BANK FOR INTERNATIONAL SETTLEMENTS

FORTY-FIRST ANNUAL REPORT

1st APRIL 1970 – 31st MARCH 1971

BASLE

14th June 1971

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FORTY-FIRST ANNUAL REPORT

submitted to the

ANNUAL GENERAL MEETING

of the

BANK FOR INTERNATIONAL SETTLEMENTS

held in

Basle on 14th June 1971

Gentlemen,

I have the honour to submit herewith the forty-first Annual Report of the Bank for International Settlements for the financial year which began on 1st April 1970 and ended on 31st March 1971.

In the course of the financial year an issue to central banks of a further 16,400 shares was made, thereby raising to 464,725 the total number of shares issued and paid up to the extent of 25 per cent. Details of this small change in the capital structure of the Bank can be found in Chapter VII of this Report.

After deduction of the transfers to provisions, the net profit for the year amounted to 99,448,906 gold francs, compared with 83,179,570 gold francs for the preceding year.

The Board of Directors recommends that, in application of Article 51 of the Bank's Statutes, the present General Meeting should allocate the sum of 25,448,906 gold francs in payment of a total dividend of 56.25 gold francs per share, consisting of 37.50 gold francs in respect of the preferential dividend of 6 per cent. per annum and 18.75 gold francs representing the maximum further dividend of 3 per cent. per annum, such total dividend being payable in respect of a full year in the case of 448,325 shares and in respect of three months in the case of the 16,400 new shares mentioned above.

The Board further recommends that 37,000,000 gold francs be transferred to the General Reserve Fund, 14,800,000 gold francs to the Special Dividend Reserve Fund and 22,200,000 gold francs to the Free Reserve Fund.

If these proposals are approved, the Bank's dividend for the financial year 1970–71 will amount to 56.25 gold francs per share on 448,325 shares and to 14.0625 gold francs per share on the 16,400 shares issued during the financial year. These amounts will be payable to shareholders on 1st July 1971 in the amounts of 75.05 Swiss francs and 18.76 Swiss francs per share respectively.

Chapter I of this Report deals with economic developments and policies in Europe, the United States, Canada and Japan in 1970 and the early months of 1971. 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 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 for international loans.

I. SURVEY OF ECONOMIC DEVELOPMENTS AND POLICIES, 1970–71.

The economic and monetary situation in the industrial countries over the past year has been unsatisfactory and frustrating in a number of respects. While the United States and the United Kingdom have been in semi-recession and while the boom has topped off in most other countries, the main difficulties have not been with the state of production and employment. As the whole of post-war experience shows, these elements of the economy can be quite well managed with the help of determined policy action. But for other troubles the way ahead is much less clear.

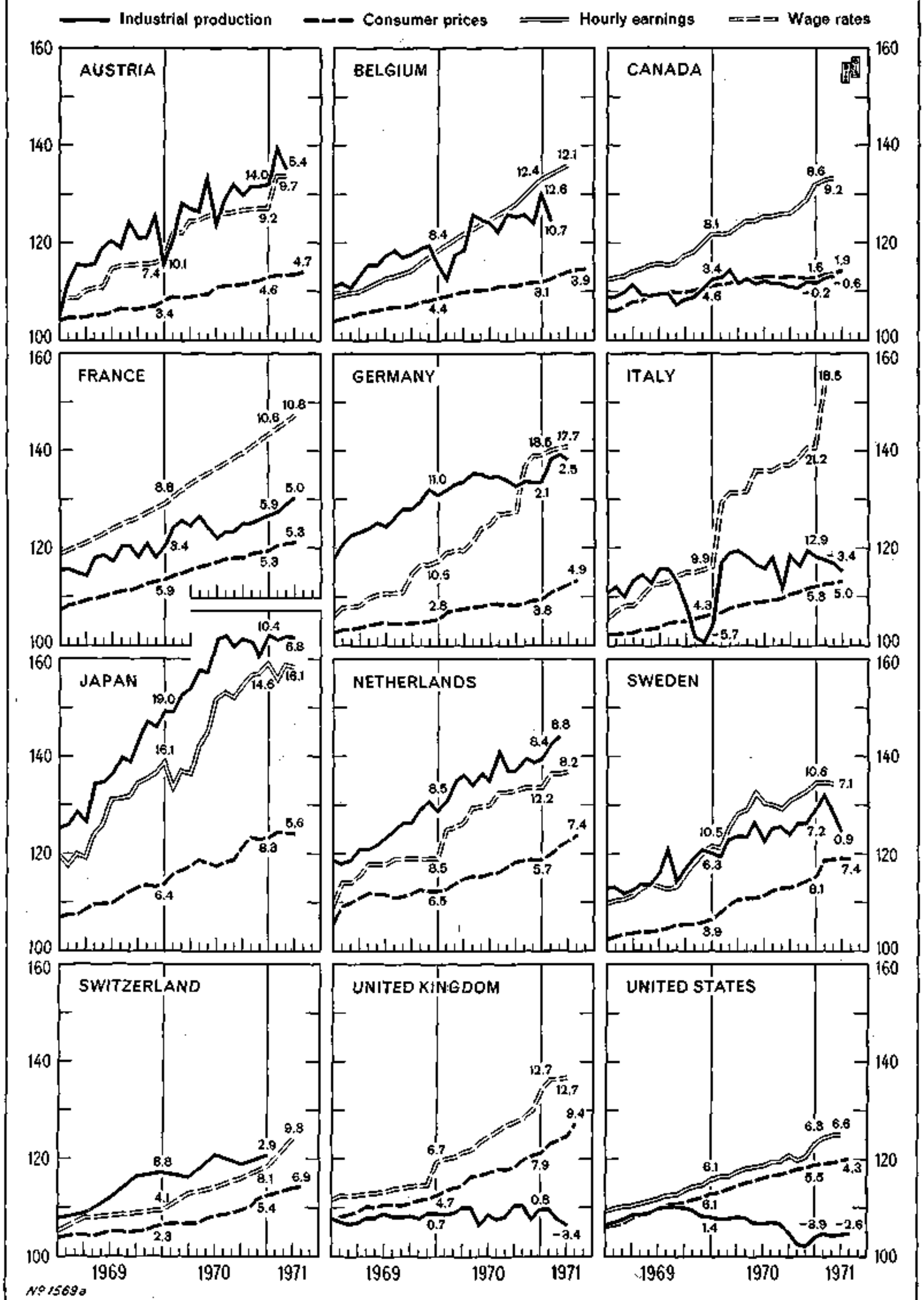
Perhaps most unsatisfactory has been the inflation of prices, pushed on by exceptionally large wage increases — which in a few countries have been beyond all reason. And coupled with this has been considerable industrial unrest. Moreover, the level of interest rates and the size of interest rate differentials have been very disturbing. Rate levels in the United States have been at record heights for a recessionary period, and even so the differentials with other markets have produced unprecedented international flows of funds. Finally, so soon after the Deutsche Mark revaluation in the autumn of 1969, there was in 1971 another eruption on the exchange markets. This involved heavy buying of other currencies besides the Deutsche Mark, pointing to the underlying weakness of the dollar — even though divergent monetary policies played a large causal rôle. Besides, the resolution of the crisis, with the Deutsche Mark and the guilder floating, shows that there are still serious problems to be solved concerning the future of the international monetary system.

