Countries or areas	Changes in 1966	1967	1968 January–March	1968 April–December	Holdings at end-1968
	in millions of US dollars				
United States	− 570	−1,170	−1,365	+ 190	10,890
United Kingdom	− 325	− 650	+ 200	− 20	1,475
Continental western Europe	+ 250	+ 150	− 860	+ 185	20,410
of which					
Belgium	*− 35*	*− 45*	*− 60*	*+ 105*	*1,525*
France	*+530*	*− 5*	*—*	*−1,360*	*3,875*
Germany	*−120*	*− 65*	*−255*	*+ 570*	*4,540*
Ireland	*—*	*—*	*+ 10*	*+ 40*	*80*
Italy	*+ 10*	*− 15*	*− 25*	*+ 550*	*2,925*
Netherlands	*− 25*	*− 20*	*− 55*	*+ 45*	*1,695*
Portugal	*+ 70*	*+ 55*	*+ 10*	*+ 145*	*855*
Sweden	*—*	*—*	*—*	*+ 20*	*225*
Switzerland	*−200*	*+250*	*−485*	*+ 20*	*2,625*
Other	*+ 20*	*− 5*	*—*	*+ 50*	*2,065*
Canada	− 105	− 30	− 40	− 115	865
Japan	—	+ 10	+ 5	+ 15	355
Latin America	− 70	+ 15	+ 5	+ 30	1,035
Middle East	− 55	+ 95	+ 150	+ 120	1,090
Other Asia	− 25	+ 60	+ 15	+ 25	750
Other Africa	+ 210	+ 105	+ 175	+ 565	1,620
of which					
South Africa	*+210*	*− 55*	*+160*	*+ 500*	*1,245*
Other countries	+ 5	+ 15	+ 35	+ 100	430
Total for all countries	− 685	−1,400	−1,680	+1,095	38,920
International institutions	+ 640	− 180	+ 310	− 440	1,970
of which					
BIS	*+135*	*−200*	*+280*	*− 5*	*−350*
European Fund	*− 10*	*− 10*	*—*	*− 10*	*30*
IMF	*+515*	*+ 30*	*+ 30*	*− 425*	*2,290*
Grand total	− 45	−1,580	−1,370	+ 655	40,890

As was to be expected, the $1,370 million decline in western official gold stocks during the first quarter of 1968 was concentrated on those countries that were active members of the gold pool. In fact, the combined gold reserves of these seven countries fell by $2,045 million during the quarter. Of this amount, $180 million represented net US gold sales other than those to active members of the pool; and in addition virtually the whole of the $280 million decline in the negative spot gold position of the BIS during the quarter had a counterpart in a decline in the combined gold reserves of these seven countries. Excluding these two items, therefore, the gold loss of these seven countries attributable to their market sales through the gold pool during the first quarter of 1968 may be put at some $1.6 milliard.

The US gold loss in the first quarter of 1968 was $1,365 million, of which $53 million was to domestic industrial users and the remainder to foreign monetary authorities. Sales to the United Kingdom alone totalled $900 million, a figure which may be assumed to represent roughly the US contribution to the gold pool sales for the quarter. Other western European countries took a total amount of $295 million in gold from the United States, of which countries that were members of the gold pool accounted for

$283 million, including purchases of $184 million by Italy, $49 million by the Netherlands, and $25 million each by Belgium and Switzerland. Total net US gold sales to other countries during the quarter amounted to $122 million.

All the other active members of the gold pool, with the exception of the United Kingdom, showed losses of gold reserves in the first quarter of 1968, but the only two really big declines were those of $485 million in Switzerland and $255 million in Germany. While Germany's loss may be attributed to its participation in the gold pool, the fall in the Swiss gold stock mainly reflected the liquidation of gold swaps with the BIS. The $200 million rise in the United Kingdom's gold reserve included gold received from other gold pool countries in settlement of the Bank of England's market interventions on behalf of the pool during the last quarter of 1967.

The gold reserves of countries that were not active members of the gold pool rose during January–March 1968 by $365 million. South Africa's holdings went up by $160 million and those of Middle Eastern countries by $150 million (of which the Lebanon accounted for $74 million), while Canada's gold reserves fell by $40 million, a figure that reflects fairly closely the sale of $50 million's worth to the United States.

The $655 million increase in western official gold reserves that occurred during the remaining nine months of 1968 was essentially due to South Africa, which, thanks to a favourable current balance of payments and major capital imports, was able to absorb $500 million from its own current production into reserves. In addition, purchases from South Africa accounted for virtually the whole of the $145 million increase in Portugal's gold reserve. Apart from these two countries, world gold reserves went up by only $10 million during the last nine months of 1968 and the fairly large movement which occurred in some countries' holdings thus reflected a reshuffling of existing stocks, including those of international institutions.

Among the leading industrial countries, the largest increases in official holdings during these nine months were shown by Germany ($570 million), Italy ($550 million), the United States ($190 million) and Belgium ($105 million). On the other hand, French official holdings declined by $1,360 million and those of Canada by $115 million. $185 million of the German gain and $144 and 56 million respectively of the Italian and Belgian increases stemmed from IMF gold sales made in connection with French and UK drawings on the IMF in June 1968. The rest of the German and Italian increases came mainly from French sales.

Purchases from France also added $600 million to the US gold stock, and purchases from the United Kingdom and the Netherlands another $95 million. At the same time, however, the United States sold $155 million to various European countries, and in addition net sales to countries outside Europe continued at a higher rate than in any of the preceding years, $235 million going to Asia and $100 million to the rest of the world. The bulk of the transactions with non-European countries occurred in the second and third quarters of the year, when there were purchases totalling $175 million by sterling-area countries. In the last quarter of 1968, following the coming into force of the arrangements guaranteeing the exchange value of sterling-area countries' sterling balances, there were almost no sales to non-European countries.

The $1,360 million decline in French gold reserves reflected the balance-of-payments consequences of the social unrest. In June alone the decrease amounted to nearly $500 million. The only other Group of Ten country to show a reduction of any size in its gold reserves was Canada. $50 million of Canadian gold was sold to Italy in May, and in September the Canadian authorities used another $63 million to repay the IMF.

On balance, gold reserves of Group of Ten countries went up by $20 million during the last nine months of 1968 and those of other OECD countries by $215 million, $145 million of this latter increase being accounted for by Portugal. Non-OECD countries' reserves rose by $860 million, or by $360 million excluding South Africa; $120 million of this rise occurred in the Middle East, whereas the rest was fairly broadly distributed. Altogether, countries' gold reserves rose by $1,095 million between end-March and end-December 1968.

Over the same nine-month period the gold holdings of international institutions fell by $440 million. Of this amount, the IMF accounted for $425 million, the main item being the gold sales of $545 million which it made to obtain currencies at the time of the UK and French drawings in June 1968.

Provisional figures indicate that during the first quarter of 1969 western gold reserves rose by a further $115 million. Countries' gold reserves went up by some $35 million, the principal changes during the quarter being increases of $125 and 20 million respectively in South Africa and Switzerland, and declines of $55 million in the United States and $50 million in France. International institutions' combined gold holdings rose by $80 million, owing mainly to a reduction of $65 million in the negative spot gold position of the BIS.

International Monetary Fund.

The year 1968 was one of exceptional activity for the IMF. Total net drawings on the Fund amounted to $1,390 million — a figure exceeded only in 1961 and 1965. And on a gross basis transactions reached the highest level ever recorded in a calendar year, with drawings at $3,550 million and repurchases (including repayments through other members' drawings) at $2,160 million. While transactions with a few leading countries accounted for the greater part of the Fund's activity in 1968, it was also significant that operations with developing countries were on a larger scale than ever before.

In the developed areas of the world operations by, or affecting the positions of, four Fund members — Canada, France, the United Kingdom and the United States — dominated the activity of the Fund in 1968.

International Monetary Fund: Drawings and repurchases in 1968.

Countries or areas	Drawings	Repurchases	Net drawings
	In millions of US dollars		
United States	200	992[1]	−792
Canada	426	186[2]	240
United Kingdom	1,400	185	1,215
France	745	1	744
Other Europe	31	89	− 58
New Zealand	—	99	− 99
South Africa	62	—	62
Developing countries	698	609[3]	79
of which			
Argentina	—	74[3]	−74
Brazil	75	87	−12
India	—	98	−98
Morocco	50	2	48
Philippines	55	—	55
United Arab Republic	63	69	− 6
Total	3,552	2,161	1,391

[1] Includes repayments of $806 million by other members' drawings. [2] Includes repayments of $121 million by other members' drawings. [3] Includes repayments of $55 million by other members' drawings.

Firstly, Canada drew $426 million on the Fund in February 1968, when the Canadian dollar was under heavy pressure following the tightening-up of the US Government's direct controls on foreign investment and lending. The Canadian drawing represented the whole of the gold and super-gold tranche positions, amounting to $391 million, as well as the reimbursement of the $35 million which Canada had previously lent to the Fund under the GAB. Only $185 million of the Canadian drawing, or that part of it which represented its gold subscription to the Fund, gave rise to a repayment obligation. And, as the crisis of the Canadian dollar was short-lived, this debt was soon fully extinguished, partly through UK and French drawings of Canadian dollars totalling $121 million in June 1968 and for the rest through a direct Canadian repayment of $64 million in September.

Secondly, there was a drawing of $745 million by France in June 1968 to help meet the severe exchange losses arising out of the crisis that began in mid-May. As in the Canadian case, the amount drawn by France was equal to its gold and super-gold tranche positions. In addition, France obtained a further $140 million of foreign exchange by transferring its previously accumulated GAB claims to other members of the GAB.

Thirdly, and also in June 1968, the United Kingdom drew the whole of the $1.4 milliard which had been placed at its disposal by the Fund under a stand-by arrangement concluded immediately following the devaluation of sterling in November 1967. Later in the year, the United Kingdom made two repayments, totalling $185 million, on its 1965 drawing of $1.4 milliard. At the end of 1968 the Fund's holdings of sterling amounted to 193 per cent. of the UK quota.

Fourthly, the gold tranche position of the United States was fully reconstituted during 1968, from a figure of $420 million at the beginning of the year to \$1,290 million at the end of December. For the larger part, this came about as a result of the drawings on the Fund made by the three countries mentioned above. In fact, total drawings of US dollars on the Fund in 1968 amounted to \$806 million, of which the US share in the Canadian, French and UK drawings accounted for \$600 million. In addition, the US gold tranche position improved by \$85 million during 1968 as a result of US-initiated transactions with the Fund. In March the United States drew a total of \$200 million in various currencies, whilst in November and December it made repurchases totalling \$285 million.

So far as other developed countries are concerned, the main transactions were a drawing of \$62 million by South Africa and repurchases of \$99 and 63 million respectively by New Zealand and Finland. Developing countries' total gross drawings amounted to \$688 million, but as there were total repurchases of these countries' currencies amounting to \$609 million, their net use of the Fund's resources during 1968 was only \$79 million. In this group, the main recipients of IMF assistance were Morocco and the Philippines, with drawings of \$50 and 55 million respectively. On the other hand, repurchases of \$98 and 74 million respectively were made by India and Argentina. The Argentine repurchases included \$55 million through other members' drawings of pesos. Brazil and the United Arab Republic also repaid earlier drawings but in both cases these were practically offset by new drawings.

Eighteen different currencies were drawn on the Fund in 1968, as against twenty-one the year before. From this point of view a salient feature of the Fund's operations in 1968 was the very substantial use made of the dollar in drawings, to an extent only exceeded in 1957 and 1961. On a gross basis the main currencies used in drawings were the Deutsche Mark, with \$841 million, the US dollar, with \$806 million, and the Italian lira, with \$478 million. These were followed in size by gross drawings of \$298 million in Dutch florins, \$246 million in Belgian francs, \$139 million in Canadian dollars, \$120 million in Australian dollars and \$102 million in Japanese yen. Since there were no repurchases in US dollars during the year, because the Fund's holdings of that currency exceeded 75 per cent. of the US quota, on a net basis the US dollar was easily the principal currency used for drawings in 1968, followed by the Deutsche Mark, the florin, the lira and the Canadian dollar.

Apart from the US dollar, the Fund's holdings of the other main currencies used for drawings in 1968 did not decline very much and indeed in some cases they actually increased. An important reason for this was that a good part of the net amounts drawn in a number of leading currencies other than the US dollar came from the proceeds of Fund gold sales and from borrowing through the GAB. Total Fund sales of gold for currency, made in connection with the French and UK drawings, were \$547 million. Total borrowings under the GAB went up by \$521 million in 1968, gross fresh borrowings of \$741 million to help finance the French and UK drawings being partly offset by repayments of \$220 million.

During the first quarter of 1969 there were net repayments to the Fund by member countries totalling $405 million. The principal transactions were repurchases by the United Kingdom of $200 million in February and $123 million in March.

Since their presentation to the Governors of the Fund in April 1968, ratification has been proceeding of the proposed amendments to the Fund Agreement concerning both the establishment of a new facility for special drawing rights (SDRs) in the Fund and certain changes in the existing rules and practices of the Fund. By the end of March 1969 forty-two countries representing just on 60 per cent. of the total voting power of the Fund's membership had formally accepted the proposed amendments. They will come into force after acceptance by three-fifths of the members of the Fund, representing 80 per cent. of the total voting power.

Official reserves and other monetary movements.

United States. As the result of an unprecedented net inflow of long-term capital, the US balance of payments, measured on the liquidity basis, was rather close to balance for the year 1968, in fact even showing a small surplus of $160 million. And the broad pattern of monetary movements that corresponded to this small surplus was in its turn determined by an exceptionally large inflow of short-term funds to the United States through the

United States: External monetary movements.

Items	1967	1968					1969
		Year	1st quarter	2nd quarter	3rd quarter	4th quarter	1st quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Reserves	− 50	+ 880	− 905	+ 140	+ 570	+1,075	+ 50
of which							
Gold	*−1,170*	*−1,175*	*−1,365*	*− 20*	*+ 75*	*+ 135*	*− 55*
Foreign exchange	*+1,025*	*+1,185*	*+ 400*	*− 265*	*+ 475*	*+ 575*	*+ 75*
IMF gold tranche position	*+ 95*	*+ 870*	*+ 60*	*+ 425*	*+ 20*	*+ 365*	*+ 30*
Liabilities to official foreigners	−3,355	+ 735	+ 995	+1,425	− 500	−1,185	.
of which							
Liquid	*−2,065*	*+3,110*	*+1,365*	*+2,200*	*+ 35*	*− 490*	.
Non-liquid	*−1,290*	*−2,375*	*− 370*	*− 775*	*− 535*	*− 695*	.
Balance on official reserve transactions basis	−3,405	+1,615	+ 90	+1,565	+ 70	− 110	.
less Non-liquid liabilities to official foreigners	−1,290	−2,375	− 370	− 775	− 535	− 695	.
Total change in official liquid position	−2,115	+3,990	+ 460	+2,340	+ 605	+ 585	.
plus Liabilities to non-official foreigners	−1,455	−3,830	− 720	−2,265	−1,040	+ 195	.
Balance on liquidity basis	−3,570	+ 160	− 260	+ 75	− 435	+ 780	.

banking system. This inflow, which took the form of a $3,830 million rise in US short-term liabilities to non-official foreigners, had two main causes. Firstly, banks in the United States were actively soliciting, through their foreign branches, funds from the Euro-dollar market. In the course of the year the liabilities of banks in the United States to their foreign branches went up by $2,735 million. Secondly, there was a rise in the rest of the world's private dollar balances as a result of financial crises affecting certain other currencies.

Given the liquidity surplus of $160 million, the large short-term inflow through the US banks led to an improvement of $3,990 million in the net balance of US reserves and liquid liabilities to official foreigners. And even after taking account of the increase of $2,375 million in non-liquid monetary liabilities to official foreigners, there was a fairly substantial surplus of $1,615 million on the official settlements account of the balance of payments.

Within this official settlements surplus, moreover, there were some very substantial changes in the individual monetary items. On the assets side total US reserves rose by $880 million, showing their first increase since 1957. The rise corresponded closely to the improvement in the IMF gold tranche position. By the end of 1968, in fact, the United States had reconstituted its full gold tranche of $1,290 million. The total of other US reserve components changed very little in 1968, but, as in 1967, there was a further significant shift from gold into foreign exchange assets. US official foreign currency holdings went up by $1,185 million, essentially through drawings by France and the United Kingdom on their swap facilities with the Federal Reserve and the US Treasury. The gold stock, on the other hand, declined by $1,175 million in 1968, mostly as a result of sales to the market during the first quarter. In the last nine months of the year, when the gold pool was no longer operating, US gold reserves increased by $190 million, largely because purchases from France, which amounted to $600 million, exceeded sales to other countries.

At the same time as the increase in reserves, total liabilities to official foreigners declined by $735 million. Liquid official liabilities fell by $3,110 million, whilst non-liquid ones increased by a further $2,375 million. The decline in liquid official liabilities was to some extent the counterpart of the rise in privately-held dollar balances. In addition, it was associated with the fall in the gold stock and with the increase in non-liquid official liabilities. This took, essentially, two forms. Firstly, there was a rise of $525 million in foreign official agencies' holdings of time deposits and certificates of deposit with original maturities of over one year. Secondly, foreign official agencies added $1,810 million during 1968 to their holdings of non-marketable medium-term US Government securities. Canada purchased $1,050 million of such securities during 1968, under an agreement of March 1968 whereby, in return for exemption from the US Government's new measures affecting capital outflows, it agreed to invest in non-liquid US Government securities all official Canadian holdings of US dollars in excess of working balances. In addition, the German monetary authorities added $625 million to their holdings of non-marketable medium-term US Government securities in 1968.

Looking at the course of developments over the year, during the first nine months the liquidity balance showed a deficit of $620 million. But at the same time there was an inflow of funds through the private sector of over $4 milliard and liquid liabilities to foreign official agencies declined by $3,600 million. And although official non-liquid liabilities increased very substantially, there was still a surplus on all official transactions of $1,725 million. This was concentrated in the second quarter, when the inflow of funds through the private sector was especially pronounced, reflecting the tight monetary conditions in the United States before Congressional approval of the fiscal programme in June. In the fourth quarter, and more particularly in December, the liquidity balance swung into large surplus, amounting to $780 million for the three months as a whole. And this was accompanied by a reduction of $195 million in liquid liabilities to foreign private holders — mainly due to repayments by US banks to their foreign branches. This still left an improvement of $585 million in the official liquidity position but since non-liquid official liabilities rose by a further $695 million, there was a small deficit on the official transactions basis for the quarter.

While other countries' drawings on their swap lines with the United States increased considerably during 1968, as is indicated by the $1,185 million rise in US official holdings of convertible foreign exchange, the use of the Federal Reserve swap network by the United States declined to quite modest proportions over the course of the year. Towards the end of 1967, in the wake of the disturbances that followed immediately on the devaluation of sterling, Federal Reserve drawings on the network had risen to a record level of $1.8 milliard. By early March this total had been reduced to $557 million, but fresh inflows of dollars to certain central banks as a result of the March crisis brought it up again to nearly $1 milliard towards the end of April. These drawings were completely liquidated by early July 1968. During the rest of the year the Federal's use of its swap facilities was on a much smaller scale than in late 1967. There were renewed drawings in Swiss francs and Deutsche Mark arising out of the November exchange crisis, but no great pressure on the dollar developed and at the end of 1968 total Federal Reserve drawings on the swap network were $432 million.

In the first quarter of 1969 the deficit on the liquidity basis was about $1.5 milliard, but on the official settlements basis there was a surplus of $1.7 milliard. The very large difference between these two figures is accounted for by an increase of $3.1 milliard in liquid liabilities to private foreign holders. Between 1st January and 26th March 1969 there was a further rise of $3.6 milliard in US banks' liabilities to their overseas branches. The whole of the official settlements surplus took the form of a reduction in liquid official liabilities.

United Kingdom. During 1968 there was a further deterioration in the official external monetary position of the United Kingdom, with some decline in the reserves and substantial recourse to foreign borrowing. This deterioration essentially resulted from three factors: the overall payments deficit of

United Kingdom: External monetary movements, 1968.

Items	Year	1st quarter	2nd quarter	3rd quarter	4th quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)				
Reserves	− 275	+ 25	− 40	+ 35	− 295
Account with IMF	−1,260	− 10	−1,410	+ 75	+ 85
Official UK liabilities in non-sterling currencies	− 40	− 305	− 195	+ 290	+ 170
Sterling liabilities to official holders in non-sterling area (net)	−1,590	− 900	+ 400	− 415	− 675
Other sterling liabilities (net)	+1,200	+ 75	+1,160	− 140	+ 105
of which					
to sterling-area holders	*+365*	*−245*	*+895*	*−170*	*−115*
to international organisations	*− 40*	*—*	*− 10*	*− 10*	*− 20*
to non-official non-sterling-area holders	*+875*	*+320*	*+275*	*+ 40*	*+240*
Liabilities of UK banks in foreign currencies (net)	− 100	− 80	− 40	− 75	+ 95
Liabilities in OSA currencies (net)	+ 110	—	− 235	+ 295	+ 50
Miscellaneous capital	+ 35	− 25	− 75	+ 65	+ 70
Exchange adjustments	+ 610	+ 295	+ 200	+ 55	+ 60
Overall balance	−1,310	− 925	− 235	+ 185	− 335

$1,310 million; exchange losses on the settlement of forward exchange contracts entered into by the Bank of England prior to devaluation and which are largely reflected in the $610 million debit item "Exchange adjustments"; and a large further decline in net external sterling liabilities. The extent of this decline can be roughly seen from the fact that the total of such liabilities, excluding those to official monetary institutions outside the sterling area (movements in which were strongly influenced by official borrowing operations), fell by $1,200 million during the year.

The major part of the change during 1968 in the United Kingdom's net sterling position vis-à-vis the rest of the world (excluding the position vis-à-vis official institutions outside the sterling area) was the result of an increase in sterling claims on foreign countries. These rose by $685 million, of which claims on non-official borrowers outside the sterling area accounted for $590 million and those on non-official sterling-area borrowers for the rest. By the end of 1968 the United Kingdom had a net creditor position in sterling vis-à-vis non-official institutions and persons outside the sterling area of some $1.2 milliard. The 1968 increase in sterling lending to the rest of the world will mainly have represented a growth in export credits following devaluation.

Gross external sterling liabilities (again excluding those to official institutions outside the sterling area) fell by $555 million in 1968. The main items were a fall of $285 million in liabilities to non-official holders outside the sterling area and a reduction of $250 million in those to sterling-area monetary authorities.

In the first part of the year a number of sterling-area countries were taking action to reduce the proportion of sterling in their reserves. On 1st June an agreement was announced with the Government of Hong Kong enabling it to switch part of its sterling reserves into non-marketable British

Government bonds denominated in Hong Kong dollars. Use of this facility and other withdrawals led to a decline of $680 million in the sterling area's sterling reserves during the second quarter of the year. And this movement would probably have continued had it not been for the conclusion in September 1968 of the arrangements under which the United Kingdom guaranteed the exchange value of these balances.

These arrangements fall into two parts. On the one hand, the United Kingdom has guaranteed that it will maintain the dollar value of that part of each sterling-area country's sterling reserves which exceeds 10 per cent. of its total official reserves, in return for an undertaking by each sterling-area country to maintain at all times an agreed minimum proportion of sterling in its reserves. The proportion varies from one country to another but broadly reflects the actual proportion of sterling in each country's reserves at the time when the agreement began to be negotiated. The agreements between the UK Government and the governments of the sterling-area countries, which included an agreement with Hong Kong replacing the earlier arrangement, came into force on 25th September 1968. In most cases they are valid for a period of three years, with a provision for a further two-year extension by mutual agreement, but in some instances they are valid for five years. In addition, the agreements with the Governments of Australia and New Zealand provide for immediate consultation between the parties concerned if, during the operation of the agreements, the United Kingdom were to impose further restrictions on the flow of capital to these countries.

On the other hand, the BIS, backed by a group of twelve central banks — those of Austria, Belgium, Canada, Denmark, Germany, Italy, Japan, the Netherlands, Norway, Sweden, Switzerland and the United States — has placed at the disposal of the Bank of England credit facilities totalling $2 milliard for the purpose of protecting the UK reserves from the effects of any declines in the sterling balances, both official and privately held, of the overseas sterling area below an agreed starting level. The facilities have a ten-year life starting from 23rd September 1968. Drawings may be made at any time during the first three years and the net amount ultimately drawn has to be repaid between the sixth and tenth years. The facility is administered by the BIS, which meets requests for drawings by the Bank of England by short and medium-term borrowings in the markets and out of the use of foreign currency deposits made at the BIS by sterling-area monetary authorities. To the extent that these resources might be insufficient, the BIS could have recourse to the group of twelve central banks, up to the amounts of their respective participations.