Production, prices and wages.

Over the past year the growth of output slowed down in most industrial countries. For Canada and the United States the whole year 1970 was one of mild recession and rising unemployment, brought on by the restrictive demand policies enforced in 1969. In the United Kingdom, too, unemployment increased, as output expanded less than productive potential for the second year running.

On the European continent and in Japan the slow-down began later, mostly in the second half of 1970; and, despite fairly tight monetary policies, the economies of these countries showed fewer signs of slack. Indeed, excess demand remained strong in Austria, the Netherlands and Switzerland and eased only moderately in Germany and Sweden. In Belgium and France productive capacity was fully employed, but not under strain. In Italy, on the other hand, output was held back by industrial unrest, and from the summer on monetary policy was not restrictive. In Japan the boom tapered off during the fourth quarter of 1970, as the growth rate of real gross national product dropped below 10 per cent. In many countries recessionary tendencies were strongest in the housing sector — which is not included in the indexes of industrial production shown in the following graph.

Production, prices and wages.
Indexes: 1967 = 100.



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

The rapid upsurge of wages and prices which had begun in 1969 continued almost everywhere, with the movements in the different countries not very much related to the degree of pressure on resources. Wages in most countries increased by 8–10 per cent., but in the United Kingdom the figure was nearer 15 per cent. and in Germany and Italy around 20 per cent. The largest increases were often obtained in the construction and service industries. Prices rose less, partly because of the usual lag and partly because the boom levelled off. The price increases as measured by the GNP implicit price deflator were mostly in the range of 4½–6½ per cent., though they reached nearly 7½ per cent. in Germany and the United Kingdom. Consumer prices went up more than the overall price level in Japan, Sweden and the United States, but less in other countries.

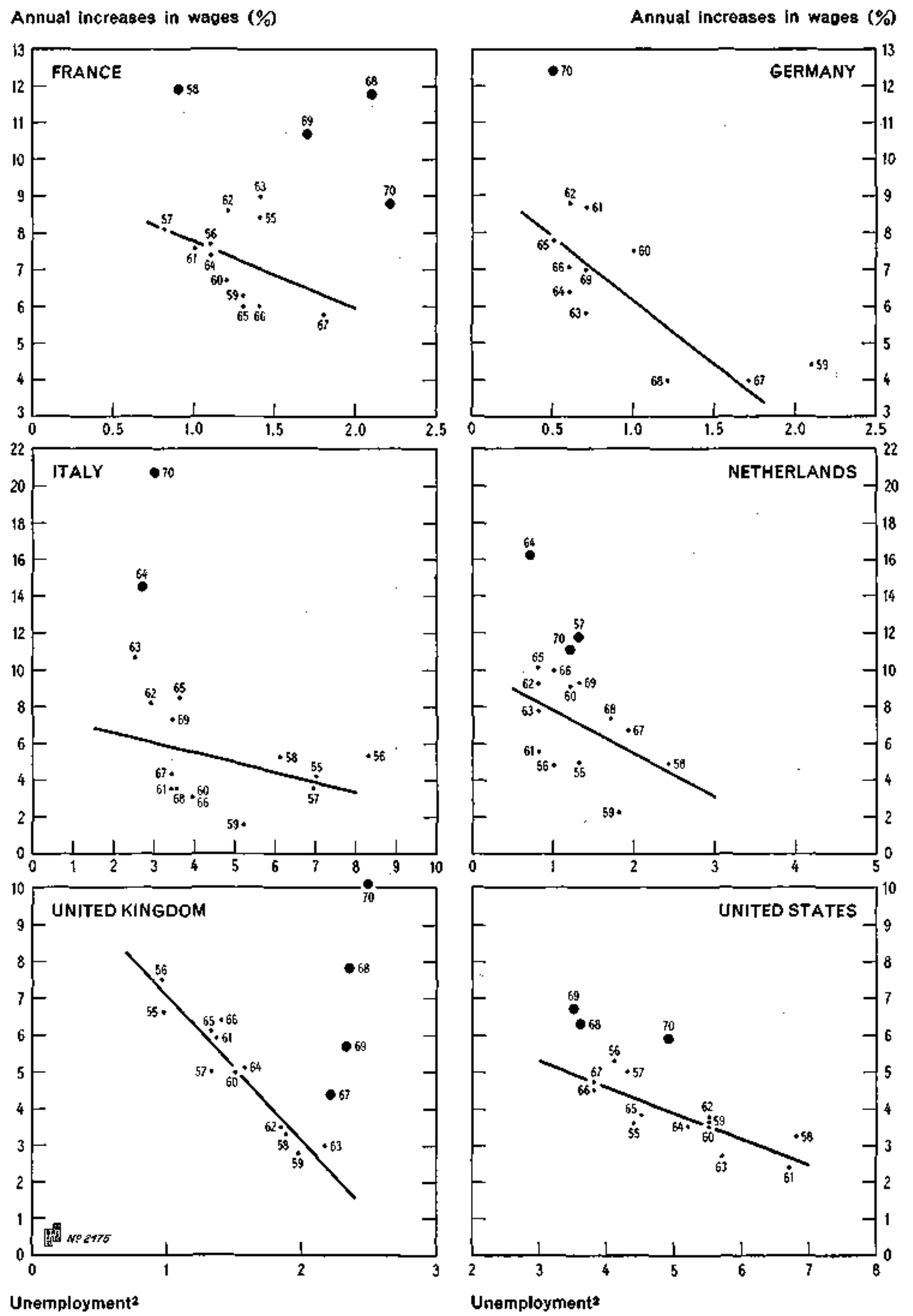
In a number of countries — the United States, Canada, Germany, Sweden and Japan — the initial impetus to faster inflation had come from excess demand. However, with this being allowed to continue too long unchecked, the trade unions took the bit between their teeth and began stepping up pay claims either to raise their members' share of the national income or to compensate for price increases. During 1970, with the economic climate cooling down, the element of wage-push began to take over the leading rôle in sustaining inflation.

In certain other countries, by contrast, the inflation started at the cost end, with excess demand in most cases emerging later on, as in the Netherlands and Switzerland. Import prices and basic changes in taxes sometimes played a part, but the main culprit was usually wages. Switzerland was one country where wage inflation was relatively subdued, though wages have been affected to some extent by increases in neighbouring countries.

Wage-push was most evident in Italy and the United Kingdom. The eruption of pay demands and the wave of strikes in Italy were partly political in character, while an important factor in the United Kingdom was discontent at the slower than usual advance of real wages in 1968–69, when the balance of payments was moving into surplus. In France the big wage-push had already taken place earlier than elsewhere, following the events of May 1968. In 1969–70 the inflationary impact of devaluation gave another twist to the spiral — directly through its effect on prices and costs and also indirectly through the strong upswing of exports. Moreover, the revaluation of the Deutsche Mark, while helping to cool off the boom in Germany, tended to accelerate price inflation in neighbouring countries. Thus, in Austria, Belgium and the Netherlands import prices accounted for about one-third of the increase in consumer prices in 1970. In Switzerland also their rôle was important.

The graph on the following page illustrates the relationship between unemployment and the rate of wage increase that has prevailed in the past in six industrial countries. It is not intended to show what would happen if there were a free market for labour, but what has actually happened since the late 1950s. It has been usual, in fact, for wages to rise faster in periods of prosperity and for trade unions to moderate their pay demands during recessions. This is indicated by the slope and position of the lines, which show the average size of wage increase associated with any given level of unemployment. The upsurge of wages in the last two or three years, however, has radically upset the previous pattern. Of course, wage explosions have occurred before — for instance in France after the devaluations of 1957–58 and in Italy and the

Wages and unemployment in selected countries.[1]



[1] The straight-line regressions of wages on unemployment exclude the years of exceptional wage increases (indicated by the large dots). [2] As percentage of labour force.

Netherlands in 1964. But the movement in 1969–70 was stronger and more widespread than ever before. Even in Germany, where there was clear excess demand in 1968–70, the striking thing is how much faster wages rose in 1970 than in earlier periods of demand pressure, such as 1960–61.

The experience of recent years has shown the importance of avoiding prolonged periods of excess demand if the wage/price spiral is to be kept under control. But it has also shown that demand management is not sufficient by itself to ensure reasonable price stability: some form of wages or incomes policy is equally necessary in the face of excessive pay increases unrelated to the demand picture.

In a few countries the search for an incomes policy has been continuous and several other countries took steps in this direction over the past year. Some governments which had gone out of their way to renounce such a policy found themselves forced to backpedal in the face of accelerating pay increases in recessionary situations. In March 1971 the US authorities introduced wage guide-lines for the construction sector, which had been notoriously aggressive in making inflationary pay demands. In Canada price rises were dampened for a while by a voluntary restraint programme, but the authorities failed to obtain union support for wage curbs. Sweden applied administrative price controls; as inflationary wage demands continued and were backed up by industrial action, a temporary ban on strikes and lock-outs was introduced early in 1971. In the Netherlands prices have been subject to administrative regulation since 1969, and at the end of 1970 a six-month ceiling was imposed on wage increases. The Belgian authorities also tightened price supervision from the start of 1971 to prevent a sudden rise in the cost of living following the changeover to value added tax.

These measures, however, have not up to now had much effect on the wage/price spiral. Many of them were of a temporary nature and many were not introduced until the damage had already been done — that is, until the inflationary momentum had become excessive.

Interest rates.

A feature of the past year was the downward slide of interest rates from the record heights to which they had climbed. The peak in short-term rates generally came at the end of 1969 and the turning-point was induced, like the previous precipitous rise, by a change in monetary policy in the United States.

With real gross national product showing a decline in the fourth quarter of 1969, the US authorities decided at the start of 1970 to relax the credit squeeze. The shift from restraint took place gradually in the course of the year, care being taken not to flood the US market with liquidity. Growth of the money stock, narrowly defined, was around 5 per cent. from the end of 1969 to the end of 1970, although in view of "reintermediation" of funds to the banking system — due to changes in the relationship between free-market rates and Regulation Q ceilings — the money stock broadly defined to include time deposits increased over the same period by about 12 per cent.

However, with the economy in recession and the demand for bank credit falling off, interest rates showed substantial declines. Initially the movement was confined to short rates. Long-term interest rates were kept up mainly by very high corporate demand for long-term funds, which were largely used to strengthen the corporations' liquidity positions and thus contributed to the fall in short-term interest rates. At the same time bond issues by State and local governments recovered sharply from their unusually low level of 1969. In the summer, as banks became increasingly liquid and bought Federal and State and local-government bonds on a large scale, the decline in rates accelerated and spread to the long end of the market. With little change in the economic situation, the trend continued in the first quarter of 1971.

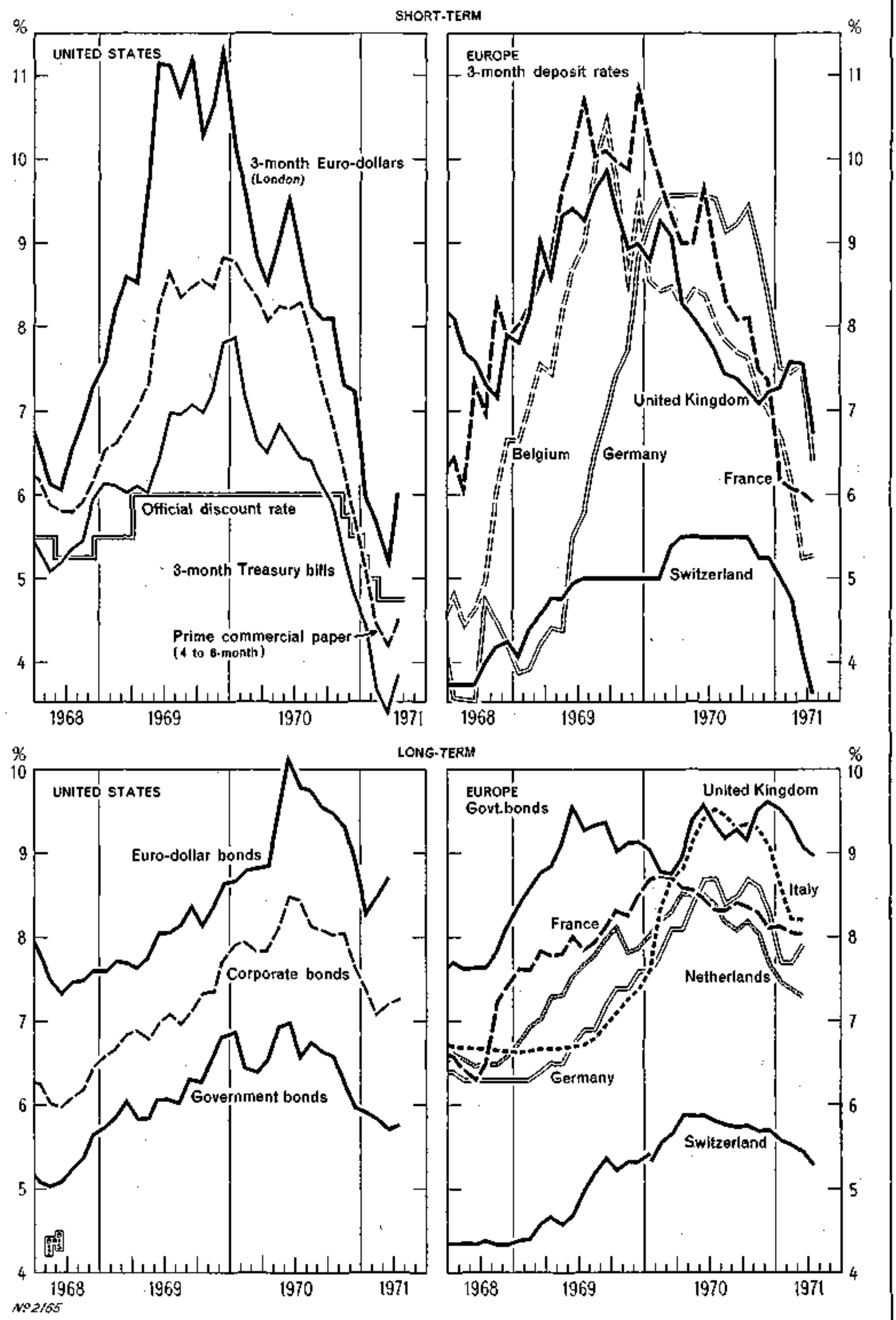
In absolute terms, this recession has seen the largest decline in rates of any post-war period. But that was more a reflection of the inordinate levels to which rates had climbed than of any excessive easing of monetary policy under recessionary conditions. In percentage terms, the declines have been either less than or approximately the same as in the 1953–54 and 1957–58 recessions; and rates have not fallen as low as in previous post-war recessions.