So far as the pattern of UK official financing in 1968 is concerned, as in 1966 and 1967 its main feature was an increase in foreign borrowing. In the first place, the United Kingdom's net indebtedness to the IMF rose by $1,260 million, a drawing of $1.4 milliard in June 1968 being followed by two repayments later in the year totalling $185 million on the $1.4 milliard drawing made in 1965. Secondly, there was an increase in central-bank assistance, as well as some use of the $2 milliard facility mentioned above. While some part of the central-bank assistance taken during 1968 showed up in an increase of $40 million in official liabilities in non-sterling currencies, it chiefly affected the sterling balances of official holders outside the sterling area. These rose during the year by a net amount of $1,590 million, but it has to be remembered that this figure includes not only the increase in assistance to which there was a sterling counterpart but also all other movements in official sterling balances held outside the sterling area. In addition to the rise in official borrowing, there was also a decline of $275 million in the United Kingdom's reserves during 1968.

Looking at the course of events over the year, it was during the first six months that the pressures on the reserves were particularly heavy. There was a large payments deficit, including a substantial outflow of capital, in the first quarter, as well as heavy losses on the Bank of England's pre-devaluation forward exchange contracts and a very large decline in the net sterling balances of the sterling area during the second quarter. Official financing during these six months included the $1.4 milliard drawing on the IMF, an increase of $500 million in official foreign currency liabilities and a rise in central-bank assistance with a sterling counterpart that is included in the increase of $500 million that occurred in net sterling liabilities to official holders outside the sterling area. The position improved considerably in the third quarter, when the overall balance of payments went into surplus and there was in addition some recovery in the level of the sterling area's sterling balances. But in the fourth quarter substantial official financing — including a fall of $295 million in reserves and a rise in assistance with a sterling counterpart that is included in the $675 million increase in official sterling balances held outside the sterling area — was again required, as the balance of payments went back into deficit and there was a further marked increase in net sterling claims on non-official institutions and persons outside the sterling area.

Available data on monetary movements in the first quarter of 1969 indicate some improvement in the official external monetary position. The reserves rose by $50 million, the indebtedness to the IMF was reduced by $305 million and central-bank assistance in the form of official currency liabilities by $130 million. Net sterling liabilities other than those to the IMF rose by $45 million; but, within this total, net liabilities to non-sterling-area countries fell by $455 million. This suggests that there may also have been some reduction in that part of central-bank assistance the counterpart to which is found in the official sterling liabilities of non-sterling-area countries. Net sterling liabilities to overseas sterling-area countries, including those to central monetary authorities, rose by $470 million. Taking all these figures together, it is clear that in addition to the favourable change in the official external monetary position there must have been a considerable improvement in the overall balance of payments (including the balancing item).

Continental western Europe. The combined overall external position of continental western Europe shifted very substantially between 1967 and 1968, *from a surplus of $2.2 milliard to a small deficit of $0.2 milliard.* The determining factor was the abrupt deterioration in France's balance of payments, from a position of about equilibrium to a deficit of $3.2 milliard. Excluding France, in fact, the combined continental surplus increased quite markedly between 1967 and 1968, from $2.3 milliard to just on $3 milliard. Essentially, this resulted from an increase of $1.1 milliard in Switzerland's surplus, partly associated with the deterioration in the French position. In addition, there were quite appreciable improvements in the balances of payments of Finland, Italy and Spain. On the other hand, in Belgium and the Netherlands the overall balance shifted from surplus to deficit and at the same time there was some reduction in the surpluses of Austria and Portugal.

Still considering the combined position of the continental countries without France, the figures on monetary movements appear to indicate that in 1968, as compared with 1967, the financing of the overall surplus shifted away from the banks to the official sector, since in 1967 the increase in the net external monetary assets of the two sectors was practically the same, whereas last year net official assets rose by $2.3 milliard and the net foreign assets of the banking systems by only $700 million. These figures are, however, difficult to interpret. The official reserves of both Germany and Switzerland were artificially high over the year-end in both 1967 and 1968, owing partly to the effects of exchange market disturbances in the fourth quarter of each year, and partly to seasonal factors. Moreover, this temporary element in official reserves undoubtedly increased from one year to the next. In Germany this was because by no means the whole of the November 1968 speculative inflow had been reversed by the end of the year, while in Switzerland it was because the scale of the banks' end-year window-dressing operations increased. The first of these factors is impossible to measure with any accuracy, but an increase of some $700 million in the outflow of funds through the German banks in January 1969, compared with January 1968, may give a rough indication of its order of magnitude. As for the Swiss banks' end-year operations, they are officially estimated to have increased by nearly $300 million in 1968 as compared with 1967. Adjusting for these factors, the result would be produced that nearly $1¾ milliard of the $3 milliard combined overall surplus of all continental European countries other than France in 1968 was financed through the commercial banks, and about $1¼ milliard through additions to net official monetary assets. This would suggest that, contrary to the impression given by the figures in the next table, there may have been, in effect, a moderate shift in the financing of the continental surplus towards the banking sector in 1968. Such a development would not be surprising in the light of the very pronounced shift towards the non-official sector in the financing of the US deficit, mainly through very heavy borrowing by US banks in Europe.

The biggest actual increase in net external banking assets during 1968 was that of $720 million in Italy, in which country also there was some fall in net official monetary assets. The Swiss banks' net external assets showed a rise of $525 million during the year. Furthermore, the financing of the

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

Countries	End of year	Gold and foreign exchange (net)	Net IMF and GAB position	Total official assets (net)	Commercial banks (net)	Total foreign assets (net)	Changes (+ = increase in assets, decrease in liabilities) Total official assets	Commercial banks
		In millions of US dollars						
Austria	1967	1,365	115	1,480	− 90	1,390	+ 155	+ 55
	1968	1,355	160	1,515	− 10	1,505	+ 35	+ 80
Belgium	1967	2,410	330	2,740	− 795	1,945	+ 250	− 90
	1968	2,155	305	2,460	− 735	1,725	− 280	+ 60
Denmark	1967	440	60	500	− 10	490	− 80	+ 15
	1968	340	85	425	65	490	− 75	+ 75
Finland	1967	170	− 65	105	− 105	—	− 60	− 15
	1968	350	—	350	− 110	240	+ 245	− 5
France	1967	6,090	885	6,975	− 560	6,415	+ 335	− 370
	1968[1]	3,325	—	3,325	− 60	3,265	−3,650	+ 500
Germany	1967	7,540	1,055	8,595	845	9,440	+ 95	+1,210
	1968	8,815	1,515	10,330	75	10,405	+1,735	− 785[2]
Greece	1967	260	25	285	10	295	+ 15	—
	1968	295	25	320	10	330	+ 35	—
Iceland	1967	30	—	30	− 10	20	− 25	—
	1968	25	− 5	20	− 10	10	− 10	—
Ireland	1967	425	10	435	315	750	− 55	+ 75
	1968	495	45	540	180	720	+ 105	− 135
Italy	1967	4,835	840	5,675	15	5,690	+ 555	− 180
	1968	4,645	895	5,540	735	6,275	− 135	+ 720
Netherlands	1967	2,260	355	2,615	− 155	2,460	+ 170	− 110
	1968	1,950	500	2,450	− 90	2,360	− 165	+ 65
Norway	1967	610	50	660	− 10	650	+ 135	+ 30
	1968	625	70	695	105	800	+ 35	+ 115
Portugal	1967	1,235	20	1,255	145	1,400	+ 140	+ 40
	1968	1,365	20	1,385	155	1,540	+ 130	+ 10
Spain	1967	1,050	—	1,050	—	1,050	− 155	—
	1968	1,095	—	1,095	—	1,095	+ 45	—
Sweden	1967	680	140	820	300	1,120	− 190	+ 165
	1968	635	165	800	275	1,075	− 20	− 25
Switzerland	1967	3,860	—	3,860	− 15	3,845	+ 175	− 60
	1968	4,485	—	4,485	510	4,995	+ 625	+ 525
Turkey	1967	40	− 20	20	.	.	+ 15	.
	1968	45	− 50	− 5	.	.	− 25	.
Total	1967	33,300	3,800	37,100	− 120[3]	36,960	+1,475	+ 765[3]
	1968	32,000	3,730	35,730	1,095[3]	36,830	−1,370	+1,200[3]
Total excluding France	1967	27,210	2,915	30,125	440[3]	30,545	+1,140	+1,135[3]
	1968	28,675	3,730	32,405	1,155[3]	33,565	+2,280	+ 700[3]
Canada	1967	2,275	435	2,710	655	3,365	+ 30	+ 315
	1968	2,635	205	2,840	960	3,800	+ 130	+ 305
Japan	1967	1,760	240	2,000	−1,030	970	− 60	− 510
	1968	2,570	290	2,860	− 790	2,070	+ 860	+ 240

[1] BIS provisional estimates. [2] After elimination of statistical changes. [3] Excluding Turkey.

Note: For Group of Ten countries, plus Switzerland, the figures (with the exception of those for France in 1968) are those used for multilateral surveillance. They do not in most cases correspond exactly to published reserve figures.

external surplus shifted markedly towards the banking sector in both Norway and Austria and there was a shift from official assets to the banking sector in Denmark, where the overall balance was in equilibrium, as well as in Belgium and the Netherlands, where there were overall payments deficits.

Looking at the changes during 1968 in the net official assets of continental countries other than France, the overall increase of $2.3 milliard was made up of $0.7 milliard in gold and $0.8 milliard each in foreign exchange and claims on the IMF. If, however, the adjustments mentioned previously are made to the positions of Germany and Switzerland, the exchange reserves of this group of countries would show a decline of some $0.2 milliard. In reality, therefore, there occurred some change in the composition of these countries' official monetary assets in favour of IMF positions and gold. The increase in gold reserves, which occurred despite substantial losses to the market in the first quarter and despite a decline of $0.5 milliard in the Swiss National Bank's holdings of gold under swaps with the BIS, included purchases from the IMF, the US Treasury and France. The rise in claims on the IMF chiefly reflected the French and British drawings on the Fund.

In the first quarter of 1969 it appears that the continental countries taken together had a quite substantial overall payments deficit. Excluding France, their combined net official assets declined by $3.5 milliard, of which $3.1 milliard in foreign exchange and the remainder in their IMF positions. The banks' net foreign position increased by almost $2 milliard, so that excluding France these countries showed a combined overall deficit of $1.6 milliard.

Germany. The pattern of Germany's external monetary movements changed completely between 1967 and 1968. In 1967, when the overall surplus amounted to $1,305 million, Germany's net official external assets rose by only $100 million owing to a very large outflow of funds through the banks. In 1968 the overall surplus declined to $950 million but at the same time there was a net reduction of $785 million in the banks' foreign assets. The surplus in the official monetary sector consequently rose to the very high figure of $1,735 million, far larger than in any country other than the United States. Even allowing for the temporary element in Germany's reserves at end-1968 mentioned earlier, the official settlements surplus was still of the order of magnitude of $1 milliard. And but for the action of the German authorities in providing the commercial banks with dollar swap facilities at rates more favourable than those prevailing in the market the official sector's surplus might have been considerably larger than it was.

The composition of the 1968 increase in net official monetary assets to a large extent reflected Germany's participation in various operations undertaken to support the reserve position of other countries. More than half of the $310 million rise in the gold reserve, as well as most of the $465 million increase in the IMF position, arose out of Germany's purchases of gold from the IMF and from the rise in its GAB claims, both of which were associated

Germany: External monetary movements.

Items	1967	1968 Year	1968 1st quarter	1968 2nd quarter	1968 3rd quarter	1968 4th quarter	1969 1st quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Net official assets . . .	+ 100	+1,735	+ 380	+ 335	+ 310	+ 710	−1,815
Gold	*− 65*	*+ 310*	*− 255*	*+ 340*	*+ 145*	*+ 80*	—
Convertible foreign exchange	*+ 145*	*+ 390*	*+ 430*	*− 635*	*+ 130*	*+ 465*	*−1,530*
IMF and GAB position .	*− 205*	*+ 465*	*+ 80*	*+ 465*	*− 40*	*− 40*	*− 160*
Other reserve assets. .	*+ 230*	*+ 655*	*+ 155*	*+ 170*	*+ 75*	*+ 255*	*− 95*
Other (net)	*− 5*	*− 85*	*− 30*	*− 5*	—	*− 50*	*− 30*
Banks' net position	+1,205	− 785	+ 395	− 330	− 245	− 605	+1,135
Assets	*+ 1,500*	*+ 700*	*+ 365*	*− 150*	*+ 345*	*+ 140*	*+ 400*
Liabilities	*− 295*	*−1,485*	*+ 30*	*− 180*	*− 590*	*− 745*	*+ 735*
Overall balance	+1,305	+ 950	+ 775	+ 5	+ 65	+ 105	− 680

with the French and UK drawings on the Fund in June 1968. In addition, practically all of the $390 million increase in official holdings of convertible foreign exchange represented the French franc and sterling counterparts of short-term assistance granted to France and the United Kingdom. Lastly, the German authorities purchased $675 million of US and UK Government securities denominated in Deutsche Mark and issued under the military offset agreements with those countries. These securities are included in the item "Other reserve assets" in the table.

The course of monetary movements during 1968 was very uneven and was increasingly affected, as the year went on, by speculative inflows of funds. In the first quarter, when the overall payments surplus amounted to $775 million, the net external assets of the official and banking sectors rose by about the same amount. There was a large seasonal outflow of funds through the banks in January; but this was subsequently reversed, especially during the March gold crisis, despite the Bundesbank's active swap policy vis-à-vis the banks.

Between April and September the overall external position was practically in balance. Nevertheless, net official monetary assets rose by $645 million during these six months. There was a large inflow through the banks in June, partly related to the French crisis, but also because of mid-year window-dressing. Then, beginning in late August, there was a substantial speculative inflow that lasted for about ten days. The effects of this were to some extent reflected in an increase of $480 million in the third quarter in the banks' external Deutsche Mark liabilities; but its impact both on the banks' external position and on the reserves was greatly reduced by a very considerable increase in dollar swaps between the Bundesbank and the banks during September.

Fourth-quarter monetary movements were dominated by the November exchange crisis and its subsequent unwinding. A second wave of speculative inflows produced an overall payments surplus of about $1 milliard in November, but there was an abrupt reversal in December and the overall surplus for the quarter as a whole was only $105 million. In November there was, in addition to the $1 milliard payments surplus, an inflow of funds through the banks of about the same size. And despite the measures taken to encourage a reversal of this inflow, including a further substantial rise in the Bundesbank's dollar swaps with the banks, seasonal factors prevented more than a small proportion of this money from being re-exported by the end of the year. This appears from the fact that over the fourth quarter as a whole the banks' net external position declined by $605 million. As a result there was an official monetary surplus of $710 million for the quarter.

Once the year-end was past, however, the German banks immediately re-exported funds on a massive scale. In January they reduced their external DM liabilities by $555 million, at the same time increasing their dollar claims by $850 million. And although, as domestic liquidity subsequently tightened, the banks repatriated foreign claims in the next two months, the outflow for the first quarter of 1969 still amounted to $1,135 million. At the same time the overall balance showed a deficit for the quarter of $680 million. These developments caused a decline of $1,815 million in net official external assets, with the exchange reserves falling to only $1,135 million, their lowest level for many years.

Switzerland. In 1968 Switzerland recorded the largest overall payments surplus of any continental country. It amounted to $1,150 million, as compared with one of only $115 million the year before. As already mentioned, the statistics of Switzerland's monetary movements for the calendar year give a misleading impression. This is because about half of the $625 million rise in net official monetary assets during the year was due to an increase between 1967 and 1968 in the amount of dollars held only temporarily, over the year-end, by the Swiss National Bank. In reality, therefore, excluding the effects of this end-year window-dressing, over three-quarters of the 1968 payments surplus was reinvested abroad by the Swiss commercial banks.

So far as the individual components of Switzerland's official monetary assets are concerned, the gold stock fell by $465 million in 1968, the exchange reserves rose by $850 million and other net official monetary assets went up by $240 million. The decline in the gold stock was essentially due to a reduction in the Swiss National Bank's holdings of gold under swaps with the BIS. The increase in the exchange reserves included, as well as the rise already mentioned of some $300 million in dollars held temporarily over the year-end, a rise of $70 million in the amount of dollars held under the swap line with the Federal Reserve. The rise of $240 million in other official monetary assets chiefly reflects purchases by the Swiss Confederation and the Swiss National Bank of US Government bonds denominated in Swiss francs.

During the first quarter of 1969 Switzerland's overall balance showed a deficit of $325 million. As, in addition, the banks increased their net foreign assets by $450 million, net official monetary assets declined by $775 million. After falling by $875 million in January and $105 million in

February, net official assets went up during March by $205 million, presumably in connection with end-quarter window-dressing by the banks.

Italy. In Italy, too, the overall payments surplus increased between 1967 and 1968, from $375 to 585 million. And in the Italian case the 1968 surplus was more than covered by an increase of $720 million in the banks' net foreign position, so that in the official monetary sector there was a moderate deficit of $135 million. Practically all of the outflow through the banking system took the form of a rise of $705 million in the banks' net foreign currency assets.

Within the overall decline of $135 million in net official monetary assets, there were over the year a number of much larger changes in the individual categories of official monetary assets. The exchange reserves declined by $460 million, official holdings of dollars under swaps with the Federal Reserve System were reduced from $500 million to nil (the Federal having fully liquidated the drawings that it had made during the second half of 1967 on its swap facility with the Bank of Italy) and the IMF gold tranche position fell by $135 million. On the other hand, the gold reserve rose by $525 million, GAB claims by $185 million and longer-term official monetary assets by $225 million. The increase in the gold reserve included purchases of $210 million from the US Treasury, $145 million from the IMF and $50 million from the Bank of Canada. Italy's GAB claims went up partly in connection with the French and UK drawings on the Fund in June 1968 and partly through a direct transfer from France of some of that country's previously accumulated GAB claims. So far as the additions to longer-term official monetary assets are concerned, they included two purchases of $100 million each of non-marketable securities denominated in lire and issued by the US and Canadian Governments respectively.

The payments surplus was concentrated in the seasonally favourable third quarter of the year, when it amounted to $600 million. In this quarter, too, there was a substantial increase of $420 million in the banks' net foreign position. During the last quarter of the year, when the balance of payments was about in equilibrium, the banks' net foreign position showed a further rise of $240 million. Half of this increase took place in December.

During the first quarter of 1969 Italy's net official monetary assets fell quite substantially, by a further $380 million. This was essentially due to a deficit on the balance of payments of $355 million. The banks' net foreign position, which showed a further increase in January, subsequently declined in February and March. For the quarter as a whole the banks' position showed a surplus of $25 million. In March the banks were instructed to bring their foreign claims and liabilities into balance by mid-year. Within the official sector's deficit of $380 million, the principal monetary movements were declines of $185 million in the exchange reserves and $105 million in the IMF and GAB position, together with an increase of $100 million in official liabilities.

Austria. The overall payments surplus declined between 1967 and 1968 from $210 to 115 million. At the same time the financing of the surplus shifted towards the banking sector. The banks' net foreign liabilities went down by $80 million, while net official assets rose by only $35 million. Most of the change in the banks' foreign position came about through a decline in their gross foreign liabilities. In the official monetary sector, the IMF's need for Austrian schillings produced increases of $45 million in Austria's gold tranche position and of $15 million in its gold reserve. The exchange reserves, on the other hand, declined by $25 million. During the first quarter of 1969, when the overall payments surplus was $65 million, net official assets fell by $40 million owing to a very substantial outflow of $105 million through the banking system.

France. The provisional BIS estimates, given on page 17, of France's balance of payments and of the changes in its net external monetary position during 1968 show an overall deficit of $3,150 million, a net outflow of $500 million through the banks and therefore a decline of $3,650 million in net official monetary assets. While full details of last year's external monetary movements are not yet available, the provisional estimates for the whole year, taken together with published data on developments during the first half of the year, indicate the broad outline of events.

In the first quarter of 1968, before the outbreak of the crisis, the balance of payments was already in deficit, to the extent of $75 million; and in addition there was a net outflow of $65 million through the banks, almost entirely as a result of an increase in their net foreign exchange assets, which had been considerably reduced during the two preceding quarters. Net official assets, therefore, fell by $140 million during the first quarter.

During the rest of the year the external monetary position was dominated by the effects of the May–June crisis and there was a net reserve loss of $3,510 million. Within this period, however, two main phases can be distinguished. In the first of these the loss of reserves was due more to an outflow of funds through the banks than to the overall deficit, while in the second the reserve loss was less than the overall deficit since there was a marked inflow of funds through the banks. The contrast between these two phases is

France: External monetary movements, 1968.

Items	1st quarter	2nd quarter	2nd half[1]	Year[2]
	in millions of US dollars (+ = increase in assets, decrease in liabilities)			
Net official assets	− 140	− 1,865	− 1,645	− 3,650
of which				
Reserves	*− 85*	*− 850*	..	..
IMF and GAB position	—	*− 885*	—	*− 885*
Other (net)	*− 55*	*− 130*	..	..
Banks' net position	+ 65	+ 1,180	− 745	+ 500
Total	− 75	− 685	− 2,390	− 3,150

[1] Residual figures. [2] BIS provisional estimates.

illustrated by the data for the second quarter and for the latter half of the year.

In the second quarter, nearly two-thirds of the decline in net official assets resulted from an outflow of $1,180 million through the banking system. This outflow had two separate components. Firstly, the banks' net foreign currency assets increased by $810 million, essentially as a result of exceptional forward covering of exchange commitments by French residents. Secondly, the banks' net French franc liabilities to non-residents declined by $370 million, reflecting an increase of $250 million in claims on non-residents together with a decline of $120 million in non-residents' French franc balances. The second-quarter fall of $1,865 million in net official assets mainly consisted of a reserve loss of $850 million, together with the use of IMF and GAB facilities for $885 million.

In the second half of the year, on the other hand, the residual figures given in the table show that the decline of $1.6 milliard in net official assets was less than it had been in the second quarter alone, despite an increase in the overall deficit to $2.4 milliard. This was because the banks reduced their net foreign position by $0.7 milliard. A large part of this reduction in the banks' foreign position came about as a result of the restriction in December 1968 of French residents' access to forward exchange cover, which reduced correspondingly the banks' need to hold spot exchange assets.

Belgium. In Belgium the balance of payments deteriorated quite substantially in 1968, to an overall deficit of $220 million. As, in addition, the banks' net foreign liabilities declined by $60 million, the official monetary sector showed a deficit of $280 million. The exchange reserves fell by $360 million and there was also a small decline of $25 million in the IMF and GAB position. The gold reserve, on the other hand, went up by $45 million and other official monetary assets — which include the National Bank of Belgium's portfolio of export bills denominated in Belgian francs — by $70 million.

During the first quarter of 1969 there was a further decline of $100 million in net official monetary assets, about half of which was due to an outflow of $55 million through the banking system. Early in April the authorities fixed limits for the total of the banks' foreign currency assets drawn from the official exchange market and of their advances in domestic currency to non-residents. The banks have been asked to comply with these limits by mid-year.

Netherlands. As in Belgium, the overall balance of payments moved into deficit in 1968 and this was accompanied by an outflow of funds through the banks. The overall deficit amounted to $100 million and the banks' net foreign liabilities declined by $65 million, so that net official monetary assets were reduced by $165 million. The exchange reserves in fact fell by $310 million, since, in addition to financing the overall deficit and the outflow through the banks, they were drawn on for the conversion into dollars of florins lent through the IMF. Altogether, the IMF and GAB position of the Netherlands increased during 1968 by $145 million. The gold reserve fell by $15 million.

During the first quarter of 1969, when there was an overall surplus of $90 million, net official assets declined again by $60 million, owing to a further large outflow of $150 million through the banks.

Other European countries. Following the devaluation of October 1967, *Finland's* balance of payments improved substantially, from an overall deficit of $75 million in 1967 to a surplus of $240 million in 1968. The 1968 surplus was closely reflected in a rise of $245 million in official monetary assets. The exchange reserves went up by $180 million and in addition $65 million was repaid to the IMF. The surplus continued in the first quarter of 1969, when net official assets rose by a further $35 million. In *Norway* the overall surplus for 1968 was $150 million, about the same as in the previous year. But, in contrast to what happened in 1967, the pull of rising interest rates abroad led to the result that most of the 1968 surplus had as its counterpart an increase of $115 million in the banks' net foreign position. During the first quarter of 1969 there was a further increase of $80 million in the banks' net foreign assets, but this was practically offset by a decline of $70 million in net official assets. In *Denmark*, where the balance of payments was almost exactly in balance for the year 1968, there was a $75 million shift of external monetary assets from the official to the banking sector. This, too, came about through the pull exerted by interest rates abroad. In the first quarter of 1969 the balance of payments showed a large deficit of $135 million. The decline in net official assets, at $160 million, was even larger since the banks' net foreign assets rose by a further $25 million. In *Portugal* the overall surplus of $140 million was a little lower than in 1967. Net official assets rose by $130 million, including additions of $155 million to the gold reserve. *Spain's* balance of payments moved from deficit into surplus between 1967 and 1968, with the whole of the 1968 surplus being reflected in a rise of $45 million in the exchange reserves. In the first quarter of 1969, however, they fell by $70 million.