On the way down, as on the way up, the movement of dollar interest rates was a source of monetary disturbance for various countries which were lagging cyclically behind the United States. At the beginning of 1970 many countries were still experiencing conditions of excess aggregate demand, and thus wanted to pursue a restrictive domestic monetary policy. From the spring of 1970 onwards activity tended in general to ease off, but reliance continued to be placed in many countries on tight money in an attempt to curb the stubborn wage inflation. Hence the downward drift in US rates, quickly transmitted to Euro-rates, induced inflows of funds which made it difficult or impossible for some countries to maintain an autonomous credit policy. The fall in rates was frequently resisted, although, naturally, the policy considerations involved varied from country to country depending on the type and degree of inflationary pressure and the state of the balance of payments. In general, national authorities continued to use direct control techniques — mainly quantitative credit ceilings, often covering non-bank financial intermediaries as well as banks, and reinforced in some cases by control on capital issues. Restrictions on the volume of credit were enforced in Japan and in practically all countries of western Europe, the principal exceptions being Germany and Italy. To enhance monetary autonomy most countries also used quantitative controls to regulate the banks' foreign positions and non-bank borrowing abroad.

In Canada the trend in economic activity tended, if anything, to precede US cyclical developments; so interest-rate movements were fairly similar to those already sketched for the United States. In principle, the floating of the Canadian dollar at the end of May 1970 would have made it possible to loosen the ties between the rate structures in the two countries; but, as in the United States, the authorities were faced with a weak economy and high unemployment, so the decline in rates was desirable on domestic grounds. The peak in Canadian long-term rates was reached — like that in short-term rates — at the end of 1969. A brisk demand for long-term funds did no more than check the downward drift of rates in this maturity range.

As regards western Europe, in France and Belgium demand-management policies had already achieved good results by the end of 1969. Thus short-term rates

Short and long-term interest rates.



were allowed in both these countries to decline more or less in line with those on the Euro-dollar market. Long-term rates followed a different pattern. In France they began to edge downwards in the second quarter of 1970, but in Belgium the peak was reached only at the beginning of the fourth quarter.

In Italy and Sweden domestic tensions eased gradually in the second half of the year. In Italy tight conditions obtained in both the short and the long-term market until the second half of 1970, with interest rates rising to peak levels above corresponding Euro-rates. Thereafter monetary policy was gradually relaxed in the presence of slackening aggregate demand. Both long and short-term rates edged downwards, though still remaining above Euro-rates. Capital inflows in 1970 and early 1971 were welcome because they helped offset capital outflows which would otherwise have been unsustainable in view of the reduced surplus on current account. In Sweden very tight monetary conditions were maintained until the fourth quarter of 1970 in order to damp down the economy. The authorities relied mainly on credit ceilings and interest rates stayed rather firm until late in the year. Inflows of funds from abroad prevented a decline in exchange reserves and eased pressure on business liquidity.

In the Netherlands conditions of excess demand continued to prevail up to the spring of 1971. An attempt was made to keep monetary policy restrictive, mainly by way of quantitative credit ceilings together with exchange controls on non-bank borrowing abroad. Credit restraint was, however, largely neutralised by shifts in the terms of payment vis-à-vis foreigners and inflows of foreign capital stimulated partly by the attraction of high-yield assets denominated in guilders. A somewhat similar situation obtained in Switzerland, where the restrictive monetary policy pursued throughout 1970 was based on credit ceilings and capital-issues control. Both short and long-term rates remained quite firm during the year, though below international levels. By the autumn of 1970, however, the decline in rates abroad, even though followed to some extent by a reduction in short-term rates at home, had begun to lead to a repatriation of Swiss assets and thus to a certain weakening of credit restraint.

In Germany excess demand gradually gave way to cost-push inflation during 1970. Monetary policy, however, remained tight. Three-month interbank deposit rates stayed between 9 and 10 per cent. from January until October and thereafter declined only moderately in comparison to other countries until the first quarter of 1971. Huge inflows of funds were thus induced in 1970 and the early months of 1971, and were permitted increasingly to expand domestic liquidity.

The UK authorities maintained a fairly restrictive monetary policy in 1970, though the justification was wage-push rather than demand inflation. Even so, from their peaks in late 1969 short-term rates were allowed to decline in line with Euro-dollar rates until the end of November 1970. As bank advances in sterling were subject to guide-line limitations, and as long-term interest rates remained high, UK companies borrowed substantially in foreign currencies for domestic purposes. Long-term yields reached previously unattained peaks in June 1970; in the second half of the year market conditions eased somewhat but rates were still high relative to those abroad. From December 1970 until the end of March 1971 the authorities, as part of the effort to contain the wage spiral, resisted the fall in rates by keeping Bank rate at 7 per cent. and by selling substantial amounts of gilt-edged.

At the beginning of April 1971 measures were taken in several European countries and in the United States to narrow short-term interest rate differentials. The Bundesbank and the Bank of England reduced their discount rates by 1 per cent. to 5 and 6 per cent. respectively, while the Nederlandsche Bank and the Bank of Italy cut theirs by ½ per cent. to 5½ and 5 per cent. In the first three cases the move was dictated largely by external considerations, but the Bank of Italy was equally concerned to revive domestic investment.

Meanwhile, the US authorities were engaging in another "operation twist" designed to sustain short-term rates while helping long-term yields to decline. This policy, which essentially consists in open-market purchases of bonds combined with sales or reduced purchases of Treasury bills, is intended to check short-term capital outflows while relieving congestion in the bond market and helping to keep down mortgage rates.

Capital movements and the exchange crisis.

From early 1970 huge movements of capital and of banking funds were again a prominent feature of the international monetary scene. Except for the inflow of funds to Canada, which was partly speculative, and for some effects of the 1969 exchange rate adjustments which continued into early 1970, these movements were essentially due to the wide divergences in monetary policies and interest rates described in the previous section. In the exchange crisis of May 1971, of course, speculative and protective considerations dominated the situation.

Broadly speaking, the large flow of banking funds from Europe to the United States in 1969 was reversed in 1970–71. Between the end of 1968 and mid-November 1969, during the period of US domestic monetary tightness, US banks had taken about $9 milliard from the Euro-dollar market through their foreign branches. Then between mid-November 1969 and mid-May 1971 they reduced these takings by over $13 milliard. The outflow has thus been much larger than the 1969 inflow — and more so than the figures cited above would suggest, since some $4 milliard of the 1969 inflow was simply a circular flow through the Euro-dollar market of funds originating in the United States.