Canada. After a deficit of $815 million in the first quarter of 1968, Canada's external position recovered strongly during the rest of the year. For 1968 as a whole there was an overall surplus of $435 million, nearly $100 million more than in the previous year, and it was financed to the extent of $305 million through a rise in the banks' net external claims, leaving a surplus of $130 million on official monetary transactions.

During the exchange crisis in the first quarter, the whole of the overall deficit was covered by a decline in net official assets. The main individual financing items were the withdrawal of $425 million of claims on the IMF and activation of the US swap facility for an amount of $250 million. The turning-point came with Canadian exemption from the reinforced US balance-of-payments programme in March. During the last nine months of the year there was an overall surplus of $1,250 million, including an official-sector surplus of $950 million. The swap drawing on the United States was fully repaid by July, and Canada's gold tranche position of $185 million was reconstituted by mid-September, but the main official financing item during this period was an increase of $695 million in official holdings of US dollars. The increase in dollar reserves was not, however, in liquid form: in return for exemption from US capital controls, Canada had agreed, inter alia, to place any official dollar holdings other than working balances in special non-liquid US Government securities, and to meet this obligation the Canadian Government purchased $1,050 million of such securities during 1968.

In the first three months of 1969 Canada's overall surplus declined, partly seasonally, to $25 million. The commercial banks, whose net position vis-à-vis third countries had been restricted since early March 1968, built up their net claims, presumably all against the United States, by $65 million. There was, therefore, a fall of $40 million in net official assets during the quarter.

Japan. In Japan, too, there had been an overall deficit in the first quarter of 1968, in this case essentially seasonal. But this gave way to increasingly large surpluses in the three remaining quarters, so that for the year as a whole a surplus of $1,100 million was recorded. Of this amount, $240 million was financed through the commercial banks, in contrast to the inflow of $510 million in 1967, and the official settlements surplus amounted to $860 million in place of a $60 million deficit in 1967. By far the largest official financing item in 1968 was a rise of $710 million in foreign exchange reserves, almost entirely in US dollars. The overall surplus persisted in the first quarter of 1969, when it totalled $280 million, and net official assets rose by a further $320 million. The increase was again almost entirely in US dollar holdings.

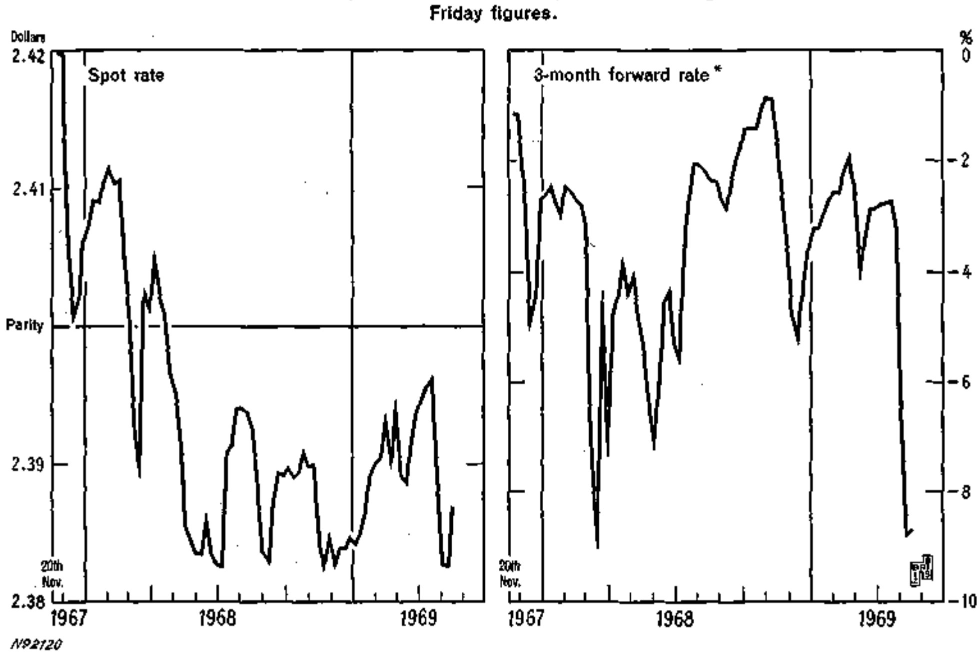
Foreign exchange markets.

In the six months up to mid-March 1968 conditions in the foreign exchange markets had been as turbulent as at any time since the introduction of currency convertibility in Europe at the end of 1958. And in the course of the past year there have been periodic further shocks to confidence. First, the French franc came suddenly under heavy pressure in May and June 1968. Then in the latter half of the year expectations of a revaluation of the Deutsche Mark — never far below the surface after the March gold crisis — became almost overwhelming. Meanwhile, the continuing weakness of the United Kingdom's balance of payments left sterling dangerously exposed. Volatile attitudes became reflected in erratic movements of short-term funds and the situation came to a head in mid-November with a huge speculative inflow into Germany. On 20th November most of the principal European foreign exchange markets were closed for three days while the Ministers and central-bank Governors of the Group of Ten met in Bonn to consider action to resolve the crisis. The steps taken by the three countries mainly involved have been described in Chapter I. Although they did not immediately restore confidence, a substantial reflux of funds from Germany soon developed and for a time the situation in the markets improved.

In contrast to the earlier months of 1968, when the dollar had been a focal point of concern, the US currency was not directly involved in the November crisis. By the early spring of 1969, to a large extent under the influence of massive US borrowing in European markets, nearly all major European currencies, with the principal exception of the Swiss franc, were well below par on the dollar, and many were at a sizable forward premium. Then in early May a further speculative inflow to Germany brought fresh turmoil to the markets.

Sterling. During most of the period under review sterling was rather weak in the exchange markets. This was due basically to the slowness of the improvement in the United Kingdom's balance of payments following devaluation, which left sterling vulnerable to disturbances arising at other important points in the monetary system. After a period of strength early in 1968, the spot dollar rate fell to $2.39 during the March gold crisis, while in the forward market, where the Bank of England was no longer actively supporting the rate, the three-month forward discount on the dollar at one point reached 15 per cent. per annum. Following the suspension of the gold pool's market intervention, sterling began to strengthen and this movement was encouraged by the UK budget. By early April the spot dollar rate had recovered to $2.40½. Almost immediately, however, it began to weaken again and by mid-year had fallen to $2.38¼. As well as the weakness of the balance of payments, unfavourable influences included the French crisis and the fact that some sterling-area countries were reducing the sterling element in their reserves.

Dollar quotations for the pound sterling.
Friday figures.



* As discount on spot rate, in percentages per annum.

In July sterling recovered quite strongly in both spot and forward markets, following the announcement on 8th July of agreement in principle to a new large international credit facility to protect the United Kingdom's reserves against reductions in the level of sterling balances of overseas sterling-area countries. By end-July the spot dollar rate had recovered to \$2.39½, while the three-month forward discount on the dollar had narrowed to just over 2 per cent. per annum. There was then a further weakening in August and early September, associated first with events in Czechoslovakia and then with renewed speculation on a DM revaluation. The position improved again following confirmation of the new \$2 milliard facility for sterling on 9th September and remained somewhat firmer until the end of October. Spot sterling never rose significantly above \$2.39 but the three-month forward discount narrowed considerably to just over ¾ per cent. per annum by the end of October.

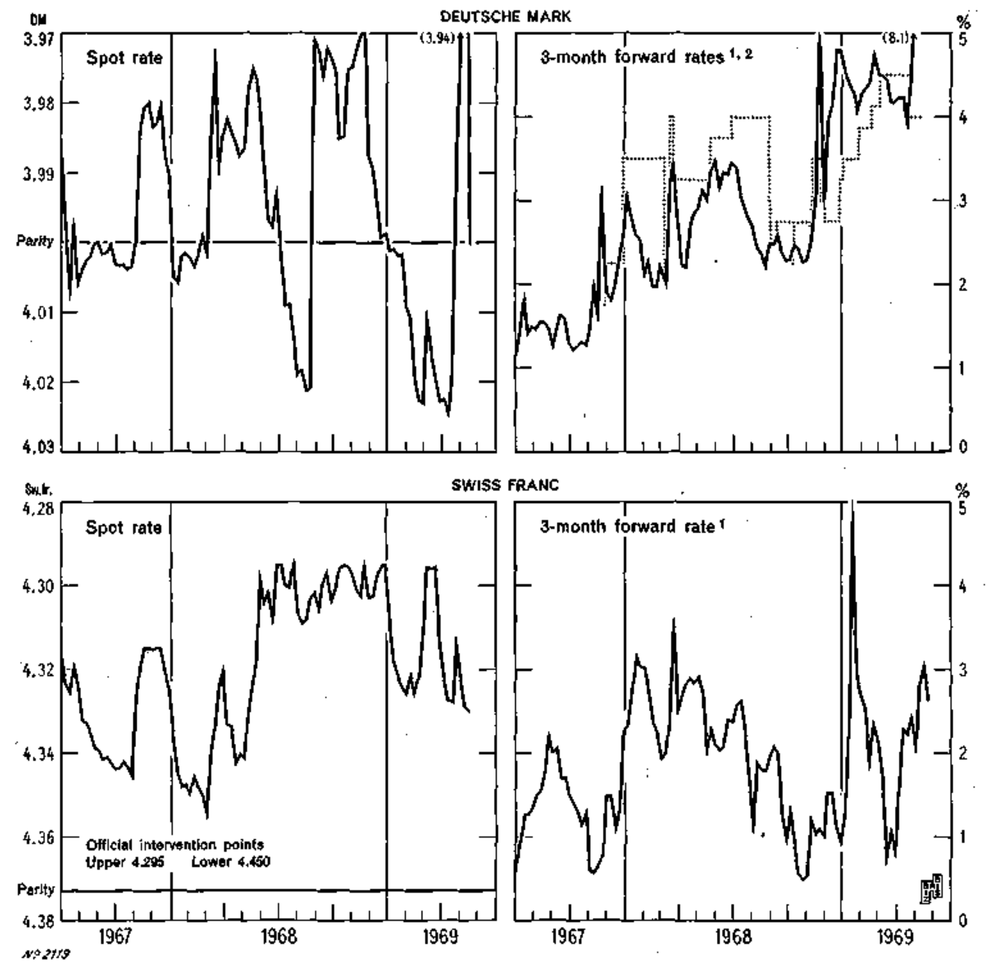
Once again, however, it proved impossible to consolidate the position. Renewed and much stronger speculation on changes in the German and French exchange parities brought sterling under very heavy pressure in November. The spot rate was held at \$2.38¼ in London but was supported at its floor of \$2.38 in New York by the Federal Reserve Bank, acting on behalf of the Bank of England, when the London market was closed from 20th to 22nd November. At the same time the three-month forward margin widened sharply to a discount of nearly 9 per cent. per annum in New York.

Speculation subsided when the main European exchange markets reopened on 25th November, but sterling remained weak for most of the rest of the year. Then in January and February 1969 it improved appreciably. There was a fairly strong commercial demand for the currency early in the new year, much of it seasonal, and some reconstitution of the sterling area's sterling balances. Although the recovery was limited by increasing monetary stringency in the United States, the spot rate had risen above \$2.39¼ by end-February and the forward discount was then at about 2½ per cent. per annum. In March, however, there was a further brief relapse, prompted partly by disappointment with the trade results for February. And the pound came under much more severe pressure in April, and again in early May when speculation in favour of the Deutsche Mark revived on an even larger scale than in November 1968. The spot rate then fell temporarily to \$2.38¼ and at the same time the three-month forward discount on the dollar widened to 16 per cent. per annum.

Deutsche Mark. Spot quotations for the Deutsche Mark against the US dollar fluctuated considerably during the period under review. On the one hand, there were a number of occasions on which inflows into Germany in anticipation of a possible revaluation of the currency brought the Deutsche Mark to its upper limit against the dollar in the spot market. On the other hand, between the waves of speculation the spot rate eased sharply, reflecting the deficit in the basic balance of payments, and was at times weaker than in any period since the existing parity was declared in 1961. In forward markets the Deutsche Mark was consistently strong — underpinned by the relatively low interest rate level in Germany — and it became exceptionally so during outbursts of speculative pressure.

As tensions relaxed after the March 1968 gold crisis, the spot rate against the dollar eased from a peak of DM 3.97 to DM 3.98¾ at the end of April. Then, in May, as uncertainties about both the dollar and sterling persisted, a minor wave of speculation in favour of the Deutsche Mark carried quotations back to DM 3.97½. The speculation quickly petered out and from mid-May until mid-August the spot rate for the dollar weakened almost continuously to DM 4.02⅛ — more than 0.5 per cent. below par. The Deutsche Mark during this time seemed to be unaffected by the flight of funds from France; nor did it strengthen with the large seasonal repatriation of foreign assets by the German commercial banks in June, since this took place to a large extent through repayment of dollar swaps to the Bundesbank.

Deutsche Mark and Swiss franc quotations for the US dollar.
Friday figures.



[1] As premium on spot rate, in percentages per annum. [2] The continuous line represents market rates. The dotted line represents special rates applied by the Bundesbank to US dollar swaps with the commercial banks.

A very large outflow of long-term capital, at a time of seasonal decline in the current-account surplus, thus made itself felt in the spot market rates during these months, and there was an accompanying decline in the forward premium after mid-year to around 2¼ per cent. per annum.

At the end of August rumours of a possible revaluation of the Deutsche Mark revived, more strongly than before. Against the background of continuing weakness of the French franc and with sterling convalescing only slowly, these rumours set off a much larger speculative inflow of funds, which took the spot rate against the dollar practically to its upper limit of DM 3.97 on 30th August. And the market premium on the three-month forward dollar might well have strengthened equally sharply had the Bundesbank not lowered its rate for three-month swaps with the banks from 4 to 2½ per cent. per annum at the end of August.

Firm denials of any intention to revalue restored calm by the second week of September; but the spot rate remained rather firm, despite the more relaxed conditions which lasted until towards the end of October. Then, in the first three weeks of November came an even greater surge of speculation. The spot Deutsche Mark moved to its ceiling of DM 3.97 against the dollar on 15th November and remained there until the closure of the German exchange market on 20th November. Meanwhile, the forward market premium on the dollar rose to a peak of almost 5 per cent. per annum, with Bundesbank swap facilities for the commercial banks, at rates ranging from 2½ to 3½ per cent. per annum, temporarily restricted to investments in US Treasury bills.

The outflow of funds from Germany immediately after the Bonn meeting carried the spot rate for the dollar to par by the end of the year, where it remained during January. Then, as capital exports pushed the overall balance into sizable deficit, the rate weakened further to DM 4.02⅝ — nearly 0.7 per cent. below parity — by early March. Forward market quotations, however, remained persistently strong, with the three-month premium almost continuously above 4 per cent. per annum, reflecting the record level of Euro-dollar interest rates.

Beginning in mid-April, the Deutsche Mark began to strengthen again, both spot and forward. By the end of the month the spot rate was hard against the ceiling and during the further massive inflow of funds in early May market quotations went at moments beyond that point. The three-month forward market premium on the dollar touched 9 per cent. per annum on 8th May. Following the German Government's decision not to revalue the currency, rates eased again, but in the forward market the Deutsche Mark remained exceptionally strong.

Swiss franc. The Swiss franc has been in strong demand for most of the time since the March 1968 gold rush. At that time, when other major European exchange markets were temporarily closed, the Swiss National Bank raised the effective ceiling for the Swiss franc against the dollar to its official limit of Sw.fr. 4.29½, equal to 1.78 per cent. above parity, from the rate customarily applied since 1961 of Sw.fr. 4.31½. In the event the currency strengthened only to Sw.fr. 4.32. Early in May the franc became firmer and with funds pouring out of France towards the end of the month it practically reached its new ceiling against the dollar. For the rest of the year it remained continuously above the pre-March intervention point.

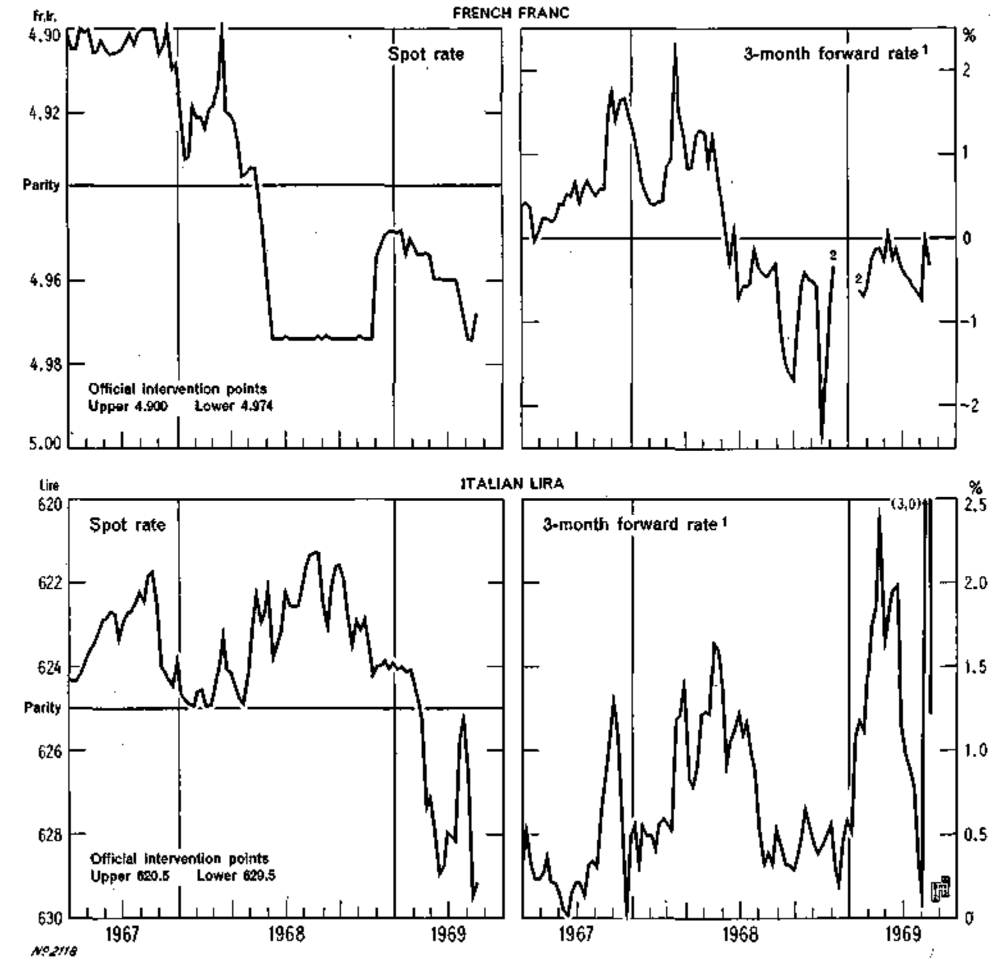
Quotations eased to Sw.fr. 4.31 in early August, but events in Czechoslovakia, followed by speculation in favour of the Deutsche Mark, changed the trend and the Swiss franc was again very strong in late September when, in addition, the banks faced a shortage of domestic liquidity. During the third week of November the Swiss franc became involved in the international currency crisis and during the Bonn conference the spot rate went to Sw.fr. 4.29½. And it was close to the intervention point again before the end of the year, although the Swiss National Bank provided the banks with domestic liquidity through very large swap operations.

Early in 1969 the seasonal outflow of funds, reinforced by the strong upward trend in Euro-dollar interest rates, carried the spot quotation down sharply to nearly Sw.fr. 4.32¾ by mid-February, and there was an accompanying recovery in the three-month forward premium on the dollar, which had shown a declining trend during most of 1968, to a level somewhat above 2½ per cent. per annum throughout January. These movements were temporarily reversed towards the end of the first quarter, when the spot quotation yet again attained its upper limit. There was, however, a further outflow of funds during April, and at Sw.fr. 4.33 — less than 1 per cent. above parity — the spot rate became weaker than for almost a year. After strengthening later in the month the rate eased again to about Sw.fr. 4.33 during the renewed bout of speculation in favour of the Deutsche Mark.

French franc. Since May 1968 the underlying position of the French franc has been very weak. While for much of the time this was reflected in market quotations for the franc, the reintroduction of exchange controls in late November 1968 brought a marked improvement in rates that lasted for about three months.

Just before the 1968 student troubles began, the spot rate on the dollar was close to par. From 20th May to 7th June the Paris exchange market was unable to function but in dealings in other centres the spot rate against the dollar went to its lower limit of Fr.fr. 4.974, where it was supported on behalf of the Bank of France by the Federal Reserve in New York and by the BIS in European markets. After the Paris market reopened, the spot rate remained very close to the lower intervention point until the November currency crisis brought a further closure of the market. With the spot rate continuously at the lower limit, the varying degrees of pressure on the franc during this period can be seen in the movements of the forward rates. The three-month forward discount on the dollar, which had appeared in May, rose to almost 1¾ per cent. per annum at the beginning of September and to over 3 per cent. during the November currency crisis.

French franc and Italian lira quotations for the US dollar.
Friday figures.



[1] As discount or premium on spot rate, in percentages per annum. [2] As from 4th December 1968 French non-bank residents were not allowed to obtain forward exchange cover at longer than one month. From 19th January 1969 three-month forward cover has been permitted for a very limited range of imports.

After the Bonn meeting of the Group of Ten and the French Government's decision not to devalue, the spot rate against the dollar improved sharply. At the end of the year it stood at Fr.fr. 4.94¾, somewhat less than 0.25 per cent. below par, and it remained continuously above Fr.fr. 4.95½ until the end of February 1969. A good part of this improvement resulted from various administrative measures taken by the authorities. One of these measures was the restriction of French residents' access to the forward exchange market. In addition, a number of restrictions were placed on the banks' foreign operations. Firstly, in December 1968 the banks were required to reduce their overall foreign currency asset position and their French franc claims on non-residents to the levels at which they had stood on 3rd September 1968 — the former by the end of the year and the latter by end-January 1969. Secondly, in January 1969, all banks with net foreign currency asset positions vis-à-vis non-residents were required, in principle, to bring them into balance by the end of the month. Banks failing to do this were required to make dollar deposits at the Bank of France over a period of three months equal to their net foreign currency asset positions vis-à-vis non-residents.

The franc began to weaken again in March and following the resignation of General de Gaulle in late April it fell to the lower limit against the dollar, at or close to which level it remained during the massive wave of speculation in favour of the Deutsche Mark in early May.

Lira. The lira was generally less affected by the recurrent speculative movements since March 1968 than the currencies so far discussed. At the same time, the exchange rate moved more widely than during any previous period. From a momentary peak of Lit. 622¼ during March, the spot rate against the dollar fell back virtually to parity in April. It then improved seasonally until late in August, when it came close to Lit. 621¼ — nearly 0.6 per cent. above par and its highest point against the dollar for over five years. The rate subsequently eased to Lit. 624 by the end of November, and then fluctuated narrowly around that level until early in February 1969.

By the beginning of 1969 the Italian authorities were becoming concerned about the strong effect which record Euro-dollar interest rates were having upon domestic monetary conditions. In mid-February, therefore, they acted to stem the loss of liquidity. The spot exchange rate was permitted, for the first time, to fall well below par and by early March it had reached Lit. 629. In addition, there was a sharp increase in the cost of dollar swaps provided to the banks by the Italian Exchange Office. As a result of these measures, money exports became more expensive. Then in March the banks were requested to bring their net external asset position, which at that time amounted to about $800 million, into balance by mid-year. In mid-April the spot lira rate began to strengthen again, but it weakened temporarily to its lower limit on 9th May, at the height of the speculative inflow into Germany.

Other currencies. Both the Belgian and Dutch currencies, which had been generally rather close to their upper limits against the dollar in the second half of 1967, weakened very considerably between March and October 1968. In the case of the Belgian franc, the spot exchange rate fell rather persistently after May, and by late October it was close to the lower limit; the Dutch florin, which had eased sharply after the gold crisis, subsequently remained at about par on the dollar until just after mid-year and then eased further to almost 0.7 per cent. below par in mid-October.