In the first four months of 1971 the US authorities acted to mop up a substantial part of the dollars that were flowing into the Euro-market and into other countries' reserves. They did this by selling to the foreign branches of US banks $3 milliard of short-term paper issued specially for that purpose. Consequently, while head-office liabilities to foreign branches declined by $5.5 milliard during those months, the resulting net outflow to other countries was reduced to $2.5 milliard.

On the European side, by far the biggest movement of funds was to Germany, where short-term capital inflows amounted to some $6.5 milliard for the year 1970. Roughly two-thirds of this is estimated to have gone directly to the German corporate sector, partly through short-term borrowing abroad and partly through changes in leads and lags, while $2.2 milliard came in through the German commercial banks. $5.3 milliard out of the total inflow for the year took place between May and November

1970, during which period rates on three-month Euro-dollar deposits declined from 8¾ to 7¼ per cent., while the yields on interbank deposits in Germany were 9–9½ per cent. The inflow was seasonally low in January 1971, but then began to increase again and gathered momentum until the exchange crisis in May.

The second largest inflow was that into the United Kingdom, which for the year 1970 totalled $1.6 milliard. This, however, included a rise of about $850 million in the sterling area's sterling balances, which, in addition to interest rate considerations, resulted from the area's payments surplus and the dollar exchange guarantee provided by the United Kingdom in connection with the Basle Second Group Arrangement. The largest single component of the inflow to the United Kingdom that can be traced simply to differences in monetary conditions was a $730 million increase in the net foreign exchange liabilities of UK banks, mainly related to short-term foreign currency borrowing by UK companies. More than half of this inflow occurred in the last quarter of 1970, prompting the authorities in January 1971 to limit such borrowing for use in the United Kingdom to periods of five years and upwards. Inflows were still heavy during the first quarter of 1971, however, because there was a backlog of foreign borrowing previously approved and because of the expectation of lower interest rates in the United Kingdom.

Other European countries were also affected by the decline in dollar interest rates. In the Netherlands inflows of foreign long-term capital (foreign purchases of Dutch securities and loans taken up abroad by Dutch residents) approximately doubled in 1970 to just on $1 milliard. And, in addition, there was a short-term inflow to the Dutch banks, including a rise of more than $300 million in the banks' guilder liabilities to non-residents. While these movements were primarily related to interest rate differentials, non-residents also increased their guilder holdings for confidence reasons.

In Italy net capital outflows, excluding changes in the banks' external positions, fell between 1969 and 1970 from $3.5 milliard to just under $0.5 milliard. With factors other than interest rate differentials playing an important rôle, however, there was an increase from $0.2 to 2 milliard in foreign loans taken up by Italian enterprises, as well as a sharp decline in the outflow of bank-notes.

In Sweden, where tight monetary conditions were maintained throughout 1970, the external capital account shifted from a net outflow of $0.1 milliard in 1969 to a net inflow of over $0.4 milliard. This shift largely reflected trade credit inflows related to the domestic credit squeeze and the adverse foreign trade balance. In Switzerland declining international yields relative to domestic yields caused money that had been placed in the Euro-currency market in 1969 to be repatriated from late 1970 onwards.

France and Belgium followed interest rate trends in the Euro-currency market more closely than the other European countries. And in Belgium the capital account actually turned from a net inflow to an outflow between 1969 and 1970. In the banking sector, however, there was an inflow in 1970 of about $250 million, including both some build-up of non-residents' franc balances and some borrowing from abroad. In France, on the other hand, capital inflows and movements of banking funds played a large part in the $1.8 milliard net improvement of the reserve position during 1970. To a considerable extent these inflows must have represented a "back-to-normal" movement, at both long and short term, as confidence in the franc strengthened. But during the second quarter of 1970, when short-term inflows amounted to $370 million, there was also substantial short-term borrowing in foreign exchange by French companies to get round domestic credit ceilings. Accordingly, in July 1970 the authorities restricted such borrowing for use inside France to periods of one year and upwards — a measure which led to repayments later in the year.

In Japan the changed relationship between domestic and dollar interest rates in 1970 led to a net short-term inflow of funds of $0.6 milliard, as against an outflow of $1.2 milliard the year before. In the banking sector the net outflow declined between the two years from $1.5 to 0.4 milliard, while in the non-bank sector (including errors and omissions) the net inflow went up from $0.3 to just on 1 milliard.

In Canada the combination of an exceptionally favourable trade balance plus the effects of lower US interest rates produced a large payments surplus during the first five months of last year. In addition, part of the $1.2 milliard of foreign exchange purchased spot and forward by the authorities in that period represented speculative inflows. Later in the year, after the currency was allowed to float at the end of May, and as Canadian short-term interest rates fell into line with those in the United States, there were sizable outflows of funds through the Canadian banks.

These capital movements were the fore-runners of the exchange crisis that erupted in early May. But there were various other factors which contributed to the lack of confidence in the stability of the exchange rate structure. Underlying all was the long-continued payments deficit of the United States and the admitted absence of any programme for a fundamental correction of the situation — unless the theory that other currencies were supposed to adjust to the dollar can be called a programme. Moreover, there had been much talk about the need for reform of the international monetary system by greater flexibility of exchange rates through such devices as "crawling pegs", "wider bands" and "temporary floats". And, over and above the talk, the Deutsche Mark had actually been revalued in October 1969 and the Canadian dollar had been floating since end-May 1970. It therefore is not surprising that the market was prepared to act quickly at the threat of further change.

The crisis itself centred on the Deutsche Mark. While the inflow of foreign exchange had been heavy since early 1970, when German interest rates had been raised abruptly, the rate of inflow jumped to over $800 million in February 1971, and to over $900 million in both March and April. The mounting tension was evident, moreover, from the fact that the Bundesbank felt obliged to sell Deutsche Mark forward in the market on a substantial scale.

The immediate causes of the crisis were two: firstly, it became known that the subject of greater flexibility of the Common Market currencies vis-à-vis the dollar was being discussed by the Council of Ministers and, secondly, the private German economic research institutes publicly advocated the floating of the Deutsche Mark. On 4th May the Bundesbank was obliged to buy about $1 milliard from the market and during the first business hour of 5th May about another milliard. In the face of this flood the authorities stopped further intervention and closed the market. The authorities of Austria, Belgium, the Netherlands and Switzerland followed suit and also stopped intervention in the market.

At the week-end the Council of Ministers of the Common Market, after an all-night session, agreed that there was no reason for any changes in exchange parities of the member countries but acknowledged that floating rates might be required temporarily for some currencies under heavy pressure. Germany and the Netherlands decided to float, while Belgium retained its dual exchange-market system, though separating the two markets entirely so as to channel all capital movements through the financial market in order to avoid any increase in reserves from possible inflows of funds.

Outside the EEC, Austria revalued by 5.05 per cent. and Switzerland by 7.07 per cent.

The expansion of global reserves.

The movements of funds described above, together with the US basic deficit and the introduction of special drawing rights, produced an unprecedented expansion of total official reserves during 1970. Holdings of gold, foreign exchange, IMF reserve positions and special drawing rights increased from $79.2 to 93.5 milliard, or by just on 18 per cent. Excluding the United States, where gross reserves declined, the rise in reserves was even more striking, amounting to $16.8 milliard, or 27 per cent. Of this total, the other countries of the Group of Ten accounted for $13 milliard, with Germany gaining $6.5 milliard, Canada, France and Japan each over $1 milliard and the Netherlands and Switzerland $0.7 milliard each.