After October, while continuing to show a similar general tendency, the movement of quotations for these two currencies diverged somewhat more. As monetary conditions tightened in the Netherlands in the last quarter, the spot exchange rate for the florin, which was held back by demand for Deutsche Mark up to mid-November, strengthened to over 0.4 per cent. above par in December, before easing abruptly again in the new year in the face of extremely strong demand for Euro-dollars. In Belgium, too, interest rates increased, but the spot rate had risen only modestly by the year-end and by early April it had fallen back to just above the lower limit. At that point the banks were requested substantially to reduce their net external foreign currency assets by mid-year and the spot rate recovered to par. In early May, both the Belgian franc and the Dutch florin were unfavourably affected by the upheavals in the exchange markets. By that time, the free market quotations for the Belgian franc, which had been easing continuously during the period under review, were showing a discount of about 8 per cent.

A further moderate surplus in Austria's balance of payments kept the schilling generally very firm against the dollar during 1968. Spot quotations never went below 0.4 per cent. above par, rising to the upper intervention point at times during the summer. In Norway, too, the overall external position showed a significant surplus and the exchange rate of the krone was held at par with the dollar almost continuously. And the Swedish krona, which fluctuated somewhat above par for most of the year, was held a little below parity during periods of balance-of-payments weakness in the fourth quarter and during the May 1969 crisis. The Danish krone, on the other hand, fluctuated more widely: it declined from near the upper limit in the spring of 1968 to around its new parity — established in November 1967 — by mid-year, and then fluctuated generally below that level. The currency was particularly weak during the most recent wave of speculation in favour of the Deutsche Mark, falling to more than 0.5 per cent. below par before the Danish market was closed. The Spanish peseta, also devalued in November 1967, subsequently moved narrowly around 0.4 per cent. above par, before easing in April 1969 to close to parity. The Portuguese escudo, which had been kept close to its dollar parity for most of 1968, began to appreciate strongly in November, rising to over 0.8 per cent. above par at one point late in March 1969.

The Canadian dollar had come under severe pressure early in 1968, following the announcement of the new US balance-of-payments programme, and the exchange rate in terms of US dollars fell from around the par value of US $0.92½ to below US $0.92 in January. Early in March Canada was granted exemption from the US capital controls, but this was overshadowed for a while by the gold crisis. Following the Washington meeting, however, the exchange-market situation improved strongly as speculative positions were unwound and as the strength of Canada's balance of payments, supported by especially heavy inflows of long-term capital from both Europe and the United States, made itself felt. Parity was regained in April, and by July the spot rate was at its effective ceiling of US $0.93¼. And it remained at or very close to this limit for the remainder of the period under review.

There was also a notable improvement in quotations for the Japanese yen during 1968. Having remained generally near to the lower intervention point against the dollar of Yen 362.7 for about three years, the spot rate strengthened continuously after April 1968, rising virtually to the upper limit of Yen 357.3 by the end of the year, for the first time since the exchange rate margins were widened to 0.75 per cent. either side of parity in April 1963. This strong improvement reflected the emergence of a very large balance-of-payments surplus. During the early months of 1969 the yen remained rather close to its ceiling.

Other exchange developments.

In the United States the stricter balance-of-payments controls introduced in January 1968, and described in last year's Annual Report, remained in force during most of the period under review. In April 1969, however, some alleviations of the controls, covering the year 1969, were announced. Firstly, as regards controls on direct investment outflows, the minimum amount above which the restrictions apply was raised from \$300,000 to \$1 million. At the same time the alternative upper limit on corporations' direct investment outflows during 1969 was raised from 20 to 30 per cent. of their 1968 foreign earnings. It has been estimated that the potential effect of these measures on total 1969 direct investment outflows subject to the Department of Commerce programme could be to raise them from \$2,950 to 3,350 million. Secondly, as an alternative to the already existing ceilings on their foreign lending (103 per cent. of the end-1964 figure for banks traditionally engaged in foreign lending and for other banks the end-1967 level plus one-third of the difference between that figure and 2 per cent. of their total assets at end-1966), banks are allowed to increase their foreign assets during 1969 to up to 1½ per cent. of their total assets at end-1968. In addition, the limits on the holding of foreign assets by non-bank financial institutions were raised from 95 to 100 per cent. of the end-1967 figure. It has been estimated that these measures also could potentially increase foreign lending by \$400 million over and above the previous limits. Thirdly, the rate of the interest equalisation tax on US residents' purchases of foreign shares was reduced from 18¾ to 11¼ per cent., and the rate of this tax applied to acquisitions of foreign bonds was reduced, in terms of interest per annum, from 1¼ to ¾ per cent.

In the United Kingdom, apart from the import deposit scheme described on page 25, the principal change in the exchange control regulations during the period under review was the withdrawal, in October 1968, of the facility under which the UK banks had provided sterling credits to non-residents for the financing of trade between countries outside the sterling area.

In France exchange control (which had been abolished at the end of 1966) was reintroduced in May 1968, temporarily abolished again in September and then reintroduced once more, in a severer form, towards the end of November. Under the controls in force since last November, official authorisation is required for all payments to non-residents, for all acquisitions of foreign securities other than out of the sales proceeds of previously-held securities, and for the import and export of gold. All foreign transactions by residents must take place through authorised intermediaries and all foreign means of payment and securities held in France must be deposited with authorised intermediaries. At the same time residents were required to repatriate all foreign claims and earnings acquired or received during the preceding four months. In addition, exchange restrictions were imposed on travellers abroad. As modified in January 1969, these allow French residents generally the equivalent of Fr.fr. 1,000 in foreign currency a year; for business travellers the allowance is between Fr.fr. 2,000 and 3,000 per trip. There is also a limit of Fr.fr. 200 on the amount which may be taken out of the country in French bank-notes.

Finally, forward purchases of exchange by residents were restricted to those relating to imports of a limited number of goods, mainly primary products, for which up to one month's forward cover may be obtained. Since January 1969 forward cover for up to three months has been allowed in respect of imports of some of these products. In March 1969 foreign borrowing by residents was made subject to prior authorisation, the liquidation of French direct investments abroad was made subject to prior declaration to the authorities and authorisation was required for the retention or reinvestment abroad of profits realised by French subsidiary companies abroad.

As well as the measures described in the preceding paragraph, in December 1968 and again in January 1969 restrictions were placed on the foreign operations of French banks. These are described on page 134. Somewhat similar restrictions have recently been placed on the foreign operations of the banks in Belgium and Italy, and these are referred to on pages 126 and 135.

So far as Germany is concerned, mention has already been made on page 11 of the November 1968 changes in the border taxes on imports and exports, as well as of the fixing of a 100 per cent. reserve requirement in respect of any increase beyond the level at 15th November 1968 (subsequently changed to the level at 15th/30th April 1969) in the banks' foreign liabilities subject to such requirements. This measure was almost immediately followed by further steps designed to discourage the inflow of foreign funds to Germany. Banks were no longer allowed, without special authorisation, to accept deposits from non-residents, to pay interest on new non-resident savings accounts or to raise loans from non-residents. Deposits or loans accepted from non-residents in settlement of normal current and long-term capital transactions were, however, exempt from this ban. Towards the end of February, by which time the earlier inflow of funds had been reversed, these restrictions were lifted. With effect from 1st June, minimum reserve requirements in respect of the banks' foreign liabilities not subject to the 100 per cent. reserve requirement mentioned above were raised by 50 per cent.

Elsewhere in Europe, there were changes in exchange rates in Iceland and Rumania during the period under review. On 12th November 1968 the Icelandic króna was devalued by 35 per cent., the parity being changed from I.kr. 57 = US \$1 to I.kr. 88 = US \$1. Shortly before this, in September 1968, a 20 per cent. surcharge on all merchandise imports and a tax of 20 per cent. on foreign exchange sold for travel purposes had been introduced and comprehensive exchange controls followed in October. The króna had previously been devalued by almost 25 per cent. in November 1967. In Rumania the exchange rate for non-trade transactions was changed from Lei 12 = US $1 to Lei 18 = US $1 on 24th October 1968. Finally, it may be mentioned that since September 1968 some fifty banks in other countries have been accepting travellers' cheques denominated in roubles and issued to Soviet citizens travelling abroad.

In Canada various steps were taken by the authorities during the period under review so as to ensure that its exemption from the reinforced US balance-of-payments programme did not result in Canada's being used as an intermediary for the export of capital and money from the United States to other countries. In May 1968 guide-lines were agreed on between the Bank of Canada and the Canadian chartered banks, the effect of which was to prevent the latter from being used as a channel for outflows of funds from the United States to third countries. In essence, these guide-lines provide for the freezing at their end-February 1968 levels of the net foreign currency positions of Canadian banks vis-à-vis residents of countries other than Canada and the United States. Similar guide-lines were accepted by all other Canadian financial institutions in July 1968.

In Latin America the exchange rate policy of the Brazilian authorities was modified in August 1968. At that time, when the cruzeiro was devalued by 12 per cent. to a new rate of Cruz. 3.64 = US $1, it was announced that in future, instead of periodic major devaluations, the rate would, if necessary, be adjusted more frequently to take account of the rise in the internal price level. Following the introduction of what may be called a "crawling peg" system, the rate was adjusted seven times between August 1968 and May 1969, when it stood at Cruz. 4.0375 = US $1. In Chile there was a continuous depreciation of the currency during the period under review, amounting in all to about one-third.

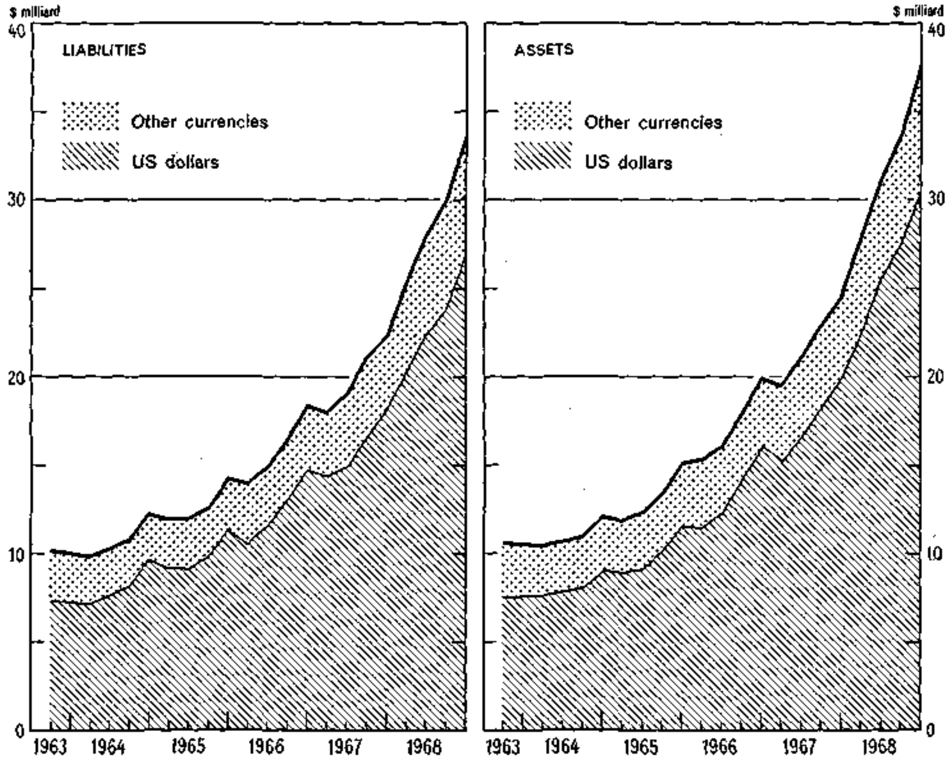
V. THE EURO-CURRENCY MARKET.

After three and a half years of rapid expansion, the growth of the Euro-currency market accelerated even further in 1968. The external liabilities in dollars and six other foreign currencies of the banks of the eight reporting European countries went up by $11.3 to 33.5 milliard and their assets by $12.9 to 37.4 milliard. Net of redeposits between banks, the total amount of credit outstanding in the market may be estimated to have expanded from about $21 milliard to $30 milliard, and the dollar component alone from somewhere around $17.5 milliard to $25 milliard. About 55 per cent. of the $7.5 milliard of new dollar funds in the market would seem to have come from within western Europe and, in addition, the greater part of the 20 per cent. which was supplied from US residents consisted of funds raised in the European capital markets. On the uses side European residents accounted for barely 20 per cent., while about 55 per cent. went to the United States. But despite the prominence of western Europe as a source of supply and of the United States as a user, the flow of new Euro-dollar funds both to and from most other areas was also larger than in 1967.

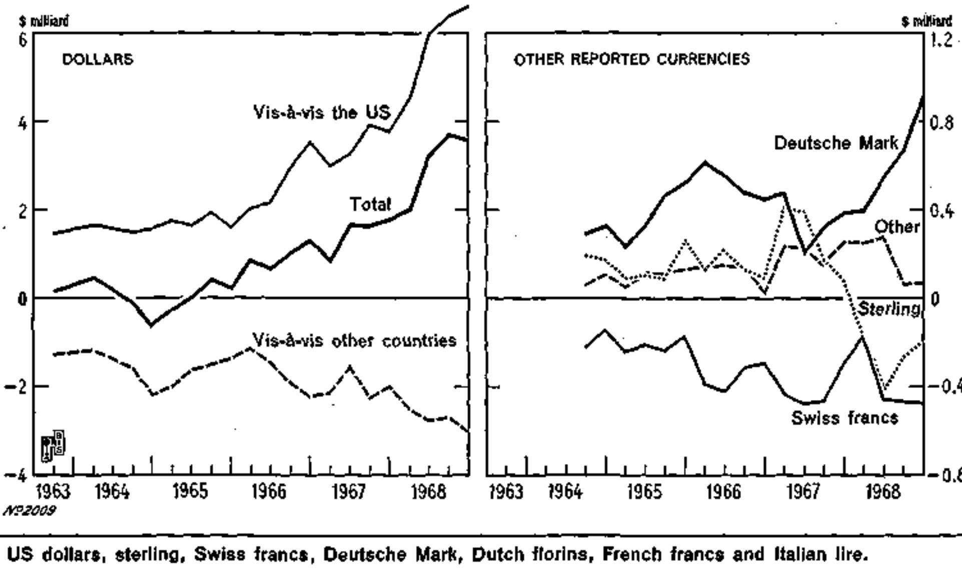
On the demand side the most important factors contributing to the strong growth performance of the market were: the tightening of credit conditions in the United States, which led to a heavy demand for Euro-dollars by US banks; the US balance-of-payments restraint programme, which increased the dependence of the European branches of US firms on Euro-dollar borrowing; the unrest in the currency markets, which at times gave rise to a demand for Euro-dollars for switching into gold or Deutsche Mark; and in the last quarter of the year the tightening of French exchange and credit policy, which led to a sharp increase in Euro-currency borrowing by the French banks. On the supply side some of the major influences were: the relative ease of monetary conditions in most continental European countries; the international currency fears, which led at times to substantial movements out of sterling and French francs into dollars; and the US mandatory restraint programme, which not only stimulated the demand for Euro-dollars but in a way contributed also to supplies, since a large part of the funds raised by US corporations in the European capital markets was subsequently deposited by them in the Euro-dollar market.

The impact of these various factors on the market was not spread uniformly over the year and, as in 1967, the trend of interest rates was subject to substantial fluctuations. In the first half of 1968, and especially in the spring quarter, when the dominant factor behind the expansion of the market was the strong demand for Euro-dollar funds by US banks, Euro-dollar rates reached new peaks. Following the temporary easing of US monetary restraints, the US banks' demand fell off in the third quarter and, with supply now becoming the main expansionary force, interest rates declined

Short-term liabilities and assets of commercial banks of eight European countries in certain foreign currencies* vis-à-vis non-residents.
End-of-quarter figures, in milliards of US dollars.



Net positions of commercial banks of eight European countries in certain foreign currencies* vis-à-vis non-residents.
End-of-quarter figures, in milliards of US dollars.



* US dollars, sterling, Swiss francs, Deutsche Mark, Dutch florins, French francs and Italian lire.

markedly. The fourth quarter saw a strengthening of the demand from continental European countries, which, apart from the usual year-end factors, mainly reflected borrowing by French banks and a demand for dollars for conversion into Deutsche Mark.

The further tightening of US monetary policy, and particularly the fact that the US authorities did not adjust the Regulation Q ceilings to the rise in domestic interest rates, led to a vast increase in the demand for Euro-dollar funds by US banks in the first quarter of 1969. At first this met with fairly elastic supplies, but gradually several European central banks began to take measures to reduce and even reverse the outflows from their countries to the Euro-dollar market, and from February onwards the flow of new funds to the market from this source started to slow down. As a result, interest rates moved up sharply and at the end of May the three-month Euro-dollar deposit rate in London stood at about 10.5 per cent., or 3¼ percentage points above its peak level of a year earlier.

*Total external positions.** In 1968 the external liabilities of the banks of the eight reporting European countries went up by $13.2 to 47.7 milliard and their assets by $15.2 to 47.7 milliard. The bulk of this increase was in foreign currencies, whereas liabilities and assets in domestic currency rose by only $1.9 and 2.3 milliard respectively.

The expansion in domestic currency liabilities was accounted for essentially by Germany ($1,200 million) and Switzerland ($730 million). The French banks' external liabilities in domestic currency fell by $370 million. In contrast to liabilities, the rise in external assets in domestic currencies was fairly broadly distributed. At $780 and 750 million respectively, the largest increases were shown by the Swiss and UK banks; the German banks' assets, on the other hand, went up by only $270 million.

The reporting European banks' external liabilities and assets in foreign currencies mounted by $11.3 and 13.0 milliard respectively. Liabilities in dollars went up by $8.8 to 26.9 milliard and assets by $10.5 to 30.4 milliard, or by about 50 per cent. The $1.8 milliard increase in the banks' net external assets in dollars reflected switches into dollars from the domestic currency or from other foreign currencies and a rise in net dollar liabilities to residents; about 60 per cent. of the increase occurred in the second quarter, when the contrast between credit tightness in the United States and monetary ease on the Continent was particularly pronounced.

The European banks' positions in the six other reported currencies also expanded much more rapidly than in 1967, liabilities going up by $2.5 to 6.7 milliard and assets by $2.4 to 7.0 milliard. As in the preceding year, the bulk of these increases was in Deutsche Mark and, to a lesser extent, Swiss francs. Net assets in Deutsche Mark went up by $530 million, while the net positions in the other currencies except the lira declined. The net position

* The figures in this section are based on the three tables to be found at the end of this chapter (pages 154-156).

Changes in the banks' external positions in certain foreign currencies.

Items	1965	1966	1967	1968	Amount outstanding at the end of 1968
	In millions of US dollars				
Reporting European banks					
Liabilities					
Dollars	+1,740	+3,380	+3,350	+ 8,760	26,870
Other currencies	+ 250	+ 750	+ 580	+ 2,520	6,670
of which					
Deutsche Mark	*+100*	*+100*	*+700*	*+1,340*	*3,010*
Swiss francs	*+110*	*+290*	*+180*	*+ 890*	*2,290*
Sterling	*— 40*	*— 20*	*+ 90*	*+ 10*	*810*
Dutch florins	*+ 80*	*—100*	*+ 30*	*+ 160*	*250*
French francs	*+ 30*	*+470*	*—420*	*+ 70*	*230*
Italian lire	*— 30*	*+ 10*	*—*	*+ 50*	*80*
Total	+1,990	+4,130	+3,930	+11,280	33,540
Assets					
Dollars	+2,580	+4,480	+3,820	+10,550	30,430
Other currencies	+ 530	+ 280	+ 740	+ 2,400	6,980
of which					
Deutsche Mark	*+300*	*+ 30*	*+630*	*+1,870*	*3,920*
Swiss francs	*+ 80*	*+160*	*+190*	*+ 710*	*1,820*
Sterling	*+ 40*	*—180*	*+ 70*	*— 270*	*610*
Dutch florins	*+ 90*	*— 60*	*+ 70*	*+ 50*	*290*
French francs	*+ 40*	*+310*	*—210*	*— 10*	*240*
Italian lire	*— 20*	*+ 20*	*— 10*	*+ 50*	*100*
Total	+3,110	+4,760	+4,560	+12,950	37,410

in sterling shifted from \$80 million of assets to \$420 million of net liabilities in the first half of 1968 but recovered by \$220 million during the rest of the year. Net liabilities in Swiss francs, after falling by \$120 million in the first quarter, rose by \$290 million in the second quarter but showed little movement during the remainder of 1968.

About 65 per cent. of the increase in the European banks' dollar liabilities and 55 per cent. of that in their dollar assets were accounted for by the UK banks alone. This of course reflected the dominant and increasing rôle of the UK branches of US banks as intermediaries in the Euro-dollar market. The very rapid growth in the UK banks' foreign currency positions was virtually unrelated to and, in turn, did not affect domestic economic developments. Although, on a covered basis, Euro-dollar yields showed throughout most of the year an unusually large premium over those on comparable sterling instruments, the exchange controls discouraged outward switching by the banks.

The French banks' external positions showed wide fluctuations during 1968. In the second quarter, with the emergence of a large forward discount on the franc, they reduced their foreign currency liabilities by \$410 million and, partly as a counterpart to forward sales commitments, built up their foreign currency assets by \$160 million. In addition, they showed a \$380 million decline in their net external liabilities in French francs. Partly as a result of the reintroduction of exchange controls the situation became more normal in the third quarter. The French banks placed another $430 million in foreign currencies abroad, but their foreign currency liabilities also expanded by $410 million and the decline in their net external liabilities in francs slowed down to $170 million. Owing to the tightening of French exchange and credit policy, the French banks became the most important net borrowers in the Euro-currency market during the last quarter of the year. Their external liabilities in foreign currency went up by $1,250 million, while their assets rose by only $470 million.

Despite the ease in domestic credit conditions in 1968, a $930 million rise in the German banks' net external liabilities in Deutsche Mark was only to a small extent offset by a $240 million rise in their net assets in foreign currencies. The fact that the domestic liquidity surplus did not overflow into other countries was of course related to the expectations of a revaluation of the Deutsche Mark. As a result of these expectations the state of the forward exchange market rendered outward switching unprofitable and the banks' dollar exports mainly reflected changes in the Bundesbank's policy of offering forward cover for short-term placements in dollars at below-market rates. In fact, when towards the end of May the Bundesbank raised its charge for forward cover to a level in line with or even above market rates the German banks completely ran off their swaps with the Bundesbank; after a $110 million increase in the first quarter, their dollar assets in the second quarter showed a $390 million decline. Under the impact of renewed upward pressures on the Deutsche Mark towards the end of August the Bundesbank again began to offer attractive swap rates, and for the second half of 1968 the German banks' dollar assets recorded a $740 million gain. Nevertheless, the increase in the banks' dollar assets seems to have been considerably smaller than that in their swaps with the Bundesbank, since the banks sold spot a substantial amount of the dollars thus obtained and used their forward dollar selling commitments under the swaps as cover for forward purchases of dollars from their customers. To the extent that this happened, the exchange pressures were simply shifted from the forward to the spot market; the Bundesbank, therefore, limited as from the middle of November the banks' use of its swap facility to actual acquisitions of foreign assets.

With domestic credit demand relatively slack, Italian banks shifted a substantial amount of their Euro-currency lending away from residents to outside borrowers. Whereas their net foreign currency claims on residents fell from $1,920 to 1,340 million, their net external assets in foreign currency went up from $20 to 740 million, the major part of the increase occurring during the second half of the year. The amount of outstanding dollar/lira swaps with the Italian Exchange Office edged up by only $80 to 2,000 million.

In Switzerland, the relative ease of domestic credit demand, the attractive rates offered on the Euro-currency market and the re-exporting of funds which had entered the country in connection with the various crises abroad led to another major rise in the banks' external positions in 1968. Their short-term liabilities went up by $1,280 to 6,530 million, $730 million of this increase being in Swiss francs. Assets advanced by \$2,110 to 8,190 million, Swiss francs again accounting for about \$780 million of the increase. Whereas the Swiss banks' net external liabilities in domestic currency thus showed little change, their net assets in foreign currencies expanded by \$780 million. The bulk of this increase occurred in the first half of the year and was in dollars, while in the second half there was a substantial movement from dollars into Deutsche Mark.

Geographical distribution. The table on the following page gives a geographical break-down of the external dollar positions of the banks of the eight reporting European countries. It may be seen that on the sources side the growth of the market was fairly broadly distributed. The banks' liabilities to their own area went up by about \$4.7 to 14.0 milliard, those to the United States by \$1.6 to 3.9 milliard and those to the "other outside area" by \$2.4 to 8.7 milliard.