Reserves last year also rose substantially outside the Group of Ten. Those of other developed countries, despite a fall of just under $0.4 milliard in South Africa, went up by over $1.2 milliard. The developing countries, mainly those of Latin America and Africa, added a record amount of $2.6 milliard to their reserves.

Besides the increase in volume, there was a marked shift in the composition of reserves. Firstly, 1970 saw the initial introduction of SDRs. Secondly, countries' gold reserves fell by $1.9 milliard, essentially through net transfers of gold to the IMF. Thirdly, and partly offsetting the fall in countries' gold stocks, there was a rise of $1 milliard in their Fund reserve positions. Lastly, and most important, there was a huge increase in gross foreign exchange reserves. In total it amounted to $12.2 milliard, and for countries other than the United States to $14.3 milliard — a rise of 47 per cent. For all countries except the United States the share of foreign exchange in total reserves rose from 49 to 57 per cent., while that of gold holdings declined from 44 to 33 per cent.

In addition to the large rise in total exchange reserves, France and the United Kingdom had exchange receipts last year which they used to repay $3.9 milliard of central-bank assistance — France $1.1 milliard, and the United Kingdom $2.8 milliard. The statistical effect of these operations on total exchange reserves was greater than the amount of assistance repaid, since repayments to the United States, unlike those to other countries, reduce the reserves of the creditor as well as those of the debtor country. As virtually all of last year's $2.1 milliard decline in US official exchange holdings was the result of British and French repayments of assistance, the total effect on reserves of these repayments, both to the United States and to other countries, Changes in global reserves.

Areas and periods	Gold	Foreign exchange	IMF reserve positions	SDRs	Total
	in millions of US dollars				
All countries					
1968	— 570	+ 2,795	+ 740	—	+ 2,965
1969	+ 195	+ 235	+ 240	—	+ 670
1970	— 1,950	+ 12,170	+ 970	+ 3,125	+ 14,315
Group of Ten					
1968	— 2,060	+ 2,185	+ 465	—	+ 590
1969	+ 310	— 1,660	+ 135	—	— 1,215
1970	— 975	+ 8,595	+ 540	+ 2,335	+ 10,495
Other developed countries					
1968	+ 965	+ 130	+ 180	—	+ 1,275
1969	— 145	+ 485	+ 85	—	+ 425
1970	— 805	+ 1,680	+ 60	+ 305	+ 1,240
Developing countries					
1968	+ 525	+ 480	+ 95	—	+ 1,100
1969	+ 30	+ 1,410	+ 20	—	+ 1,460
1970	— 170	+ 1,895	+ 370	+ 485	+ 2,580
All countries excluding United States					
1968	+ 605	+ 1,610	— 130	—	+ 2,085
1969	— 775	+ 985	— 795	—	— 585
1970	— 1,165	+ 14,320	+ 1,360	+ 2,275	+ 16,790
Group of Ten excluding United States					
1968	— 885	+ 1,000	— 405	—	— 290
1969	— 660	— 910	— 900	—	— 2,470
1970	— 190	+ 10,745	+ 930	+ 1,485	+ 12,970
United States					
1968	— 1,175	+ 1,185	+ 870	—	+ 880
1969	+ 970	— 750	+ 1,035	—	+ 1,255
1970	— 785	— 2,150	— 390	+ 850	— 2,475

may be put at $6 milliard. Hence, but for the reversal of special official credit transactions concluded in earlier years, total exchange reserves could have risen by $18 milliard in 1970, other things being equal.

As central-bank assistance to the United Kingdom and France had mostly taken the form of swaps of sterling and French francs against other currencies, last year's repayments brought about a marked reduction in official holdings of these two currencies. Total sterling reserves, despite an increase of about $0.4 milliard in the holdings of sterling-area monetary authorities, declined by $2 milliard, and reserves in French francs by about $1 milliard. Official holdings of Deutsche Mark, on the other hand, increased by some $1 milliard in 1970. On the assumption that there were no other significant changes in official holdings of currencies other than the US dollar, total non-dollar exchange reserves therefore declined during 1970 by about $2 milliard. The increase in dollar exchange reserves was thus greater than the increase in total exchange reserves of all kinds and came to $14.2 milliard. Countries added $7.8 milliard to their official holdings of dollars in the United States; inter-central-bank dollar deposits outside the United States declined by several hundred million dollars as a result of the British and French repayments of assistance; and official holdings, direct and indirect, of dollars in the Euro-dollar market appear to have gone up by getting on for $7 milliard.

To appreciate the significance of this large flow of dollars, it must be remembered that in 1970 the United States had to finance not only last year's underlying payments deficit but also a large short-term outflow, as US banks repaid funds borrowed from the Euro-dollar market the year before. In 1970, therefore, the reserve position of the United States was in effect burdened with the financing of the underlying payments deficits for both 1969 and 1970, as well as with the reversal of the rather artificial surplus on the official settlements account which had been recorded in 1969.

Apart from the US deficit, another factor which affected the growth of total dollar reserves last year was the increased placing of official exchange holdings in the Euro-currency market. Once placed in the market, such funds were often borrowed by residents of countries where domestic monetary conditions were tight, and converted into local currency through the central bank. As a consequence, they would show up in the reserves not only of the central banks from which they came into the market but also in those of the central banks which had bought them. While this mechanism may have been quite significant last year, it was to be expected that the large prevailing interest differentials would have caused very substantial flows of funds through the Euro-market in any case — as happened in 1969, when the magnetic attraction came from the United States.

Last year's huge increase in total dollar reserves thus reflected primarily an exceptional compression into one year of a US payments deficit that would normally have been spread more evenly over the two years 1969 and 1970. However, the persistence of a substantial underlying deficit in the United States is bound to produce substantial increases in dollar reserves even in normal circumstances. One object of introducing SDRs into the monetary system was to reduce the system's reliance on the dollar for bringing about an adequate increase in total reserves over time. The introduction of SDRs, however, does no more than permit this to happen. Its actual realisation will depend on a reduction of existing payments imbalances through the working of the international adjustment process.

United States.

The recessionary tendencies in the US economy which began in the second half of 1969 persisted into the spring months of 1971. Output levelled off and unemployment rose, but the effects on the rate of inflation were disappointingly slow as unions continued to demand substantial wage increases.

It was apparent by late 1969 that the fiscal and monetary restraint maintained over the previous twelve months had brought the long period of boom to an end. Although unemployment was still below 4 per cent. in January 1970, industrial production was down by 2 per cent. from its peak and real gross national product had also declined.

In these circumstances some relaxation of the squeeze on demand was appropriate. The Federal budget was already moving out of surplus, mainly because of increased social security payments and the halving of the 10 per cent. income-tax surcharge on 1st January 1970. However, with government purchases of goods and services declining on account of the cut-back in defence, the total demand stimulus in prospect from the budget was not large. Monetary policy was therefore shifted from severe restraint to moderate ease. The banks were supplied more liberally with reserves, and the money stock (currency plus demand deposits), which had remained almost constant in the second half of 1969, was allowed gradually to reach a growth rate of about 5½ per cent. In addition, interest ceilings under Regulation Q were raised to permit the banks to recoup time deposits.

Short-term interest rates retreated by about one percentage point between January and April. Long-term rates, however, were kept up by strong demand for funds, with corporations seeking to consolidate short-term debt incurred in 1969 and to rebuild their liquidity in the face of rising costs and declining business profits. Furthermore, the Federal Government became a large-scale borrower in the second quarter, as the budget deficit rose sharply to an annual rate of $14.2 milliard (national-accounts basis). A certain atmosphere of apprehension developed in financial markets, which was intensified at the beginning of May by the entry of US forces into Cambodia. The yield on triple-A corporate bonds rose to over 8½ per cent. and that on long-term government bonds to over 7 per cent., while share prices plunged to a seven-year low.

Then, on 19th June, it became known that the Penn Central Transportation Company, the sixth largest corporation in the United States, was insolvent. As the company was defaulting on some $82 million of commercial paper, the Federal Reserve moved quickly to head off a possible crisis of confidence in the financial system. Additional reserves and discount facilities were made available and the Regulation Q ceiling was suspended for large certificates of deposit at 30–89 days' maturity, thus enabling the banks to step in and meet the extra demand for credit.

Thereafter a calmer climate was restored in the money and capital markets. Short-term interest rates resumed their downward movement, while long-term borrowing both by corporations and by State and local governments continued at record levels. The decline in rates accelerated during the autumn, as corporations used the proceeds of bond issues partly to repay bank loans. Between early September 1970 and end-March 1971 the banks' prime lending rate was lowered in nine steps from 8 to 5¼ per cent. and the Federal Reserve discount rate in five steps from 6 to 4¾ per cent. Long-term rates also fell back and at end-March the yield on triple-A bonds was around 7¼ per cent. and that on long-term government paper around 5¾ per cent.

The easing of monetary conditions had a rather limited impact on aggregate demand. Its effect was most marked in the housing sector, where the greater availability of mortgage funds enabled the fall in output to be halted in the second quarter and reversed during the autumn. Business investment, however, continued to decline from its high level at the end of 1969 and consumer spending remained flat in real terms after the second quarter of 1970, despite the abolition of the remaining 5 per cent. surcharge on income tax on 1st July. The volume of consumer credit outstanding grew by only 3½ per cent. during the year ended January 1971, the smallest increase for nearly a decade, and the personal savings ratio rose sharply to 7.5 per cent.

Altogether the real gross national product fluctuated around a stationary level during 1970. The picture was distorted by a drop in output due to the strike at General Motors in the autumn, but the basic recovery in the early months of 1971 was quite modest. A significant margin of spare capacity in the economy was opened up, with the unemployment rate rising steadily to reach 6 per cent. in December and staying at about that level in the early months of 1971.

The increase in unemployment had no discernible effect on wage settlements, which continued to be highly inflationary. Wages plus fringe benefits per man-hour in 1970 were nearly 7 per cent. higher than in 1969, while output per man-hour expanded by only 1½ per cent. At the start of the year the Administration sought to postpone a scheduled pay rise for Federal employees, but the attempt backfired when resentment at the decision among postal workers boiled over into a spontaneous and illegal strike in the second half of March. The outcome was a general 6 per cent. increase in Federal pay scales, the second within twelve months. In November the three-year contract which ended the General Motors strike gave a rise of 12½ per cent. in the first year and of 3 per cent. plus compensation for any cost-of-living increase in each of the two following years. Similar agreements were reached in other parts of industry. The heavy front-loading in these contracts gives some hope that the wage spiral may taper off after current negotiations in the steel industry are concluded.

The persistence of strong wage inflation in a recession year was probably encouraged by the Administration's much-advertised renunciation of incomes policy and possible price control. When it became evident that the increase in unemployment was not leading to a reduction in the size of wage gains, the Administration took some tentative steps in the direction of a prices and wages policy. In June 1970 the President announced the establishment of a Regulations and Purchasing Review Board to adjust government policies which might be contributing to inflation. Subsequently efforts were made to restrain increases in the price of oil by liberalising imports from Canada and raising production on Federal offshore leases.

Stronger measures were adopted, however, with regard to the construction industry, where wage increases were quite out of hand, with first-year gains under new contracts averaging almost 20 per cent. despite high rates of unemployment. In February 1971 the President suspended the Davis-Bacon Act, under which contractors on Federal or federally-assisted building projects — about one-third of total US construction activity — were obliged to pay local union wage scales. A month later this suspension was replaced by a system of wage and price guide-lines for the construction sector. Wage increases are to be reviewed by craft boards composed of union and management representatives in the light of criteria laid down by a Federal committee. The criteria themselves will be based mainly on productivity trends and changes in the cost of living.

In framing the budget for the fiscal year 1971–72 the Administration aimed to permit a renewed upswing in the economy, sufficient to narrow the margin of unused resources but not to recreate demand pressures which would worsen the inflationary spiral. A strong revival was forecast in consumer spending, mainly because of the high savings ratio in 1970–71 and the recovery in the stock market since the autumn. Prospects for industrial investment were weak, but residential construction and State and local-government outlays were expected to increase significantly. In these circumstances the budget was not designed to give a major stimulus. Expenditure at current prices was planned to rise by 8 per cent., mostly because of transfer items. With a projected expansion of 9 per cent. in nominal gross national product and 4½ per cent. in real gross national product from 1970 to 1971, the budget deficit for 1971–72 was estimated at $11.6 milliard, compared with a revised estimate for 1970–71 of $18.6 milliard.

The slow-down in the US economy at a time of continuing pressure on resources in other industrial countries brought an increase in the US trade surplus from $600 million in 1968–69 to $2.2 milliard in 1970. The total surplus on current account widened correspondingly. In relation to the cyclical position this was not a large improvement, particularly since exports were boosted by higher sales of agricultural products and by deliveries of jumbo jets. On the other hand, two-thirds of the rise in imports was due to higher prices, and the US terms of trade showed a deterioration of 2½ per cent. during 1970. This partly reflected the faster rise in unit labour costs in other industrial countries and thus indicated some improvement in the US competitive position after its decline in the later 1960s.