As regards the inside area, the largest increases in liabilities were those vis-à-vis Switzerland (\$1,260 million), Italy (950), the United Kingdom (910), France (490) and Belgium (410). The sharp rise in liabilities to Switzerland, which followed upon an increase of only \$290 million in 1967, was to some extent due to end-year factors. Under the impact of the sterling devaluation and the unrest in the gold market, the Swiss banks at the end of 1967 had met most of their end-year needs not, as usual, through dollar/Swiss franc swaps with the Swiss National Bank, but mainly through outright sales of dollars. At the end of 1968, in contrast, with confidence restored, the bulk of these needs were met by way of swaps. Since the Swiss National Bank rechannelled to the Euro-dollar market only those dollars which it acquired under swaps, its outstanding Euro-dollar placements (either direct or through the BIS) were about \$650 million higher at the end of 1968 than a year earlier. The \$910 million expansion in the reporting banks' liabilities to the United Kingdom last year, after their increase of only \$40 million in 1967, is perhaps somewhat surprising. The whole of it took place in the second half of 1968, whereas the first half actually saw a \$170 million decline. This pattern mainly reflects the falling-off in the second half of the year of the strong demand for Euro-dollars from US banks and the strengthening of demand in some of the reporting countries. Over one-half of the \$490 million expansion of liabilities to France occurred in the second quarter. Despite the intensification of the Bundesbank's swap policy, the supply of new funds from Germany slowed down, from \$550 million in 1967 to \$310 million.

Liabilities to US residents went up by \$1,570 to 3,930 million. About \$1,100 million of this increase, most of which occurred in the first half of 1968, represented funds raised by US corporations in the European bond markets, and even part of the remaining \$470 million may have reflected unspent proceeds of loans extended to US corporations by European banks and by branches of US banks. At \$390 million, the increase in the reporting banks' liabilities to Canada was also quite pronounced; \$150 million of this occurred at the time of the Canadian exchange crisis in the first quarter of

Dollar positions of reporting European banks vis-à-vis non-residents.

Positions, vis-à-vis	1967 March	1967 June	1967 September	1967 December	1968 March	1968 June	1968 September	1968 December
	In millions of US dollars							
Liabilities								
Outside area								
Other western Europe	1,120	1,230	1,470	1,400	1,570	1,570	1,850	1,900
Eastern Europe	300	310	400	470	440	430	510	660
Canada	580	730	720	910	1,060	1,040	1,040	1,300
Japan	60	60	60	70	90	100	110	90
Latin America	770	850	900	950	1,120	1,210	1,230	1,320
Middle East	1,090	960	1,080	1,120	1,320	1,500	1,510	1,480
Other	1,140	1,220	1,320	1,380	1,580	1,720	1,840	1,970
Total	5,060	5,360	5,950	6,300	7,180	7,570	8,090	8,720
United States	1,840	1,740	1,860	2,360	2,770	3,620	3,690	3,930
Total outside area	6,900	7,100	7,810	8,660	9,950	11,190	11,780	12,650
Inside area								
Belgium	620	560	690	790	960	1,250	1,200	1,200
France	970	1,060	1,250	1,220	1,340	1,600	1,570	1,710
Germany	600	650	730	790	1,010	610	830	1,100
Italy	1,210	1,150	1,370	1,590	1,490	1,670	1,830	2,540
Netherlands	360	380	470	510	570	610	660	720
Sweden	150	180	280	180	200	270	270	300
Switzerland	2,500	2,740	2,850	2,870	3,150	3,770	3,680	4,130
United Kingdom	1,020	1,030	1,040	1,380	1,400	1,210	1,520	2,290
Total inside area	7,430	7,750	8,680	9,320	10,110	10,990	11,560	13,990
Unallocated	90	70	120	130	220	180	400	230
Grand total	14,420	14,920	16,610	18,110	20,280	22,360	23,740	26,870
Assets								
Outside area								
Other western Europe	910	1,080	1,070	1,210	1,330	1,430	1,490	1,520
Eastern Europe	650	770	800	770	800	820	910	950
Canada	500	630	660	740	800	910	900	910
Japan	790	900	890	1,030	1,230	1,450	1,510	1,690
Latin America	480	640	700	760	900	970	990	1,180
Middle East	200	250	230	310	390	310	410	470
Other	410	580	520	700	780	890	960	1,040
Total	3,940	4,850	4,870	5,520	6,230	6,780	7,170	7,760
United States	4,930	5,040	5,880	6,240	7,500	9,790	10,460	10,740
Total outside area	8,870	9,890	10,750	11,760	13,730	16,570	17,630	18,500
Inside area								
Belgium	480	530	540	550	640	700	700	820
France	840	630	790	1,130	1,180	880	1,030	1,600
Germany	440	430	340	320	330	340	480	590
Italy	910	860	1,020	1,310	1,120	1,070	1,160	1,740
Netherlands	520	560	530	590	590	600	640	690
Sweden	190	240	240	190	160	170	200	220
Switzerland	700	740	770	780	1,000	960	1,140	1,130
United Kingdom	2,310	2,700	3,260	3,230	3,520	4,270	4,450	5,120
Total inside area	6,390	6,690	7,490	8,100	8,540	8,990	9,800	11,910
Unallocated	—	—	—	20	—	—	—	20
Grand total	15,260	16,580	18,240	19,880	22,270	25,560	27,430	30,430

1968 and $260 million in the last quarter. The rise in the supply of Euro-dollars from the rest of the outside area, which, at $2,030 million, was more than twice as large as in 1967, was fairly broadly distributed.

Turning to the uses side, $3.8 milliard of the aggregate $10.5 milliard rise in the reporting banks' external assets was vis-à-vis their own area. Claims on the United States soared by $4.5 to 10.7 milliard and those on Japan rose by $0.7 to 1.7 milliard. Assets vis-à-vis the "other outside area" went up by $1.6 milliard, or $0.3 milliard more than in 1967. The sharp rise in claims on the United States, which followed upon an increase of $970 million in 1967, was mainly a reflection of the strong demand for Euro-dollar funds from US banks, but it was also due to some extent to Euro-dollar borrowing by US non-bank corporations.

Of the $3,810 million rise in claims on the inside area, $1,890 million was vis-à-vis the United Kingdom and chiefly reflected the rôle of the UK banks (especially London branches of US banks) as intermediaries in the Euro-dollar market. Claims on France contracted by $300 million in the second quarter but expanded by $720 million during the remainder of the year. Assets vis-à-vis Germany, which had declined by $170 million in 1967, rose by $270 million; if, however, the banks' other foreign currency assets (i.e. mainly in Deutsche Mark) vis-à-vis Germany are included, the increase works out at $1,260 million, $1,050 million of which occurred in the second half of 1968.

Net size of the Euro-dollar market. The table on page 149 gives an estimate of the amount of credit outstanding through the Euro-dollar market. The figures shown on the sources side are based on the dollar liabilities reported by the banks of the eight reporting European countries vis-à-vis banks and non-bank residents outside their own area and vis-à-vis non-bank residents inside the reporting area. In addition, an attempt has been made to include the amount of funds converted by the banks themselves out of the domestic currency or third currencies into dollars and used for Euro-dollar types of lending or deposits. Correspondingly, the figures for uses are based on the dollar assets reported by the banks vis-à-vis banks and non-banks outside their own area and non-bank residents within their own area. They include an estimate of the amount of Euro-dollar funds converted by the banks into the domestic currency or third currencies.

The figures for the net size of the market differ from those in the table on page 146 in so far as they exclude interbank deposits within the reporting area and include the reporting banks' assets and liabilities vis-à-vis residents of their own countries and funds obtained (or used) by the banks by conversions into (or out of) dollars. The reason for considering only the ultimate sources and uses of dollars while leaving the interbank aspect of the market out of account is that such redepositing between banks, though leading possibly to a more efficient allocation, does not directly increase the available supply of credit. The reporting banks' assets and liabilities vis-à-vis banks outside their own area have, of course, to be included, since otherwise these flows would not be reflected in the figures at all. For that purpose outside banks have to be considered as ultimate suppliers or users. However, to the extent that the funds received from the outside banks represent simply redeposits by these banks of funds they have obtained from banks within the reporting area, the figures for the net size of the market may also contain duplication. A similar kind of duplication arises if non-banks borrow Euro-dollars from the reporting banks and, pending their final use, redeposit them with these banks. On the other hand, the figures may tend to understate the total size of the Euro-dollar market since they include only credit flows which on their way from the original lender to the ultimate user go through at least one of the banks of the eight reporting European countries.

"Inside area" covers residents of the eight reporting European countries and "outside area" everything else. The United States and Canada have been grouped together because of their close monetary ties and because Canadian banks have on occasion acted as a channel for the flows of funds between Europe and the United States. Japan and eastern Europe are shown separately because of their rôle as net users of Euro-dollars.

Except for the United States, the figures for the outside area are roughly the same as those given in the table on page 146. For the positions vis-à-vis the United States complications arise owing to the fact that the reporting banks already had substantial positions in dollars before the development of the Euro-currency market in the form, inter alia, of working and compensating balances and of loans and credits. Inclusion of these positions would have given a somewhat exaggerated impression of the importance of the Euro-dollar market. After examining the positions of the banks of the individual reporting countries, the conclusion was originally reached that at the end of 1964 only about half of the dollar liabilities and about two-thirds of the dollar assets vis-à-vis the United States should be included in the estimate of the net size of the market. Since then, however, the Euro-dollar market has grown in size and in pervasiveness and it has become even more difficult to distinguish between the banks' Euro-dollar positions and their other positions vis-à-vis the United States. It has therefore been assumed that the bulk of the rapid expansion in dollar positions vis-à-vis the United States that has occurred since then has been related to the growth of the Euro-dollar market. As regards the position of the reporting banks vis-à-vis residents of the "inside area", improvements in the available statistics now make it possible to compute the positions vis-à-vis non-banks, although some major gaps in the statistics remain and have to be bridged by means of estimates.

The item "Banks" on the uses side gives an estimate of the amount of funds converted into dollars by the banks from domestic currency or third currencies, on their own initiative or under special swap arrangements with the official monetary authorities, and used for Euro-dollar type lending. These funds, too, of course ultimately derive from non-bank sources, but they come out of the banks' general pool of resources and cannot be identified with any specific liabilities. Funds rechannelled by the monetary authorities of the reporting countries into the Euro-dollar market are also included under bank

Estimated size of the Euro-dollar market.

Items	1964	1965	1966	1967	1968
	end-year figures, in milliards of US dollars				
Sources					
Outside area					
United States and Canada	1.5	1.3	1.7	2.6	4.5
Japan	—	—	—	—	0.1
Eastern Europe	0.3	0.3	0.4	0.5	0.6
Other	2.8	3.3	4.0	4.8	6.6
Total	4.6	4.9	6.1	7.9	11.8
Inside area					
Non-banks	1.8	2.2	2.8	3.9	5.2
Banks	2.6	4.4	5.6	5.7	8.0
Total	4.4	6.6	8.4	9.6	13.2
Grand total	9.0	11.5	14.5	17.5	25.0
Uses					
Outside area					
United States and Canada	2.2	2.7	5.0	5.8	10.2
Japan	0.4	0.5	0.6	1.0	1.7
Eastern Europe	0.5	0.5	0.7	0.8	0.9
Other	0.9	1.5	1.9	3.0	4.2
Total	4.0	5.2	8.2	10.6	17.0
Inside area					
Non-banks	2.3	3.3	3.7	4.1	4.7
Banks	2.7	3.0	2.6	2.8	3.3
Total	5.0	6.3	6.3	6.9	8.0
Grand total	9.0	11.5	14.5	17.5	25.0
Net*					
Outside area					
United States and Canada	+ 0.7	+ 1.4	+ 3.3	+ 3.2	+ 5.7
Japan	+ 0.4	+ 0.5	+ 0.6	+ 1.0	+ 1.6
Eastern Europe	+ 0.2	+ 0.2	+ 0.3	+ 0.3	+ 0.3
Other	— 1.9	— 1.8	— 2.1	— 1.8	— 2.4
Total	— 0.6	+ 0.3	+ 2.1	+ 2.7	+ 5.2
Inside area					
Non-banks	+ 0.5	+ 1.1	+ 0.9	+ 0.2	— 0.5
Banks	+ 0.1	— 1.4	— 3.0	— 2.9	— 4.7
Total	+ 0.6	— 0.3	— 2.1	— 2.7	— 5.2

* *A plus sign indicates that the area or grouping in question is a net user of Euro-dollar funds, whereas a minus sign indicates that it is a net supplier.*

sources. Similarly, a bank is considered as an end-user of Euro-dollar funds to the extent that it converts dollars into the domestic currency or into third currencies. However, one major exception has been made. The dollars converted by the Italian banks into third currencies for the purpose of re-lending to residents have been included under non-bank uses. The reason is that in this case the amount of dollars employed for this purpose can be fairly accurately estimated.

It can be seen from the table that between 1964 and 1968 the demand and supply structure of the market changed quite profoundly. At the end of

1964 the reporting European area, North America, Japan and eastern Europe were all net users of Euro-dollar funds, whereas the "other outside area", i.e. mainly the Middle East, Latin America and "other western Europe", was the only net supplier. Since then the relative importance of the "other outside area" as a net supplier of Euro-dollar funds has decreased; instead, the reporting area has turned into the main supplier, while the rôle of North America as a net absorber of Euro-dollar funds has become very pronounced. Between the end of 1964 and the end of 1968 there was a net outflow of about $5.8 milliard from the reporting area and $0.5 milliard from the "other outside area", $5.0 milliard of which was to North America (mainly the United States) and about $1.2 milliard to Japan. $2.5 milliard, or about 45 per cent., of the total net outflow from the reporting area and more than the whole of the outflow from the "other outside area" occurred in 1968 alone, $2.5 milliard going to North America and $0.6 milliard to Japan.

Between 1964 and 1968 total credit outstanding through the Euro-dollar market expanded by about $16 milliard to approximately $25 milliard. On the sources side the most important factor in this rapid growth was the increase in supplies from banks within the reporting area, which seem to have gone up from just over $2.5 milliard to about $8 milliard. The sharp increase in this item in 1965 largely reflected the Bank of Italy's policy of offering forward cover at par which enabled the Italian banks to swap large amounts of domestic currency into dollars. The 1966 increase still owed something to developments in Italy, but it was much more broadly distributed. The main cause was the steep rise in Euro-dollar rates resulting from the credit squeeze in the United States, which made it advantageous to convert many currencies into dollars. In 1967 the supply of new funds from the reporting banks tapered off almost completely. This was due not only to the temporary decline in Euro-dollar rates following the easing of credit conditions in the United States and to a strengthening of domestic credit demand in France and Italy, but seems also to have been associated with some weakening of confidence in connection with the sterling devaluation in November and the unrest in the gold market. In 1968 a recovery of confidence in the dollar and its effect on the forward markets enabled the banks to take substantial advantage of high Euro-dollar rates, which reflected the retightening of credit in the United States. Moreover, the Deutsche Bundesbank's swap policy strongly encouraged conversion of Deutsche Mark into dollars and, unlike at the end of 1967, the Swiss National Bank at the year-end rechannelled large amounts of funds into the Euro-dollar market. As a result of these various factors the funds provided by banks within the reporting area may be estimated to have gone up by about $2.3 milliard in 1968. Funds supplied by non-banks rose from $1.8 to 5.2 milliard between 1964 and 1968; the increase partly reflected the rôle of the Euro-dollar market as an outlet for the liquid funds of US corporations in Europe, and in 1968 it may also have been due to a shift of liquid balances out of French francs into dollars.

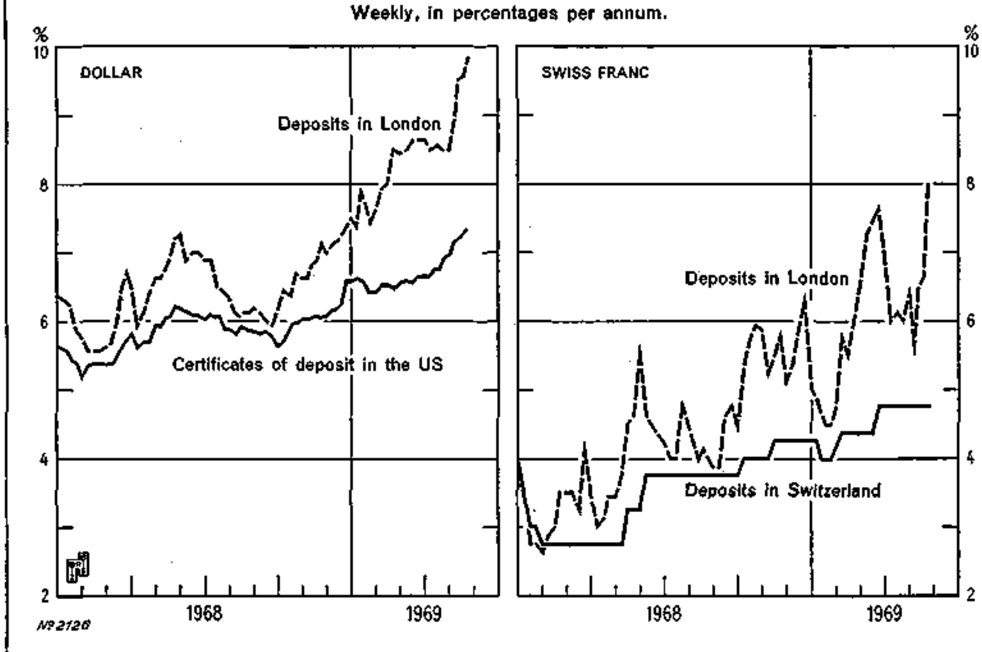
Despite the US balance-of-payments restraint programme, funds supplied by North America also expanded quite substantially. After a $0.2 milliard decline in 1965, the year in which the programme was introduced, they rose by \$3.2 to 4.5 milliard between 1966 and 1968. About \$2.5 milliard of this increase was vis-à-vis the United States and reflected to a large extent deposits by US corporations of funds raised in the European financial markets. The \$4.2 milliard increase in funds supplied by the outside area other than North America was fairly evenly spread over the years and between the various geographical areas.

On the uses side, North American (mainly US) takings alone have accounted for some \$8 milliard, or roughly half of the growth of the market since 1964. At about \$2.3 and 4.4 milliard respectively, the increase was particularly pronounced in 1966 and 1968 and was mainly due to borrowing by US banks at times of domestic credit tightness. In 1968, moreover, direct Euro-dollar market borrowing by US non-bank corporations also appears to have been of considerable importance. Credits extended to the outside area other than North America climbed from \$1.8 to 6.8 milliard between 1964 and 1968. The increase was particularly pronounced vis-à-vis Japan and Latin America.

Funds used by the banks within the reporting area were the only item which would seem to have shown relatively little increase. To some extent this reflected a decline in the amount of funds switched by the UK banks into sterling, but the main factor was the rise after 1965 of US interest rates relative to those in continental European countries. The \$0.5 milliard increase in this item in 1968 was due partly to a movement by the banks from dollars into Deutsche Mark and partly to Euro-dollar borrowing by the French banks for conversion into French francs in the last quarter of the year. Borrowing by non-banks expanded from about \$2.3 to 4.7 milliard between 1964 and 1968. The \$0.6 milliard increase in 1968 occurred despite a substantial reduction in Italian residents' foreign currency borrowing and may have partly reflected the demand for Euro-dollar funds by US corporations in Europe.

Interest rate developments. In the first two months of 1968 a substantial reflux of funds from Switzerland, Germany and France contributed to the usual seasonal ease of the Euro-currency market. In early March, however, the renewed unrest in the gold market led to major withdrawals from the Euro-dollar market. Despite forward support of the dollar by the Deutsche Bundesbank, the Swiss National Bank and the Nederlandsche Bank, the three-month Euro-dollar deposit rate in London climbed to a peak of 7 per cent. on 18th March. Market conditions eased after the gold price was unpegged, but before interest rates had fallen back anywhere near their mid-February level strong demand for dollars by the US banks pushed the rate up to 7¼ per cent. by the end of May. Japanese demand also contributed to the rise in rates. This sharp advance in interest rates occurred despite a remarkable elasticity of supply; continental European banks shifted large amounts out of domestic currencies and reduced their use of dollars for domestic purposes. In addition, the high Euro-dollar rates attracted funds from other areas.

Three-month interest rates on national markets and abroad.
Weekly, in percentages per annum.



In June the interest rate trend began to change again. The social disturbances in France led to substantial shifts out of French francs into dollars. Moreover, to avoid mid-year pressures, the BIS increased its placements in the market, and the Swiss National Bank rechannelled the substantial funds it had taken over on a swap basis from the commercial banks. Although the US banks continued to borrow and the German banks, after a tightening of the Bundesbank's swap policy, made large-scale withdrawals from the market, the three-month rate, instead of showing its usual mid-year rise, edged downwards to $6^7/_8$ per cent. at the end of June.

In the third quarter the enactment of the US tax surcharge and the announcement of new support arrangements for sterling led to a decline in the forward discount of the dollar against most continental European currencies. This stimulated a further flow of European funds into the market. The three-month rate eased to 6 per cent. in early August and moved around this level until the middle of September. On the other hand, the supply of funds from outside Europe slowed down or, as in the case of the Middle East, even declined slightly. The US banks continued to take up funds in the market, but now mainly as a result of the decline in Euro-dollar rates. The premium of three-month Euro-dollars over dollar certificates of deposit in New York, which had widened to nearly 1 per cent. in the second half of May, fell to approximately ¼ per cent. in the course of July and remained at about that level until the second half of September, which meant that Euro-dollars were cheaper for US banks than domestic currency funds. There was, moreover, during the later part of August and in September a substantial demand for dollars for switching into Deutsche Mark, while the German banks in July and — as a result of the reactivation of the Bundesbank's swap policy — in September were net exporters of funds to the Euro-dollar market.

Preparations for the year-end set off a fresh rise in the three-month Euro-dollar rate towards the end of September. A sharp increase in the demand for Euro-dollar funds from the French banks and use of Euro-dollars for conversion into Deutsche Mark maintained the upward trend of rates throughout most of October and November. The renewed buoyancy of interest rates in the United States may also have contributed somewhat to the upward momentum of Euro-dollar rates, but the US banks did not increase their Euro-dollar indebtedness beyond the peak reached in the second half of September.

After reaching $7^1/_8$ per cent. at the height of the currency turmoil, the three-month Euro-dollar rate opened December at 7 per cent. — a level which could not be considered abnormal in seasonal terms. But whereas in earlier years rates used to decline during the rest of the month, this time they continued to go up; this occurred despite the rechannelling by the Swiss National Bank of $746 million of year-end funds, large reflows of funds from Germany and the use by the BIS of its swap line with the Federal Reserve. An important factor behind continued stiffening of market conditions was the reinforcement of French exchange controls. But the main influence was the further tightening of US monetary policy. As a result the US banks again became the dominant group of borrowers. This was not yet too apparent in the two weeks after the US discount rate increase, but in the course of January US banks' liabilities to their foreign branches went up by $2.6 milliard and over the following two months by a further $1 milliard.

At first the demand for funds by the US banks met with elastic supplies; the three-month dollar deposit rate, after touching 8 per cent. in early January, receded to about 7½ per cent. in the second half of the month. Subsequently, however, the supply of new funds began to dry up. During February and March the German banks made large withdrawals from the market, while the French banks also embarked on substantial repatriations. Early in February the Bank of Italy began to increase the cost of forward cover in respect of dollar/lira swaps and on 22nd March the Italian banks were asked to reduce gradually their net external assets, then standing at $800 million. On 3rd April the Belgian monetary authorities imposed ceilings on the Belgian banks' foreign positions. And the Swiss National Bank sought to discourage the re-export of the funds the Swiss banks had repatriated in March to meet their end-of-quarter requirements. The three-month dollar deposit rate went above 8 per cent. in the second half of February and stayed close to the unprecedentedly high level of 8½ per cent. throughout March and April. At the same time the premium of Euro-dollars over secondary market rates for certificates of deposit in New York rose to the record level of 2 per cent. In early May the demand for Euro-dollars for switching into Deutsche Mark was a major factor contributing to a further upward movement which carried the rate to 10½ per cent. at the end of the month.

Short-term liabilities and assets of the reporting banks of individual countries vis-à-vis non-residents.[1]

Countries	End of month	Liabilities		Assets		Net position		
		Domestic currency	Foreign currencies	Domestic currency	Foreign currencies	Domestic currency	Foreign currencies	Total
		in millions of US dollars						
Belgium-Luxemburg	1967 December	490	1,950	190	1,480	— 300	— 470	— 770
	1968 March	530	2,110	240	1,610	— 290	— 500	— 790
	June	620	2,420	270	1,980	— 350	— 440	— 790
	September	610	2,520	310	2,080	— 300	— 440	— 740
	December	600	2,670	330	2,320	— 270	— 350	— 620
France	1967 December	1,070	2,590[2]	290	2,850[2]	— 780	260	— 520
	1968 March	1,170	3,390	360	3,600	— 810	210	— 600
	June	990	2,980	560	3,760	— 430	780	350
	September	810	3,390	550	4,190	— 260	800	540
	December	700	4,640	390	4,660	— 310	20	— 290
Germany	1967 December	1,830	350	1,230	1,170	— 600	820	220
	1968 March	1,800	350	1,500	1,330	— 300	980	680
	June	1,930	400	1,640	980	— 290	560	270
	September	2,410	510	1,700	1,300	— 710	790	80
	December	3,030	580	1,500	1,640	—1,530	1,060	— 470
Italy	1967 December	550	2,920	200	2,940	— 350	20	— 330
	1968 March	510	2,980	200	2,950	— 310	— 30	— 340
	June	550	3,080	240	3,160	— 310	80	— 230
	September	540	3,160	270	3,620	— 270	460	190
	December	600	3,730	300	4,470	— 300	740	440
Netherlands	1967 December	520	1,120	290	1,200	— 230	80	— 150
	1968 March	490	1,270	310	1,310	— 180	40	— 140
	June	600	1,350	350	1,460	— 250	110	— 140
	September	560	1,370	380	1,460	— 180	90	— 90
	December	620	1,460	430	1,560	— 190	100	— 90
Sweden	1967 December	190	270	100	630	— 90	360	270
	1968 March	190	260	70	580	— 120	320	200
	June	200	300	70	600	— 130	300	170
	September	190	310	60	650	— 130	340	210
	December	230	300	90	700	— 140	400	260
Switzerland[3]	1967 December	2,450	2,800	1,800	4,280	— 650	1,480	830
	1968 March	2,750	2,970	2,200	4,660	— 550	1,690	1,140
	June	3,100	3,050	2,460	5,170	— 640	2,120	1,480
	September	3,050	3,390	2,660	5,400	— 390	2,010	1,620
	December	3,180	3,350	2,580	5,610	— 600	2,260	1,660
United Kingdom . .	1967 December	4,810	10,520	3,300	10,500	—1,510	— 20	—1,530
	1968 March	4,790	12,150	3,530	12,100	—1,260	— 50	—1,310
	June	4,750	14,660	3,900	14,570	— 850	— 90	— 940
	September	4,780	15,690	3,850	15,530	— 930	— 160	—1,090
	December	4,840	17,130	4,050	17,060	— 790	— 70	— 860
Total	1967 December	11,910	22,520	7,400	25,050	—4,510	2,530	—1,980
	1968 March	12,230	25,480	8,410	28,140	—3,820	2,660	—1,160
	June	12,740	28,240	9,490	31,660	—3,250	3,420	170
	September	12,950	30,340	9,780	34,230	—3,170	3,890	720
	December	13,800	33,860	9,670	38,020	—4,130	4,160	30
Canada	1967 December	540	2,370	60	3,500	— 480	1,130	650
	1968 March	500	2,320	60	3,420	— 440	1,100	660
	June	520	2,450	70	3,660	— 450	1,210	760
	September	550	2,580	80	3,970	— 470	1,390	920
	December	610	2,750	80	4,240	— 530	1,490	960
Japan	1967 December	370	3,740	—	3,700	— 370	— 40	— 410
	1968 March	400	3,880	—	3,670	— 400	— 210	— 610
	June	350	3,920	—	3,890	— 360	— 30	— 390
	September	370	3,900	—	4,070	— 370	170	— 200
	December	370	4,210	—	4,450	— 370	240	— 130

[1] The figures in this table are partly based on different series from those used in the rest of this chapter and are therefore not strictly comparable with them. [2] Position vis-à-vis banks only. [3] Including Euro-currency assets and liabilities of the BIS.

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

Countries	End of month	US dollars			Other currencies[1]		
		Liabil-ities	Assets	Net position	Liabil-ities	Assets	Net position
		in millions of US dollars					
Belgium-Luxemburg . . .	1967 December	890	970	80	1,050	470	— 580
	1968 March	990	1,020	30	1,110	560	— 550
	June	1,120	1,320	200	1,280	620	— 660
	September	1,180	1,370	190	1,310	660	— 650
	December	1,310	1,460	150	1,330	810	— 520
France	1967 December	1,700[2]	1,890[2]	190	890[2]	970[2]	80
	1968 March	2,150	2,390	240	1,240	1,210	— 30
	June	1,890	2,690	800	1,090	1,070	— 20
	September	2,040	2,980	940	1,350	1,210	— 140
	December	3,040	3,430	390	1,600	1,230	— 370
Germany	1967 December	280	1,030	750	60	120	60
	1968 March	280	1,140	860	60	160	100
	June	330	750	420	60	180	120
	September	420	1,160	740	80	120	40
	December	510	1,490	980	60	120	60
Italy	1967 December	2,140	2,260	120	780	680	— 100
	1968 March	2,010	2,140	130	960	810	— 150
	June	1,920	2,250	330	1,160	900	— 260
	September	2,050	2,540	490	1,100	1,060	— 40
	December	2,630	3,200	570	1,090	1,250	160
Netherlands	1967 December	810	650	— 160	300	480	180
	1968 March	910	780	— 130	360	480	120
	June	870	820	— 50	450	560	110
	September	880	880	—	500	570	70
	December	970	990	20	500	560	60
Sweden	1967 December	170	350	180	90	260	170
	1968 March	160	370	210	90	190	100
	June	180	430	250	120	170	50
	September	200	420	220	110	210	100
	December	210	490	280	90	190	100
Switzerland[3]	1967 December	2,430	3,520	1,090	310	610	300
	1968 March	2,680	3,850	1,170	350	760	410
	June	2,630	4,340	1,710	340	670	330
	September	2,840	4,370	1,530	400	850	450
	December	2,820	4,390	1,570	410	1,020	610
United Kingdom	1967 December	9,690	9,210	— 480	670	990	320
	1968 March	11,100	10,580	— 520	940	1,240	300
	June	13,420	12,960	— 460	1,090	1,370	280
	September	14,130	13,710	— 420	1,370	1,540	170
	December	15,380	14,980	— 400	1,590	1,800	210
Total	1967 December	18,110	19,880	1,770	4,150	4,580	430
	1968 March	20,280	22,270	1,990	5,110	5,410	300
	June	22,360	25,560	3,200	5,590	5,540	— 50
	September	23,740	27,430	3,690	6,220	6,220	—
	December	26,870	30,430	3,560	6,670	6,980	310
Canada	1967 December	2,370	3,440	1,070	10[4]	70[4]	60
	1968 March	2,320	3,350	1,030	10[4]	70[4]	60
	June	2,430	3,580	1,150	20[4]	80[4]	60
	September	2,550	3,880	1,330	30[4]	90[4]	60
	December	2,700	4,130	1,430	50[4]	110[4]	60
Japan	1967 December	3,490	3,340	— 150	250	340	90
	1968 March	3,640	3,350	— 290	250	300	50
	June	3,660	3,580	— 80	270	290	20
	September	3,600	3,740	140	320	300	— 20
	December	3,930	4,090	160	300	350	50

[1] Sterling, Swiss francs, Deutsche Mark, Dutch florins, French francs, Italian lire. [2] Position vis-à-vis banks only.
[3] Including Euro-currency assets and liabilities of the BIS. [4] All other currencies, but mainly sterling.

Short-term liabilities and assets of ten countries'[1] 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]		
		Liabilities	Assets	Net position	Liabilities	Assets	Net position
		in millions of US dollars					
Belgium-Luxemburg	1967 December	730	700	− 30	720	160	− 560
	1968 March	790	740	− 50	700	230	− 470
	June	870	1,010	140	870	250	− 620
	September	950	1,020	70	880	270	− 610
	December	1,060	1,060	—	860	350	− 510
France	1967 December	1,480[2]	1,360[2]	− 120	580[2]	600[2]	20
	1968 March	1,910	1,760	− 150	730	870	140
	June	1,640	1,900	260	710	690	− 20
	September	1,680	1,930	250	880	700	− 180
	December	2,600	2,320	− 280	1,140	710	− 430
Germany	1967 December	240	680	440	20	10	− 10
	1968 March	230	950	720	20	—	− 20
	June	280	520	240	20	10	− 10
	September	370	860	490	30	10	− 20
	December	450	960	510	20	—	− 20
Italy	1967 December	1,990	2,010	20	450	420	− 30
	1968 March	1,880	1,930	50	490	550	60
	June	1,740	1,990	250	640	620	− 20
	September	1,880	2,270	390	660	740	80
	December	2,480	2,910	430	620	870	250
Netherlands	1967 December	740	520	− 220	170	270	100
	1968 March	780	640	− 140	240	310	70
	June	750	650	− 100	300	400	100
	September	750	690	− 60	350	370	20
	December	860	840	− 20	320	310	− 10
Sweden	1967 December	150	250	100	50	80	30
	1968 March	140	250	110	40	60	20
	June	160	320	160	50	70	20
	September	180	310	130	60	100	40
	December	190	330	140	60	70	10
Switzerland[3]	1967 December	2,120	2,990	870	190	240	50
	1968 March	2,430	3,090	660	180	330	150
	June	2,360	3,550	1,190	200	280	80
	September	2,500	3,520	1,020	240	390	150
	December	2,500	3,540	1,040	260	480	220
United Kingdom	1967 December	8,180	5,120	−3,060	.	.	.
	1968 March	9,140	5,420	−3,720	.	.	.
	June	10,750	5,830	−4,920	.	.	.
	September	11,340	6,360	−4,980	.	.	.
	December	12,580	7,720	−4,860	.	.	.
Total	1967 December	15,630	13,630	−2,000	.	.	.
	1968 March	17,300	14,780	−2,520	.	.	.
	June	18,550	15,770	−2,780	.	.	.
	September	19,650	16,960	−2,690	.	.	.
	December	22,720	19,680	−3,040	.	.	.
Canada	1967 December	1,590	1,250	− 340	—	40[4]	40
	1968 March	1,630	1,360	− 270	—	40[4]	40
	June	1,710	1,370	− 340	10[4]	50[4]	40
	September	1,960	1,470	− 490	20[4]	50[4]	30
	December	2,190	1,800	− 390	30[4]	80[4]	50
Japan	1967 December	990	830	− 160	60	190	130
	1968 March	1,150	850	− 300	60	150	90
	June	1,240	970	− 270	40	130	90
	September	1,340	1,060	− 280	40	150	110
	December	1,450	1,240	− 210	30	170	140

[1] Sterling, Swiss francs, Deutsche Mark, Dutch florins, French francs, Italian lire. [2] Position vis-à-vis banks only.
[3] Including Euro-currency assets and liabilities of the BIS. [4] All other currencies, but mainly sterling.

VI. THE EUROPEAN MONETARY AGREEMENT.

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

Continuation of the Agreement.

In 1965 the Agreement was renewed for a period of three years until 31st December 1968. In accordance with the mandate received on that occasion the Board of Management proceeded in the course of last year to a comprehensive review of the working of the Agreement in order to submit to the Council proposals as to the conditions on which the Agreement might remain in force beyond 1968. The Board concluded that the Agreement should be renewed unchanged for a further three-year period until 31st December 1971, but proposed some minor technical amendments in the Directives for its application. While the Agreement will be kept under continuous review, a further general assessment is to be carried out by September 1971 to decide on its renewal beyond 31st December of that year.

Operations under the Agreement.

European Fund. At the end of March 1968 the total of credits outstanding was $125 million,* the highest figure since the start of the Agreement. Of this amount, $95 million represented the sixth and seventh credits to Turkey and the remaining $30 million a credit to Greece.

In June 1968 the Turkish authorities requested a medium-term credit in the light of an unexpected fall in Turkey's foreign exchange receipts, which would otherwise have necessitated a reduction of imports and thereby have hindered the implementation of the country's Second Five-Year Plan. In order to allow time for a fuller examination of the Turkish situation before making any

* 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.

recommendation to the Council, the Board of Management granted a credit of \$25 million with effect from 28th June and repayable within six months. This was the first time that the Board had exercised its authority, delegated by the Council in 1965, to grant credits of not more than \$50 million each for periods of up to one year. This eighth credit to Turkey, which carried interest on amounts outstanding at 3 per cent. per annum, was fully drawn within a week of becoming available and was used to the extent of \$5 million to make the first repayment on the sixth credit from the European Fund, which fell due on 30th June.

Following a further review of Turkey's economic prospects in December, the Board recommended to the Council that a new credit of \$25 million should be granted with effect from 27th December 1968 — the date on which the short-term credit was due for repayment — for a period of sixteen months to 30th April 1970, bearing interest at 3.5 per cent. per annum. This recommendation was adopted by the Council and the Turkish authorities were therefore able to finance the repayment of the eighth credit by drawing the whole of the new credit immediately it became available.

On the due dates at end-December 1968 and end-March 1969 Turkey made the second and third repayments, of \$5 million each, on the sixth credit. This reduced the amount outstanding on that credit to \$55 million. Including \$25 million each for the seventh and ninth credits, the total of credits outstanding to Turkey amounted to \$105 million at the end of March 1969, representing a net increase in assistance to that country of \$10 million during the year.

Late in October 1968 a request for assistance from the European Fund was received from Iceland to provide support for that country's reserves. The Board responded by granting a six-month credit of \$5 million with effect from 15th November 1968. The short-term credit bears interest at 3 per cent. per annum and was fully drawn on 20th November 1968. It was the third credit from the European Fund to be granted to Iceland.

Finally, on 20th January 1969 — somewhat in advance of the scheduled date, which was 7th February 1969 — Greece made the first repayment of \$5 million on the \$30 million credit outstanding.

All these transactions are included in the table on the next page, which shows the position regarding the utilisation of credits from the European Fund at the value date for multilateral settlements (the fifth working day of the following month) for February 1959, when the first credits were granted, for the end of each year from 1959 to 1966 and for each month from end-1966 to March 1969 in which changes occurred.

On the various credits granted between June 1959 (when the first drawing was made) and March 1969 there were thirty-one drawings totalling \$399.5 million; of this amount, \$264.5 million was repaid. The amount outstanding at the end of March 1969 was, therefore, \$135 million, of which \$105 million was owed by Turkey, \$25 million by Greece and \$5 million by Iceland.

EMA: Utilisation of credits granted from the European Fund.

At value date for settlements for month	Greece		Iceland		Spain		Turkey		Totals		
	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Total credit granted
	in millions of units of account										
1959											
February	15.0	—	—	—	—	—	21.5	—	36.5	—	36.5
December. . . .	—	—	—	—	51.0	24.0	0.5	21.0	51.5	45.0	96.5
1960											
December. . . .	—	—	5.0	7.0	76.0	24.0	15.0	21.5	96.0	52.5	148.5
1961											
December. . . .	—	—	7.0	5.0	—	—	—	50.0	7.0	55.0	62.0
1962											
December. . . .	—	—	5.0	—	—	—	—	80.0	5.0	80.0	85.0
1963											
December. . . .	—	—	—	—	—	—	—	95.0	—	95.0	95.0
1964											
December. . . .	—	—	—	—	—	—	—	105.0	—	105.0	105.0
1965											
December. . . .	—	—	—	—	—	—	—	90.0	—	90.0	90.0
1966											
December. . . .	—	30.0	—	—	—	—	—	80.0	—	110.0	110.0
1967											
March	—	30.0	—	—	—	—	—	70.0	—	100.0	100.0
June	—	30.0	—	—	—	—	—	95.0	—	125.0	125.0
1968											
June	—	30.0	—	—	—	—	—	115.0	—	145.0	145.0
November . . .	—	30.0	—	5.0	—	—	—	115.0	—	150.0	150.0
December. . . .	—	30.0	—	5.0	—	—	—	110.0	—	145.0	145.0
1969											
January.	—	25.0	—	5.0	—	—	—	110.0	—	140.0	140.0
March	—	25.0	—	5.0	—	—	—	105.0	—	135.0	135.0

Multilateral System of Settlements. Details of the transactions carried out under the Multilateral System of Settlements since the Agreement came into force are shown in the table on the following page.

In the earlier years these transactions related for the most part to the settlement of balances held under bilateral payments agreements between member countries, and the volume of transactions declined gradually from $15 million in 1959 to about $1 million in 1964, reflecting the termination of those agreements. Settlements originating under the exchange guarantee given on member countries' central-bank holdings of other members' currencies took place on only three occasions before 1964 and then for small amounts.

For three years after October 1964, when the last bilateral payments agreement between member countries — that between Greece and Turkey — was terminated, the settlement mechanism was not used. It was brought into operation again, however, in November 1967 in order to implement the

EMA: Payments made under the Multilateral System of Settlements.

Country	Payments made by the Fund (+) or to the Fund (—)				Net amount of settlement
	1959–64	1967	1968	Total 1959–68	
	in thousands of US dollars				
Austria	+ 25,083 —	+ 823 —	— —	+ 25,906 —	+ 25,906
Belgium	— —	+ 633 —	— —	+ 633 —	+ 633
Denmark	+ 240 — 150	+ 1,830 — 2,434	+ 9 —	+ 2,079 — 2,584	— 505
France	— —	+ 1,383 —	— —	+ 1,383 —	+ 1,383
Germany	— —	+ 3,444 —	— —	+ 3,444 —	+ 3,444
Greece	+ 689 — 28,762	+ 1,210 —	— —	+ 1,898 — 28,762	— 26,864
Iceland	— — 24	+ 306 — 9	— — 9	+ 306 — 42	+ 264
Italy	+ 243 —	+ 1,047 —	— —	+ 1,290 —	+ 1,290
Netherlands	+ 1,400 — 1,378	+ 1,604 —	— —	+ 3,004 — 1,378	+ 1,626
Norway	+ 889 — 2,505	+ 12 —	— —	+ 902 — 2,505	— 1,604
Portugal	— —	+ 1,926 —	— —	+ 1,926 —	+ 1,926
Spain	— —	+ 53 —	— —	+ 53 —	+ 53
Sweden	— — 243	+ 2,447 —	— —	+ 2,447 — 243	+ 2,204
Switzerland	— —	+ 2,338 —	— —	+ 2,338 —	+ 2,338
Turkey	+ 9,212 — 4,694	+ 132 —	— —	+ 9,344 — 4,694	+ 4,650
United Kingdom	— —	+ 624 — 17,368	— —	+ 624 — 17,368	— 16,744
Total	37,756	19,812	9	57,576	—

exchange guarantee as a result of the several adjustments of the exchange parities of member countries' currencies in that month. The settlement mechanism was again utilised in 1968 when the Icelandic krona was devalued, although only one balance, for an amount of $8,620, was brought into the special settlement on 21st November. The cumulative total of settlements under the Multilateral System now amounts to $57.6 million.

No amounts of interim finance have been drawn under the Agreement since March 1963.

Statement of Account.

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

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 outstanding		Capital Fund	Income and expenditure account
	in millions of units of account						
Opening	113.0	123.5	328.4	35.0	600.0	600.0	—
1959 December	104.4	123.5	302.9	80.0	610.9	607.5	3.4
1960 December	106.4	123.5	297.9	87.5	615.3	607.5	7.8
1961 December	109.2	123.5	297.9	87.8	618.4	607.5	10.9
1962 December	90.4	123.5	297.9	110.5	622.3	607.5	14.8
1963 December	82.1	123.5	297.9	123.1	626.6	607.5	19.1
1964 December	79.3	123.5	297.9	130.6	631.4	607.5	23.9
1965 December	101.3	123.5	297.9	113.1	635.8	607.5	28.3
1966 December	89.4	123.5	297.9	130.5	641.3	607.5	33.8
1967 December	82.6	123.5	297.9	142.8	646.9	607.5	39.4
1968 January	82.2	123.5	297.9	142.8	646.5	607.5	39.0
February	82.3	123.5	297.9	142.8	646.6	607.5	39.1
March	82.4	123.5	297.9	142.8	646.7	607.5	39.2
April	82.5	123.5	297.9	142.8	646.8	607.5	39.3
May	82.7	123.5	297.9	142.8	647.0	607.5	39.5
June	65.2	123.5	297.9	162.8	649.5	607.5	42.0
July	64.9	123.5	297.9	162.8	649.2	607.5	41.7
August	65.1	123.5	297.9	162.8	649.4	607.5	41.9
September	65.3	123.5	297.9	162.8	649.6	607.5	42.1
October	65.5	123.5	297.9	162.8	649.8	607.5	42.3
November	60.6	123.5	297.9	167.8	649.9	607.5	42.4
December	71.8	123.5	297.9	160.1	653.3	607.5	45.8
1969 January	76.3	123.5	297.9	155.1	652.8	607.5	45.3
February	76.5	123.5	297.9	155.1	653.0	607.5	45.5
March	81.6	123.5	297.9	150.1	653.1	607.5	45.6

Credits and claims outstanding, which amounted at the beginning of operations to $35 million, representing long-term claims on Norway and Turkey taken over from the EPU, stood at $142.8 million at end-March 1968. Of this sum, $125 million represented credits outstanding and $17.8 million the balance of the long-term claims on Norway and Turkey. The total rose to a peak of $167.8 million in November 1968 as a result of the drawings by Turkey and Iceland already described. It then declined following the eighth annual amortisation payment in respect of the long-term claims on Norway and Turkey, amounting to $2.7 million, in December and because of the credit repayments by Turkey and Greece noted earlier. At the end of March 1969 the total was $150.1 million.

The Fund's non-liquid assets thus increased by $7.2 million during the year. This was slightly more than the increase of $6.4 million in undistributed net income during the period and there was therefore a small decline, of $0.8 million, in the Fund's liquid resources.

There was no call-up of capital in the period under review, so that the amount of member countries' uncalled contributions remained at $297.9 million. In addition, the sum of $123.5 million, representing the unused balance of the EPU capital contributed by the United States and transferred to the European Fund, may still be called, provided that the amount of member countries' paid-up contributions has reached a level of $148 million (i.e. equal to the active EPU capital transferred to the Fund in 1958), in equal proportion to the payment of further contributions by member countries. At present, member countries' paid-up contributions total $38 million and, together with the $148 million of active former EPU capital, the total of the Fund's operating capital comes to $186 million. The amount of $607.5 million shown as the capital liability of the Fund in the Statement of Account includes also the uncalled amounts just mentioned.

Net income received during the calendar year 1968 amounted to $7.5 million — the highest figure yet recorded. This reflected the high average level of credits outstanding, as well as the high yields obtained on the Fund's liquid dollar investments. It brought the cumulative total of net income received since the start of operations to $53.7 million. The payment of interest on member countries' contributions was again based upon the principle that the cumulative amount of interest paid to each member country should be equal to 90 per cent. of the share in the Fund's net income which the country would have received if the Fund had been liquidated at the end of the period in respect of which interest is paid. The amount paid out in respect of 1968 came to $1.2 million and brought the cumulative amount of interest paid in gold to member countries to $8.6 million. This corresponds to an average annual rate of interest of 2.4 per cent. on the $38 million of called-up contributions. After the payment of interest in January 1969 on contributions in respect of the second half of 1968, undistributed net income amounted to $45.3 million. Of this amount, $39.8 million represented the equivalent share, in the Fund's net income, attributable to the $148 million of active EPU capital transferred to the Fund. Virtually all of the remainder represented the 10 per cent. balance of the Fund's net income not yet allocated.

Management of the European Monetary Agreement.

The Board of Management of the EMA supervises the execution of the Agreement and advises the Council of the OECD on all related matters. The Board also follows the economic and financial situation in member countries on the basis of reports made by the Secretariat, by the various committees of the Organisation and, on occasion, by special missions. In discharging these functions the Board meets when necessary, recently about six times a year. In December 1968 the Council re-appointed M. Hay of the Swiss National Bank as Chairman of the Board for a further year.

The Bank for International Settlements, as Agent, presents monthly reports on the operations carried out under the Agreement and on the investments of the European Fund. To assist the Board in following international financial developments the Bank also provides monthly statistical material which the Representative of the Bank comments upon regularly at the Board's meetings.

Since 1963 the Bank for International Settlements has also been entrusted with the transmission of confidential information to participating member central banks relating to the conclusion and utilisation of concerted bilateral arrangements through which special support is given to the currency of an EMA country. During the period under review some new arrangements have been concluded and some of the existing arrangements have been extended. As a result of this the activity of the Bank connected with the notification of support operations among EMA central banks has been considerably intensified.

VII. ACTIVITIES OF THE BANK.

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

During another eventful year the need for close co-operation between central banks in monetary matters has again been evident and the rôle played by the Bank in this field has continued to grow in importance.

The Bank has increased its participation in arrangements set up by groups of major central banks with the aim of relieving pressures within the international monetary system and has also served as a channel for the facilities provided for this purpose. These arrangements include the new $2 milliard facility (referred to in this chapter as "the Second Group Arrangement") accorded to the Bank of England in September 1968, to which reference is also made in Chapter IV of this Report, and the facilities for $1.3 milliard and $2 milliard in favour of the Bank of France, which were granted in July and November 1968 respectively. The Bank's field of activity has also been enlarged by the establishment of new business relations with a number of central banks. On the other hand, the total of the swap arrangements concluded between the Federal Reserve Bank of New York and the BIS remained unchanged during the year at $1,600 million, of which $600 million is against Swiss francs and $1,000 million against other European currencies. As in previous years, the Bank has participated, in collaboration with certain central banks, in co-ordinated action to alleviate undesirable strains on markets, in particular the Euro-dollar market.

In addition to the regular meetings of the Governors of the Group of Ten and of the Board of Directors, the Bank has continued to organise meetings of central-bank experts to study and exchange information on economic and monetary problems of general interest and to examine matters such as the development of the gold and foreign exchange markets and the Euro-dollar market.

During the year the Bank also continued to carry out the functions entrusted to it in August 1964 by the Ministers of the Group of Ten of collecting and distributing to all participants of the Group and to Working Party No. 3 of the OECD statistical data relevant to the means used to finance surpluses and deficits on external account. These data provide the essential basis for multilateral surveillance of international liquidity creation. On the occasion of their meetings at the Bank the Governors of the central banks of the Group and Switzerland also have the opportunity of exchanging information at the earliest possible stage on arrangements entered into between members of the Group for new or enlarged credit facilities and on the evolution of such credits. Co-operation in this field continues to be of great value. The Bank has also again been associated in the work of the Deputies of the Group of Ten.

2. Operations of the Banking Department.

The balance sheet of the Bank as at 31st March 1969, certified by the auditors, is reproduced at the end of this Report.

The presentation of the balance sheet has been slightly altered: on both the assets and the liabilities side the amounts at over three months, which in respect of various items used to be broken down according to term, are now all shown, for simplicity, under one heading.

* * *

The balance-sheet total as at 31st March 1969 amounted to 14,642,777,907 francs,* against 12,041,331,123 on 31st March 1968, thus recording a very marked increase — of 2,601,446,784 francs, or 22 per cent. This rise was due to various large-scale transactions, connected, inter alia, with the entry into force in September 1968 of the Second Group Arrangement concluded by the BIS with the Bank of England, on the one hand, and a large number of central banks, on the other.

BIS: Development of the balance-sheet total over the past ten financial years.

Financial years ended 31st March	Total of balance sheet	Movement over the year	
	in millions of francs		in percentages
1960	3,430	— 98	— 3
1961	3,973	+ 543	+ 16
1962	4,732	+ 759	+ 19
1963	4,950	+ 218	+ 5
1964	5,778	+ 828	+ 17
1965	7,850	+ 2,072	+ 36
1966	7,882	+ 32	—
1967	8,232	+ 350	+ 4
1968	12,041	+ 3,809	+ 46
1969	14,643	+ 2,602	+ 22

The total of the monthly statement of account increased more or less regularly up to the end of December 1968, when it for the first time exceeded the 15 milliard mark, to stand at the new record level of 15,763 million.

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 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

* Except where otherwise indicated, the term "francs" in this chapter 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 1968	Financial years ended 31st March 1969
	in millions of francs	
Earmarked gold	1,219	1,116
Bank balances	32	32
Bills and other securities	641	594
Total of items not included in the balance sheet	1,892	1,742

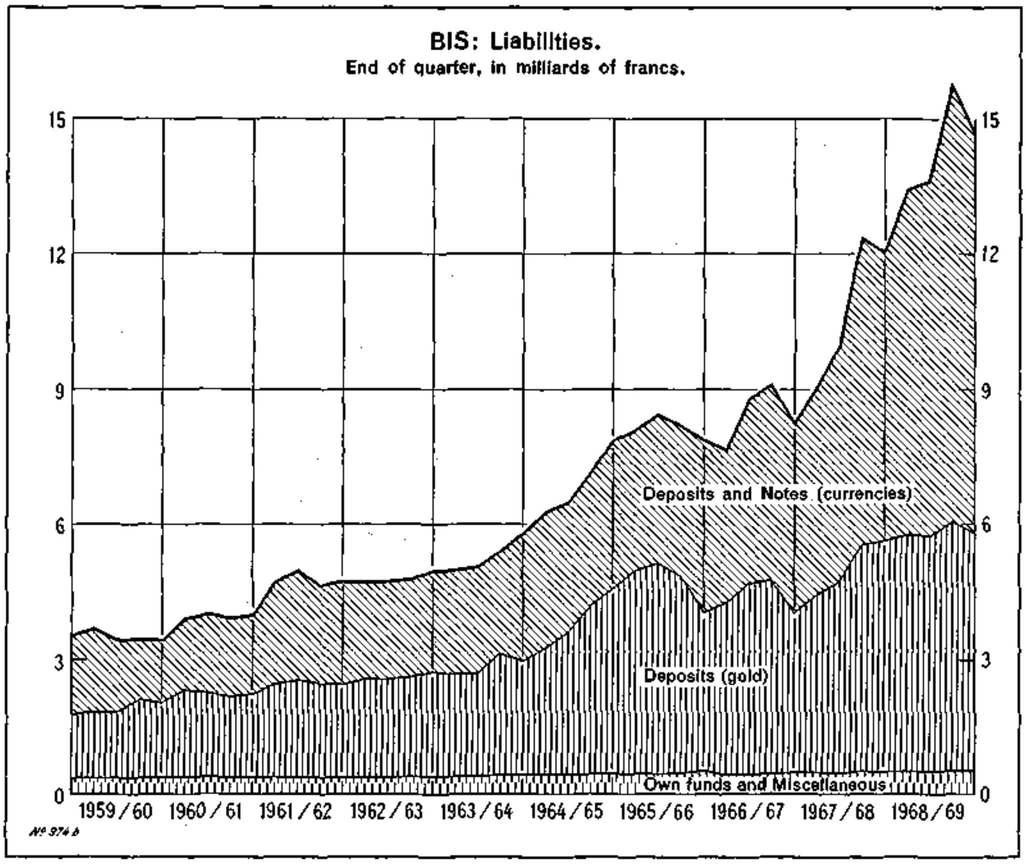
as at 31st March 1968, the amounts in question are shown at the foot of the assets column under the heading "Memorandum accounts (b)". The figures are given in the above table.

COMPOSITION OF RESOURCES (liabilities).

A. Own funds.

The "Capital authorised and issued" remained unchanged at 500 million francs, of which 125 million was paid up.

There were also no changes in the Legal Reserve Fund and the Special Dividend Reserve Fund, which amounted to 12.5 and 10 million respectively.



After distribution of the available net profit for the financial year 1967–68 the General Reserve Fund went up from 22.8 to 37.8 million and an amount of 15 million was credited to a newly-created Free Reserve Fund.

The Bank's reserves were thus increased by 30 million, from 45.3 to 75.3 million.

The item "Miscellaneous", which had stood at 40.6 million at the beginning of the financial year, amounted to 43.4 million at the end.

The "Provision for contingencies" remained unchanged at 220 million.

The "Provision for building purposes", which had totalled 17.5 million at the beginning of the financial year, stood at 1.5 million at the end (see Section 6).

The net profit for the financial year 1968–69 was the same as in the previous year, viz. 45 million (see Section 6).

At the end of March 1969 the Bank's own funds (excluding "Miscellaneous liabilities") amounted to 467 million, i.e. 3.3 per cent. of its borrowed funds (14,133 million) and 3.2 per cent. of the balance-sheet total (14,643 million). If the non-paid-up capital (375 million) were included in the calculation, the ratios would be 6.0 per cent. and 5.8 per cent. respectively.

BIS: Development of the composition of resources, in absolute and percentage terms, over the past ten financial years.

Financial years ended 31st March	Own funds	Borrowed funds	Miscellaneous liabilities	Balance-sheet total
	In millions of francs			
1960	342	3,069	19	3,430
1961	353	3,603	17	3,973
1962	359	4,353	20	4,732
1963	368	4,561	21	4,950
1964	379	5,370	29	5,778
1965	396	7,417	37	7,850
1966	400	7,449	33	7,882
1967	424	7,764	44	8,232
1968	452	11,548	41	12,041
1969	467	14,133	43	14,643

Financial years ended 31st March	Ratio of own funds to borrowed funds	Ratio of own funds to balance-sheet total	Ratio of own funds plus non-paid-up capital to borrowed funds	Ratio of own funds plus non-paid-up capital to balance-sheet total
	In percentages			
1960	11.1	10.0	23.4	20.9
1961	9.8	8.9	20.2	18.3
1962	8.2	7.6	16.9	15.5
1963	8.1	7.4	16.3	15.0
1964	7.1	6.6	14.0	12.3
1965	5.3	5.0	10.4	9.4
1966	5.4	5.1	10.4	9.4
1967	5.5	5.2	10.3	9.3
1968	3.9	3.8	7.2	6.7
1969	3.3	3.2	6.0	5.8

The growth of the Bank's operations, particularly over the past few years, is one of the reasons for the Board of Directors' proposal to the Extraordinary General Meeting convened for 9th June 1969 that the Bank's share capital be increased. This matter is dealt with in detail in Section 7.

B. Borrowed funds.

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

BIS: Borrowed funds, by origin.

Origin	Financial years ended 31st March 1968	Financial years ended 31st March 1969	Movement
	in millions of francs		
Central banks	9,711	11,324	+ 1,613
Other depositors	1,305	1,224	— 81
Notes	532	1,585	+ 1,053
Total	11,548	14,133	+ 2,585

The deposits of central banks increased fairly substantially (+ 17 per cent.), whereas those of other depositors showed a slight decline (— 6 per cent.).

The rise in central banks' deposits was accounted for almost exclusively by deposits in currencies; it was mainly due to the receipt of funds from central banks in the overseas sterling area.

The amount of notes outstanding practically trebled. All the notes issued were expressed in currencies and were sold to commercial banks. The proceeds enabled the Bank to finance various operations which it carried out at the request of monetary authorities.

BIS: Borrowed funds, by nature and term.

Term	Deposits in gold			Deposits in currencies			Notes in currencies		
	Financial years ended 31st March 1968	Financial years ended 31st March 1969	Movement	Financial years ended 31st March 1968	Financial years ended 31st March 1969	Movement	Financial years ended 31st March 1968	Financial years ended 31st March 1969	Movement
	in millions of francs								
Sight	1,989	2,234	+ 245	71	40	— 31	—	—	—
Not exceeding 3 months	2,825	2,778	— 47	5,103	5,031	— 72	62	594	+ 532
Over 3 months	314	286	— 28	714	2,179	+ 1,465	470	991	+ 521
Total	5,128	5,298	+ 170	5,888	7,250	+ 1,362	532	1,585	+ 1,053

Whereas "Deposits in gold" rose very little (+ 3 per cent.), "Deposits in currencies" increased substantially (+ 23 per cent.).

As regards "Deposits in gold", the total on time account declined slightly as a result of conversions into sight deposits.

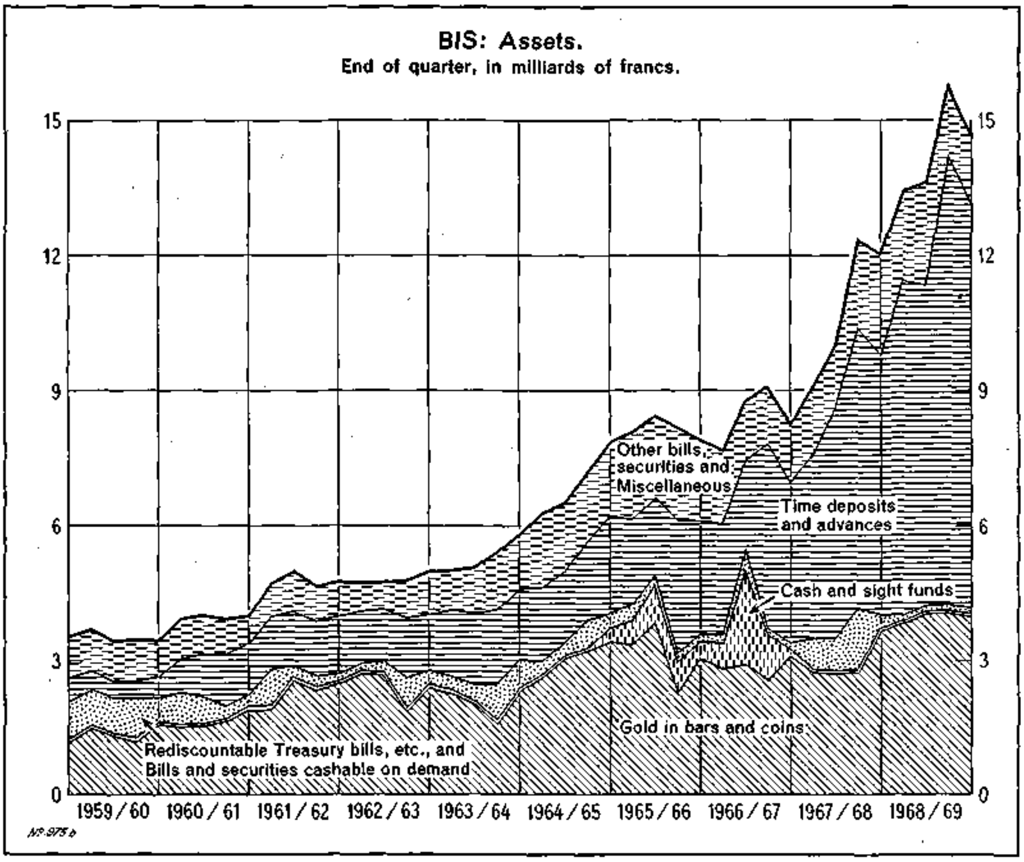
As "Currency deposits" at sight and at not exceeding three months decreased somewhat, the rise in funds at over three months was greater than the overall increase in currency deposits. This development is attributable in particular to the consolidation in September 1968 of the facilities under the Group Arrangement concluded in June 1966 (repayment is to be completed by 1971). Consequently, the funds at relatively short term which the BIS had received for the partial financing of that Arrangement have been placed at its disposal for longer periods.

The increase in the total amount of "Notes" was divided equally between funds at not exceeding three months and those at over three months.

At the beginning of the financial year "Deposits in gold" represented 44 per cent. of total borrowed resources, "Deposits in currencies" 51 per cent. and "Notes" 5 per cent. On 31st March 1969 the percentage ratios were 37, 52 and 11 respectively. Thus, over the financial year the share of total resources in currencies increased appreciably, viz. from 56 to 63 per cent.

EMPLOYMENT OF RESOURCES (assets).

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



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					
1968						
March . . .	3,666 (min.)	407	5,128 (min.)	−1,055	+1,510	455 (min.)
September .	4,034	406 (min.)	5,252	− 812	+1,278	466
November. .	4,116 (max.)	416	5,328	− 796 (max.)	+1,270 (min.)	474 (max.)
December. .	4,057	417	5,543 (max.)	−1,069 (min.)	+1,528 (max.)	459
1969						
March . . .	3,976	451 (max.)	5,298	− 871	+1,341	470
Movement: 31st March 1968 to 31st March 1969	+ 310	+ 44	+ 170	+ 184	− 169	+ 15

The increase of 310 million in the Bank's gold holdings was the result of the maturing of gold/currency swaps with central banks, the settlement of forward purchases of gold and the receipt of fresh deposits.

The fluctuations in the Bank's gold position were considerably less marked than in the preceding financial years.

BIS: Distribution by nature of cash holdings and other investments.

Nature	Financial years ended 31st March: 1968		1969		Movement	
	in millions of francs					
Cash						
Gold	3,666		3,976		+ 310	
Currencies	49	3,715	56	4,032	+ 7	+ 317
Other investments						
Gold	407		451		+ 44	
Currencies	7,918	8,325	10,159	10,610	+ 2,241	+ 2,285
Total						
Gold	4,073		4,427		+ 354	
Currencies	7,967	12,040	10,215	14,642	+ 2,248	+ 2,602

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

A. Sight funds and rediscountable investments.

The item "Gold in bars and coins" (which consisted on 31st March 1969 exclusively of gold in bars) rose by 310 million, as explained above.

The figure for the item "Cash on hand and on sight account with banks", which had amounted to 49 million at the beginning of the financial year, showed little change.

On 31st March 1969 total cash holdings (gold and currencies) represented 27.5 per cent. of the balance-sheet total, compared with just under 31 per cent. a year earlier.

The item "Rediscountable Treasury bills" had amounted to 232 million on 31st March 1968. Funds received during the financial year 1967-68 under the central-bank swap arrangements in which the Bank participates had been invested in such paper. When these swaps matured, in May 1968, the investments in question were liquidated, reducing the figure for this item to 67 million; it subsequently remained at that level until the end of the financial year.

The item "Bills and securities cashable on demand" showed little change; it decreased from 70 to 61 million.

At the beginning of the financial year the total of the Bank's sight funds and rediscountable investments, comprising the asset items so far analysed, was 4,017 million and represented 33 per cent. of the total of the balance sheet; on 31st March 1969 the corresponding figures were 4,160 million and 28.5 per cent. Over the same period sight deposits on the liabilities side increased from 2,060 to 2,274 million, while their share of the balance-sheet total fell from 17.0 to 15.5 per cent.

B. Time funds.

The figure for the item "Time deposits and advances" stood at 5,775 million at the beginning of the financial year and 8,964 million at the end, thus registering a very marked increase — of 3,189 million, or 55 per cent. A substantial proportion of these investments was made under the Second Group Arrangement, mostly with funds received for the purpose; the remainder consisted of investments on the Euro-currency market. On various occasions the Bank obtained resources from central banks with a view to intervention on the Euro-currency market so as to moderate the movements of funds on that market. These interventions were effected for short periods, chiefly at the year-end; they were reflected in the item "Time deposits and advances", which rose from 8,132 million at the end of November to 9,949 million at the end of December.

The total of "Other bills and securities" declined from 2,248 million to 1,518 million, or by almost one-third. This decrease occurred in investments

BIS: Time deposits and advances and other bills and securities, by term.

Periods	Financial years ended 31st March 1968	1969	Movement
	in millions of francs		
Not exceeding 3 months	7,319	6,935	− 384
Over 3 months	704	3,547	+ 2,843
Total	8,023	10,482	+ 2,459

in currencies and was chiefly due to the monthly instalments in the redemption — as from June 1968 — of the British Treasury notes purchased by the Bank in November 1967. Holdings of other bills and securities in gold, in contrast, underwent a very slight rise.

It may be noted that, parallel with the rise in resources at over three months (deposits and notes), there was an increase in investments at over three months. The main reasons for this increase were the consolidation of the Group Arrangement concluded in June 1966 and the use of the proceeds of note issues to finance the Second Group Arrangement of September 1968.

* * *

As in preceding financial years, the Bank's activity was connected principally with the growth of co-operation between central banks. Among the operations briefly touched upon above, stress should be laid on the importance to the Bank of the entry into force, in September 1968, of the Second Group Arrangement, for the Bank's rôle in this is threefold: it acts as a participant, as an intermediary between the central banks and as a link between the latter and the market.

The high level of the Bank's activity, which is reflected in particular in the rise in the balance-sheet total, was spread over most items. However, certain gold transactions — purchases and sales on the market — had to be suspended, though the others — gold/currency swaps and exchanges between different centres — continued at their normal rate.

The volume of the Bank's operations reached a new record of 184 milliard in 1968–69, against 174 milliard in 1967–68 and 110 milliard in 1966–67.

3. 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 1968–69 ended for the Dawes Loan on 15th April 1969 and for the Young Loan on 1st June 1969. The interest in respect of the financial year 1968–69 amounted to the equivalent of about 9.7 million francs for the Dawes Loan and of about 34.5 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 1968–69 partly by purchases of bonds on the market and partly by drawings. All of the outstanding bonds of the conversion issues of the Dawes Loan will mature on 15th October 1969.

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 1967–68	1968–69	Balance after redemption
		Conversion bonds			
American . . .	$	44,118,000	17,285,000	2,278,000	24,555,000
Belgian	£	583,500	161,300	19,900	402,300
British	£	8,277,200	2,286,200	286,000	5,705,000
Dutch.	£	1,324,000	347,000	44,900	932,100
French	£	1,929,600	527,200	66,300	1,336,100
Swedish . . .	S.kr.	14,209,000	3,656,000	468,000	10,085,000
Swiss	£	1,130,800	309,100	38,500	783,200
Swiss	Sw.fr.	8,251,000	2,082,000	269,000	5,900,000
		Funding bonds			
American . . .	$	8,208,000	2,383,000	260,000	5,565,000
Belgian	£	157,800	48,000	5,300	104,500
British	£	2,232,000	671,300	74,900	1,485,800
Dutch.	£	291,700	79,900	9,700	202,100
French	£	498,900	151,300	16,800	330,800
Swiss	£	115,000	34,100	3,800	77,100
Swiss	Sw.fr.	415,000	112,000	12,000	291,000

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 1967–68	1968–69	Balance after redemption
		Conversion bonds			
American . . .	$	55,490,000	7,012,000	908,000	47,570,000
Belgian	B.fr.	202,842,000	25,337,000	3,172,000	174,333,000
British	£	20,655,600	2,560,800	321,800	17,774,000
Dutch.	Fl.	52,558,000	6,415,000	814,000	45,329,000
French	Fr.fr.	445,700,000	55,265,000	6,963,000	383,472,000
German	DM	14,504,000	1,788,000	225,000	12,491,000
Swedish . . .	S.kr.	92,763,000	11,548,000	1,448,000	79,767,000
Swiss	Sw.fr.	58,385,000	7,279,000	912,000	50,194,000
		Funding bonds			
American . . .	$	9,009,000	1,108,000	127,000	7,774,000
Belgian	B.fr.	45,681,000	5,704,000	643,000	39,334,000
British	£	4,928,700	607,700	69,200	4,251,800
Dutch.	Fl.	8,499,000	1,044,000	123,000	7,332,000
French	Fr.fr.	98,172,000	11,926,000	1,375,000	84,871,000
German	DM	416,000	50,000	6,000	360,000
Swedish . . .	S.kr.	6,014,000	750,000	83,000	5,181,000
Swiss	Sw.fr.	1,405,000	172,000	20,000	1,213,000

* Nominal value on 1st May 1969 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 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.

The position as regards the Dawes and Young Loans is shown in the tables on the previous page.

The Bank is also Trustee for the assented bonds of the Austrian Government International Loan 1930, the service of which was carried out in conformity with the relevant agreements.

The following table shows the position with regard to this loan.

Austrian Government International Loan 1930.

Issue	Currency	Nominal value			
		Bonds assented	Bonds purchased or drawn for redemption in respect of the financial years		Balance after redemption
			1959 to 1967	1968	
American . . .	$	1,667,000	623,000	92,000	952,000
Anglo-Dutch .	£	856,600	314,400	45,500	496,700
Swiss	Sw.fr.	7,102,000	2,194,000	323,000	4,585,000

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

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

The total amount of these secured loans was originally equivalent to about 817 million francs. Repayments by the Community up to 1st April 1969 amounted to the equivalent of about 366 million francs, so that the total amount outstanding was reduced to the equivalent of about 451 million francs. Further particulars of these loans are given in the table on the next page.

The Community has used the proceeds of these loans to grant credits in the member countries.

During the financial year 1968–69 the Bank received from the borrowers and distributed among the Paying Agents the equivalent of about 24 million francs in respect of interest and the equivalent of about 39 million francs in respect of redemption.

The Community 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.

Secured loans of the European Coal and Steel Community.

Series of Secured Notes	Dates of issue	Countries of issue	Lenders	Original amounts of loans		Amounts unredeemed on 1st April 1969	Rates of interest %	Year of final maturity
1st	1954	United States	US Government	$	100,000,000	60,400,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	133,800,000	3⅞	1982
3rd	1955	Germany	Westdeutsche Landesbank Girozentrale, Düsseldorf and Münster[1]	DM	50,000,000	29,666,400	3¾	1981
4th	1955	Luxemburg	Caisse d'Epargne de l'Etat, Luxemburg	B.fr. L.fr.	20,000,000 5,000,000	13,380,000 —	3½ —	1982 —
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[2]	1,634,620	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	23,750,000	4¼	1974
7th[3]	1957	United States	Public issue	$	25,000,000	11,700,000	5½	1975
10th	1957	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	77,895,261	5⅝	1982
11th[3]	1958	United States	Public issue	$	35,000,000	23,500,000	5	1978
13th[3]	1960	United States	Public issue	$	25,000,000	20,050,000	5⅝	1980
15th	1961	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	88,223,554	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	43,300,000	4½	1981

[1] The original lenders, Rheinische Girozentrale und Provinzialbank and Landesbank für Westfalen Girozentrale, were merged as from 1st January 1969 under the name Westdeutsche Landesbank Girozentrale. [2] This loan, which was contracted in French francs, was converted into Deutsche Mark in 1959. The original amount was 350,000,000 old French francs. [3] The Secured Notes of the 8th, 9th, 12th and 14th Series have been entirely redeemed.

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

The Bank's activities in its continuing capacity as Agent for the execution of the financial operations of the EMA under the Organisation for Economic Co-operation and Development have been described in Chapter VI of this Report. The Bank has received in this connection, as last year, a contribution of Sw.fr. 500,000 towards its administrative expenses, together with the reimbursement of its out-of-pocket expenses; these amounts have been credited to "Costs of administration" in the Bank's Profit and Loss Account.

6. Net profits and their distribution.

The accounts for the thirty-ninth financial year ended 31st March 1969 show a surplus of 49,686,320 francs. The surplus for the financial year 1967–68 was 53,497,848 francs.

The Board of Directors has decided to transfer 1,336,320 francs to the Provision for Exceptional Costs of Administration and 3,350,000 francs to the Provision for Building Purposes. After deduction of these two transfers to the provisions, the net profit again amounts to 45 million francs. The appropriation of this amount is fixed by Article 53, sub-clauses (b), (c), (d) and (f), of the Statutes.

On the basis of these provisions, the Board of Directors recommends, as last year, that the net profit of 45 million francs be applied by the General Meeting in the following manner: (i) a sum of 7,500,000 francs in payment of the cumulative dividend of 6 per cent., or 37.50 francs per share; (ii) a further sum of 7,500,000 francs in payment of the supplementary dividend of 6 per cent., or 37.50 francs per share; (iii) an amount of 15 million francs to be transferred to the General Reserve Fund; and (iv) the remainder of the available net profit, namely 15 million francs, to be transferred to the Free Reserve Fund. The Board of Directors has the right to use the Free Reserve Fund not only for meeting losses incurred by the Bank but also for any other purpose that is in conformity with the Statutes.

Under the proposals of the Board of Directors the Bank's total dividend for the financial year 1968–69 will remain unchanged at 75 francs. It will be payable in Swiss francs in the amount of 107.15 Swiss francs per share and the payment will be effected on 1st July 1969 to the shareholders whose names are entered in the Bank's share register on 25th June 1969. The proposed distribution of 75 francs per share for the financial year 1968–69 represents the total dividend provided for in sub-clauses (b) and (c) of Article 53 of the Bank's Statutes.

The Balance Sheet, the Profit and Loss Account and the proposed Appropriation of the Net Profit will be found at the end of this Report.

During the past financial year the Bank acquired the greater part of a site in the centre of Basle, on which it intends to construct new premises. A sum of 19,350,000 francs has been paid for the land acquired up to 31st March 1969 and charged to the Provision for Building Purposes.

The Bank's accounts have been duly audited by Messrs. Price Waterhouse & Co., Zurich, who have confirmed that the Balance Sheet and the Profit and Loss Account give a true and correct view of the state of the Bank's affairs as at 31st March 1969 and of its profit for the year ended on that date. Messrs. Price Waterhouse & Co.'s certificate is appended at the foot of the Balance Sheet.

7. Adjustment of the Bank's capital and amendment of its Statutes.

The Board of Directors, considering that the time has come for the Bank to adjust its capital and amend its Statutes in view of the growth of its activity in recent years, decided at its meeting on 14th April 1969 to convene an Extraordinary General Meeting for 9th June 1969 and to propose to it:

(1) that the Bank's authorised capital be raised from 500 million to 1,500 million francs;

(2) that 200,000 new shares, constituting the second tranche of the Bank's capital, be issued and that they be offered to its present shareholders;

(3) that the Board of Directors be authorised to issue a third tranche of 200,000 shares, which would be reserved for central banks; and

(4) that the Bank's Statutes be amended in the light of these changes and that various other provisions in the Statutes be revised at the same time.

It is recalled in this connection that under the terms of Article 5 of the Statutes the Bank's authorised capital is fixed at 500 million francs. It has been fully issued and is divided into 200,000 shares of 2,500 francs each, paid up to the extent of 25 per cent., or 625 francs. The above proposals aim, therefore, at trebling the present amount of the authorised capital. The Statutes would be amended accordingly, the Bank's capital being divided henceforth into 600,000 shares. All these shares, of equal gold nominal value, would confer the same rights. Since they would only be partly paid up, all the holders would have the same obligations.

The second tranche would be issued in the near future, doubling the capital already issued. The third tranche, on the other hand, would be issued in stages as circumstances required. The uncalled capital, which currently amounts to 375 million francs, would thus first be raised to 750 million francs as a result of the issue of the second tranche. It would finally be increased, when the third tranche had been issued in full, to 1,125 million francs. The paid-up capital, which at the moment amounts to only 125 million francs, would then total 375 million.

The amount required for paying up one-quarter of the nominal value of the second tranche of the capital would be drawn from the Provision for Contingencies. The new shares would be offered to the shareholders registered in the Bank's books, who, in agreeing to subscribe for them, would undertake to pay up the unpaid three-quarters in the event of a call being made. As a result of the drawing, the Provision for Contingencies would be reduced from 220 to 95 million francs. This remaining balance would then be liquidated by distributing it between the Legal Reserve Fund, the Provision for Building Purposes and the Free Reserve Fund.

The third tranche of capital would be reserved for central banks; thus shares of this issue would not be available for subscription or purchase by the public. This tranche would, in fact, be issued in stages, as and when further central banks became members, and ownership of the new shares would confer the corresponding rights of voting and of representation. It would be for the Board to make the requisite allotments of such shares to central banks which "make a substantial contribution to international monetary co-operation and to the Bank's activities".

As a counterpart to the advantages which the issue of the second tranche will entail for shareholders, the proposals submitted to the Extraordinary General Meeting aim at modifying the rules concerning the allocation of dividends (Article 53 of the Statutes — or Article 51 in the new draft) in two respects: by making the preferential dividend of 6 per cent. non-cumulative and by reducing from 6 to 3 per cent. the maximum rate of the supplementary dividend that can be distributed provided that the amount required does not exceed 20 per cent. of the profit remaining after payment of the preferential dividend. The proposals would, however, allow for a larger portion of the profits to be appropriated to the Special Dividend Reserve Fund, the purpose of which is to ensure the regular payment of the preferential dividend of 6 per cent. Furthermore, the liquidation of the balance of the Provision for Contingencies (referred to above) would allow the Legal Reserve Fund to be raised to its ceiling. The whole of the net annual profit could then be used to pay the preferential dividend of 6 per cent. and for other appropriations, including the distribution of a supplementary dividend of up to 3 per cent.

In view of the changes described above — and of the procedure required for their adoption — it seemed advisable to take the opportunity to bring certain other provisions in the Statutes up to date — principally those relating to the Bank's functions in connection with the Young Plan and, secondarily, those concerning the composition of the Board of Directors. The functions assigned to the Bank under the Young Plan ceased, in practice, following suspension of the execution of the Plan in 1931. Moreover, a settlement was reached in 1966 concerning the deposits that had been entrusted to the Bank by the governments in accordance with the Plan. It is therefore proposed that all the provisions relating to these functions and deposits should be deleted from the Statutes. It is, however, intended to retain Article 56 (Article 54 in the new draft), which concerns the Arbitral Tribunal. With regard to the Board of Directors, the purpose of the proposed amendments is to bring the relevant provisions into line with the practice adopted up to now; no basic change is involved.

As stated in Article 3 of the Statutes, the main objects of the Bank, which is an international institution with special public responsibilities, are "to promote the co-operation of central banks and to provide additional facilities for international financial operations". The Board of Directors considers that the proposed changes will considerably strengthen the Bank's ability to carry out its functions within the framework of central-bank co-operation and at the same time respect the interests of the shareholders, who will receive, without payment, one new share for each old share held.

The proposed changes, if approved by the Extraordinary General Meeting on 9th June 1969, will have to be sanctioned by the Swiss Government, acting with the agreement of the other governments that were signatories to the 1930 Convention respecting the BIS, before they can enter into force.

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

The Board suffered a great loss in the death on 21st November 1968 of Professor Pietro Stoppani. Professor Stoppani had first been appointed as an alternate member by Professor Einaudi in 1945. He had served on the Board as a full member from 1948 to 1960 and thereafter, up to the time of his death, as an alternate member in the absence of Dr. Baffi. A warm tribute was paid to him by the Chairman at the Board meeting held on 9th December 1968.

At the meeting of the Board held on 10th February 1969 the Chairman announced that Dr. Carli, Governor of the Bank of Italy, had appointed Professor Francesco Masera as his Alternate in the absence of Dr. Baffi, to succeed the late Professor Stoppani.

The mandate of Mr. Per Åsbrink, who had been elected to the Board under Article 28 (3) of the Statutes, being due to expire on 31st March 1969, Mr. Åsbrink was re-elected at the meeting of the Board held on 10th March 1969 for a further period of three years ending on 31st March 1972.

The mandate of M. Henri Deroy as a member of the Board was due to expire on 31st March 1969 and he was re-appointed under Article 28 (2) of the Statutes by M. Jacques Brunet, Governor of the Bank of France, in March 1969 for a further period of three years expiring on 31st March 1972.

In April 1969 M. Olivier Wormser succeeded M. Brunet as Governor of the Bank of France and became an ex officio member of the Board. At the meeting of the Board held on 14th April 1969 the Chairman expressed the Board's sincere appreciation and gratitude for the eminent services which M. Brunet had rendered to the Bank during his term of office, which had exceeded nine years. In May he welcomed M. Wormser on the occasion of his first attendance at a meeting of the Board.

The mandate of Mr. M. J. Babington Smith as a member of the Board was due to expire on 6th May 1969 and he was re-appointed under Article 28 (2) of the Statutes by Sir Leslie O'Brien, Governor of the Bank of England, in April 1969 for a further period of three years expiring on 6th May 1972.

The Chairman informed the Board at its meeting on 12th May 1969 that Herr Blessing, President of the Deutsche Bundesbank, had appointed Dr. Otmar Emminger or, should the latter be absent, Herr Johannes Tüngeler to act as his Alternate.

Mr. Jan Knap, Assistant Manager, retired at the end of November 1968. At the Board meeting held on 18th November 1968 the Chairman thanked him for the loyal and valuable services he had rendered the Bank over a period of more than eleven years.

At the Board meeting held on 18th November 1968 the Chairman announced that as from 1st December 1968 Mr. D. H. Stapleton and Professor F. E. Klein had been appointed Assistant Managers and that Mr. A. N. Barltrop had been appointed Sub-Manager. All three had been senior members of the staff for many years.

CONCLUSION.

If expansion of output were the only objective of economic policy, the performance over the past year would have been praiseworthy. However, ...

One blot on the record has been price inflation. While not a general malady, its occurrence in several of the larger countries was of more than national importance, as it contributed to international imbalances. In the United States taxes were increased in mid-1968 to curb the excessive overall demand originating from the large budget deficit itself. But this restraining action, coming three years after the escalation of military spending began, was offset by a splurge of consumption and private investment spending. Private demand pressures were surely motivated in part by inflationary expectations and they were facilitated by premature easing of monetary restraint. Hence, the gross national product continued to rise rapidly in the second half of last year and, of course, even more rapidly in terms of current prices. By December monetary restraint was again being applied to dampen the boom.

The new Administration installed in January 1969 has continued the anti-inflation battle. Besides supporting a stern monetary policy, despite the onus of soaring interest rates, it tightened budget restraint by further limitations on government expenditures. And, significantly, it proposed elimination of the tax credit on business investment outlays after the survey of investment intentions indicated a sharp rise for the current year. While signs of slow-down have not yet been conclusive, it can hardly be doubted that the present policy posture will prove effective — perhaps sooner than the talk of gradualism would seem to imply.

Price inflation in the United Kingdom has not been a result of excess demand, as resources have not been under pressure over the past year. It was caused partly by the direct effects of currency devaluation on prices and partly by the cost-push of sharply rising wages. It was, of course, far from the intention of the authorities that wages should rise by 9 per cent. in the first year after devaluation. This meant that real consumption tended to increase instead of declining somewhat to help the balance-of-payments adjustment, and it meant also that further restraining measures, after the severe budget of 1968, have been required to counteract weakness of the currency. While effective monetary restriction would have been quite helpful, there is no denying that when a government is unable to gain adequate support for effective incomes policy and orderly labour relations, the progress of the economy is bound to suffer. It should be evident that the rise of British labour's real standard of living has fallen behind that in continental countries year after year. And yet it does not seem to be widely enough realised that this is connected with insistence on maintaining a tinge of anarchy in labour relations and on clinging to the money illusion of unrealistic increases in take-home pay. While wage increases have slowed down in recent months, they still seem to be in excess of what the growth of productivity can accommodate.

In France price inflation was, likewise, a consequence of wage increases, agreed upon to settle the social disturbances of May–June 1968. By April of this year wages had risen to about 16 per cent. above the level of the same month a year ago. Even though a more reasonable wage situation is to be expected in the months ahead, adjustment of economic relationships to the past year's increases is still in process.

Price inflation contributed to a second blot on the record of the past year, namely imbalances in international payments and violent disturbances on exchange markets. This was true even though a larger imbalance of the external current account in several important cases was more than offset by shifts in capital movements. Demand and price pressures in the United States sucked in imports to an extent that erased all surplus on trade account, despite a healthy rise of exports. At the same time, high interest rates and direct controls on capital exports reversed the capital-account deficit and sucked in liquid funds through the banks in large volume. And thus, an official settlements surplus! Apart from brief periods of exchange crisis, the dollar has been strong in the market partly because Euro-dollar borrowings by US banks fall outside the regulations covering domestic bank deposits. While all this may be a hardship for some European countries which tend to lose reserves in the process, it temporarily relieves the authorities in Washington of the need for decisive action on the underlying deficit position. It is clear that just to stop inflation will not wholly solve the problem, as there was a persistent deficit before the inflation started, and there has been abundant experience to show that relying on long-term corrective forces is betting against very poor odds.

In the case of sterling, exports responded fairly well to devaluation, but a trade deficit has persisted owing to a continued high level of imports. Thus, expectations of a large surplus have been frustrated and even the process of erasing the deficit has been a continual struggle. In this situation, confidence in the currency has been fragile and sterling has been drawn into exchange-market crises, even when these did not originate from developments in the United Kingdom. At the present time it seems that the screws of monetary policy are to be further tightened and a surplus is foreseen in the overall budget of the central government. Hence, more than ever, the prospects depend on reasonable success on the labour front.

The wage and price inflation in France, set in motion by the events of May and June 1968, turned the external account into significant deficit. It is true that a confidence flight of capital funds was the major factor in the immediate large reserve losses; also the initial attempt to cure inflationary and balance-of-payments difficulties by budget and monetary spurs to expansion did not help matters. But although fiscal and monetary policy was soon redirected to relieving demand and price pressures, a serious deficit on external account developed. While some temporary reflow of reserves was obtained by exchange control measures, it does not seem that the underlying deficit could be readily eliminated by the adjustment possibilities still to flow from the present complex of policies.

It is an anomaly that the major exchange crises of the past twelve months centred on the Deutsche Mark, since Germany was in basic balance-of-payments deficit most of the time. There was a large current-account surplus from booming exports, but it was more than offset because Frankfurt took over from New York and London the rôle of the world's leading exporter of capital funds. Most of the bursts of demand for Deutsche Mark came from protective shifts in the terms of payment, although there was also significant outright speculation.

The problem basically was that large enough capital exports might prove to be unsustainable and that the huge trade surplus, enlarged by inflated demand from abroad and by a deterioration of price competitiveness in the inflating countries, might not recede sufficiently as the cyclical position changed. If a large overall surplus re-emerged, it would not only be a burden for Germany's trading partners, it would also embarrass domestic restraining action as the onrushing expansion reached the stage of inflationary boom. In other words, a possible dilemma between the fixed parity and inflation.

Influenced by the apparent finality of revaluation, the difficulty it raises with respect to farm prices and the memory of the unpopularity of the 1961 experiment, the government decided to struggle on without change. Various measures have been taken: to discourage the inflows of short-term funds from abroad, to recycle redundant foreign exchange, to reduce the trade surplus and to give a mild check to the boom without too much pressure on DM interest rates. While no one who supports the goal of price stability will begrudge sympathy to the German Federal authorities, it is not yet clear that their problems will be resolved by the measures thus far taken.

A crisis in monetary affairs can sometimes reflect the insistence of market forces to free the adjustment process from the bond of official controls. So it was with the gold crisis of 1967–68, which ended with a free price for gold in the market. In consequence, the international system during the past year was relieved of the burden of official gold reserves being drained off by market demand.

While this was a solid gain, as compared with the large loss of gold from monetary reserves the year before, it has to be said that doubts have emerged about the present state of the monetary system and, more particularly, about its future development. Experience has shown that the Bretton Woods system does not work satisfactorily unless certain conditions are fulfilled. These conditions include, on the one hand, a regular increase in global reserves that does not depend upon the creation of official monetary debt and, on the other, the basic adjustment of payments through prompt changes, under the guidance of the IMF, in the exchange parities of countries in fundamental disequilibrium. That these conditions have not been fulfilled is not through faults in the system itself.

In these circumstances, quite different views about the future of the system are being expressed. Some people see it gradually evolving — with the present stock of monetary gold and on the basis of fixed exchange rates — towards a dollar standard, either by formal inconvertibility of the dollar or by some sort of self-denying ordinance on the part of creditor countries. In such a system reserve growth would continue to take place through the creation of foreign exchange assets as a result either of deficits in the US balance of payments or of special transactions to finance imbalances of other countries. The prospect of a more or less acknowledged dollar standard can hardly appeal to the partner countries of the United States, since it would limit their freedom in domestic monetary policy without in the end guaranteeing the maintenance of a fixed-rate system.

Other proposals for the future of the system, favoured mainly by non-official monetary doctors, look to the elimination or relaxation of the objective of fixed parities either by crawling pegs, wider bands or fully floating rates. As the adoption of floating rates would involve some sacrifice of things held to be significant up to now — such as the discipline of the balance of payments, the ease of maintaining liberal trading policies and the operational preference of the business world — there has been no rush of official support for these proposals.

The main official view is that the system should function with its present stock of gold — on the assumption that adequate reserve growth to maintain the fixed-rate system can and will be provided by the Special Drawing Rights plan to be established in the IMF. Moreover, as it has come to be recognised that the adjustment process itself is tortuous in the absence of autonomous growth of global reserves, there is a desire to see the plan approved and activated fairly soon and with rather substantial issues of SDRs.

This approach presents a number of problems. Firstly, there are the possible effects of an across-the-board creation of liquidity on the determination with which countries resist the inflationary pressures that are so often at the root of payments imbalances. More fundamentally, there are the difficulties associated with the maintenance of a fixed stock of monetary gold and with the co-existence of different types of reserve assets (gold, dollars and SDRs). In particular, it is not clear how complications are to be prevented from arising out of shifts in the country distribution of the static gold stock except, again, by a self-imposed decision of the creditor countries or by the establishment of some sort of reserve settlement accounts in which all types of reserves would be lumped and used together. Either of these approaches requires that countries give up the right to determine the composition of their reserves.

In the meantime, it seems likely that the monetary system will continue to operate under somewhat uncertain and unstable conditions. And one waits to see by experience if Gresham's Law will operate and, if so, what bad money will drive out what good — gold, dollars or SDRs.

Finally, it cannot be said too often that no international monetary system will work properly unless countries are prepared to follow domestic policies that are compatible with the maintenance of external equilibrium. The task of monetary co-operation and co-ordination is to operate in a way that assists countries in achieving this essential goal.

GABRIEL FERRAS

General Manager

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AS AT 31st MARCH 1969

BALANCE SHEET

ASSETS

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

			%
Gold in bars and coins		3,976,260,975	27.2
Cash on hand and on sight account with banks		55,690,790	0.4
Rediscountable Treasury bills		66,967,570	0.5
Bills and securities cashable on demand		60,477,805	0.4
Time deposits and advances			
Not exceeding 3 months	5,630,478,799		38.4
» » » » (gold)	34,085,713		0.2
Over 3 months	3,299,635,119		22.5
		8,964,199,631	
Other bills and securities			
Gold			
Not exceeding 3 months	295,205,527		2.0
Over 3 months	121,989,743		0.8
Currencies			
Not exceeding 3 months	975,049,473		6.7
Over 3 months	125,817,231		0.9
		1,518,061,974	
Miscellaneous assets		1,119,161	0.0
Land, buildings and equipment		1	0.0
		14,642,777,907	100

MEMORANDUM ACCOUNTS

a. Forward gold operations:

Net balance: gold receivable (currencies to be delivered)	1,341,167,263

b. Funds, bills and other securities administered or held by the Bank for account of third parties:

Earmarked gold	1,116,167,302
Bank balances	32,521,430
Bills and other securities	593,610,901

AS AT 31st MARCH 1969

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	0.9
Reserves			
Legal Reserve Fund ...	12,500,000		
Special Dividend Reserve Fund ...	10,007,964		
General Reserve Fund ...	37,751,960		
Free Reserve Fund ...	15,000,000		
		75,259,924	0.5
Deposits (gold)			
Central banks			
Sight ...	1,758,829,934		12.0
Not exceeding 3 months ...	2,664,959,515		18.2
Over 3 months ...	285,988,601		1.9
Other depositors			
Sight ...	474,788,277		3.2
Not exceeding 3 months ...	113,670,999		0.8
		5,298,237,326	
Deposits (currencies)			
Central banks			
Sight ...	22,647,238		0.2
Not exceeding 3 months ...	4,415,219,595		30.1
Over 3 months ...	2,175,700,532		14.9
Other depositors			
Sight ...	17,631,833		0.1
Not exceeding 3 months ...	615,423,848		4.2
Over 3 months ...	3,092,180		0.0
		7,249,715,226	
Notes			
Not exceeding 3 months ...	593,968,154		4.1
Over 3 months ...	990,675,289		6.8
		1,584,643,443	
Miscellaneous ...		43,421,988	0.3
Provisions			
Provision for contingencies ...	220,000,000		
Provision for building purposes ...	1,500,000		
		221,500,000	1.5
Profit and Loss Account ...		45,000,000	0.3
		14,642,777,907	100

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

In our opinion the foregoing Balance Sheet and the annexed Profit and Loss Account give a true and correct view of the state of the Bank's affairs as at 31st March 1969 and of its profit for the year ended on that date.

We have obtained all the information and explanations which we considered necessary. In our opinion the Bank has kept proper books and the said accounts are in agreement with them and with the said information and explanations.

ZURICH, 2nd May 1969. PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT

for the financial year ended 31st March 1969

		Gold Francs
Net interest and other income		60,109,089
Less: Costs of administration:		
Board of Directors	175,272	
Management and Staff	8,375,659	
Office and other expenses	1,871,837	10,422,768
Net operating surplus		49,686,320
Less: Amounts appropriated to the following provisions:		
Exceptional costs of administration	1,336,320	
Building purposes	3,350,000	4,686,320
NET PROFIT for the financial year ended 31st March 1969		45,000,000

APPROPRIATION OF NET PROFIT

(Article 53, sub-clauses b, c, d and f, of the Statutes)

	Gold Francs
Net profit	45,000,000
Cumulative dividend of 37.50 gold francs per share (6% on paid-up capital)	7,500,000
	37,500,000
Additional non-cumulative dividend of 37.50 gold francs per share (6% on paid-up capital)	7,500,000
	30,000,000
Transfer to General Reserve Fund	15,000,000
	15,000,000
Transfer to Free Reserve Fund	15,000,000
	—

Movement on the provision for building purposes during the financial year ended 31st March 1969

	Gold Francs
Balance as at 1st April 1968	17,500,000
Add: Transfer from Profit and Loss Account	3,350,000
	20,850,000
Less: Amortisation of expenditure so far incurred on purchase of land for new Bank building	19,350,000
Balance as at 31st March 1969 per Balance Sheet	1,500,000

BOARD OF DIRECTORS

Dr. J. Zijlstra, 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
Dr. Guido Carli, Rome
Henri Deroy, Paris
Dr. Donato Menichella, Rome
Sir Leslie O'Brien, London
Dr. Edwin Stopper, Zurich
Olivier Wormser, Paris
Per Åsbrink, Stockholm

Alternates

Dr. Paolo Baffi, Rome, or
Prof. Francesco Masera, Rome
Bernard Clappier, Paris, or
Marcel Théron, Paris
Dr. Otmar Emminger, Frankfurt a/M., or
Johannes Tüngeler, Frankfurt a/M.
C. J. Morse, 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

D. H. Stapleton	Assistant Manager
Prof. Dr. F. E. Klein	Assistant Manager
A. N. Barltrop	Sub-Manager