The favourable movement on current account in 1970 was swamped by the turn-round in capital movements, as the easing of monetary policy led US banks to repay the huge sums they had borrowed in the Euro-dollar market the year before. In addition, foreigners bought less US equities in 1970, while US corporations

United States: Balance of payments.[1]

Items	1968		1969		1970	
	in milliards of US dollars					
Balance on goods and services		2.5		1.9		3.7
Net exports of goods and services	5.6		5.2		7.0	
Net military expenditures	− 3.1		− 3.3		− 3.3	
Unilateral transfers		− 4.1		− 3.7		− 3.6
US Government grants and transfers[2]	− 3.4		− 2.9		− 2.7	
Private transfers	− 0.7		− 0.8		− 0.9	
Total I		− 1.6		− 1.8		0.1
Exports of US capital		− 6.4		− 6.5		− 7.4
Official	− 1.0		− 1.3		− 1.1	
Private	− 5.4		− 5.2		− 6.3	
Errors and omissions[3]		− 0.5		− 2.8		− 1.3
Total II		− 6.9		− 9.3		− 8.7
Total I and II		− 8.5		−11.1		− 8.6
Financed by:						
Foreign capital (inflow +)		9.4		12.3		5.2
Private	6.3		4.9		4.5	
Banking	2.6		7.7		0.8	
Commercial banks	3.4		9.2		− 6.5	
Foreign official agencies	− 0.8		− 1.5		7.3	
Other foreign capital	0.5		− 0.3		− 0.1	
Official reserves (increase −)		− 0.9		− 1.2		3.4[4]

[1] Presentation suggested by Professor R. Triffin. [2] Including government grants and credits repayable in foreign currencies. [3] Errors and omissions are considered as consisting mainly of US capital exports to the Euro-dollar market. [4] Excludes initial SDR allocation of $867 million in 1970.

transferred larger sums abroad for direct investment. Altogether, the balance of payments on an official settlements basis, after a surplus of \$2.7 milliard in 1969, recorded a deficit of no less than \$10.7 milliard in 1970 and an even higher rate of deficit in the first quarter of 1971.

The preceding table shows the changes in the financing of the payments deficit on current account plus US capital exports. Though much larger than before 1968, this deficit has varied comparatively little in the past three years, but its financing has altered radically from year to year. In 1968 the major offset was an inflow of private non-bank capital, as foreigners bought US equities and also bonds issued by US corporations overseas. In 1969 banks became the main financing channel, as the US credit squeeze drew in funds through the Euro-dollar market. Finally, in 1970, with funds flowing out of the United States to add to the underlying deficit as monetary policy was relaxed, foreign central banks obligingly took in the over-supply of dollars from the exchange markets.

At the end of November 1970 the Federal Reserve Board, in an effort to limit the outflow of funds, announced stiffer reserve requirements on future increases in Euro-dollar borrowing for banks which reduced their Euro-liabilities below the previous reserve-free base. However, the banks evidently found it too expensive to hold on to their Euro-liabilities, for the movement of funds continued and even accelerated. Action was then taken to mop up part of the outflow by making special short-term securities available to foreign branches of US banks at rates approximately competitive with Euro-dollar rates. Altogether \$3 milliard of such securities were issued between January and April 1971.

Apart from technical measures to contain the outflow of funds, the Administration had no plans for curing the US payments deficit. The Council of Economic Advisers declared in its Annual Report that unilateral policy action by the United States cannot eliminate the deficit so long as other countries insist on running surpluses over and above their SDR allocations. This attitude seems rather far removed from the spirit — and the letter — of the Bretton Woods system, which SDRs are supposed to be preserving.

Germany.

The boom in Germany lost momentum from the spring of 1970, but wage/price inflation continued at a disquieting pace. Foreign demand slackened late in 1969 as an immediate consequence of the revaluation in October. Under the influence of record credit costs, investment, which had risen steeply for nearly three years, was the first component of domestic demand to taper off. This occurred against a background of sharply rising wage costs and a squeeze on profits. Restrictive fiscal policy measures did not prevent a deterioration in the budgets of the public authorities.

As to the effects of revaluation, there was a very quick curtailment of foreign orders, partly in reaction to the earlier anticipatory order boom. Early in 1970, however, they resumed a slightly rising tendency. The rate of growth of exports including invisibles (national-accounts basis) fell back in real terms from 12.6 per cent. in 1969 to 9.0 per cent. in 1970. Total imports increased again at a rate of just over 16 per cent.

As a result the excess of total exports over total imports was reduced in 1970 to 1.4 per cent. of gross national product, as against between 3.8 and 3.0 per cent. in the years 1967–69. The current-account surplus (including a rise of DM 0.9 milliard in unilateral transfers) declined from DM 6.2 to 2.4 milliard. The adjustment took place mainly in the invisibles account. That the trade surplus (f.o.b. basis) actually increased slightly to DM 21.1 milliard reflected the effect of revaluation on the terms of trade as well as the cyclical easing, which particularly depressed imports of raw materials and semi-finished products.

Domestic investment-goods orders started to decline early in 1970. Companies were faced with credit costs exceeding 10 per cent. and diminished self-financing capacity. From mid-year onwards the suspension for seven months of the degressive scale for investment allowances may have dampened investment. All in all, real gross investment in equipment increased in 1970 by over 15 per cent., which was well below the rate of 22.6 per cent. recorded in 1969. Including construction activity, total fixed investment went up in 1970 by 10.7 per cent., compared with 12.1 per cent. the year before. The change in business sentiment also resulted in slower inventory accumulation. Boosted by rising wages and salaries, private consumption increased in real terms by 7.3 per cent., providing a major support for total demand. The growth in public consumption, at 2.9 per cent. in real terms, was quite modest, but in money terms it was as much as 12.8 per cent.

On the supply side, industrial production registered an increase of 6.1 per cent. for the year as a whole, but was flat from the second quarter onwards. There was a slight easing of strains on the labour market, and the seasonally adjusted ratio between vacancies and the total of unemployed came down from 5.9 in the second quarter of 1970 to 4.9 in the last quarter of the year. The rate of growth of real gross national product dropped back from 8.1 per cent. in 1969 to 4.9 per cent. in 1970.

The momentum of inflation is indicated by the rise in the GNP price deflator to 7.4 per cent. for 1970 from 3.5 per cent. the year before. As to the components, construction and public consumption showed price increases of 16 and 9.6 per cent. respectively. The cost of equipment goods went up by 6.2 per cent. and consumer prices by 3.8 per cent. While productivity in industry was stagnating throughout 1970, hourly wage rates rose by 18.5 per cent., following a 10.7 per cent. increase the year before.

Economic policy in Germany has so far sought to come to grips with inflation by restraining both foreign and domestic demand. The public authorities' budget position (excluding the social security institutions) had been relatively restrictive during 1969 but it was less so in 1970. Including the temporary tax surcharge, their overall cash surplus turned round by some DM 7 milliard into a DM 4.5 milliard deficit. For the Federal Government alone, with tax revenue slackening because of the profit squeeze, the budget balance moved from a DM 1.7 milliard surplus in 1969 to a DM 560 million deficit. However, aggregate demand was dampened from July 1970 onwards by the change in depreciation schedules and the 10 per cent. temporary surcharge on corporate and personal income tax. The proceeds of this surcharge came by end-1970 to DM 2.2 milliard, and were deposited with the Bundesbank; they are to be refunded not later than March 1973. Moreover, the Federal and Länder

Supply and use of resources.

Countries	Years	Sources of demand						Resources	
		Consumption		Gross fixed domestic capital formation			Exports of goods and services	Imports of goods and services	Gross national product
		Private	Public	Total	Plant and equipment	Dwellings			
		volume changes, in percentages							
Austria	1968	3.8	3.2	1.9	2.4	– 0.5	10.2	7.2	4.6
	1969	3.3	3.5	4.3	4.8	2.0	16.5	8.9	6.2
	1970	5.8	3.0	10.5	11.0	7.5	15.5	15.4	7.1
Belgium	1968	5.7	4.0	– 2.2	– 1.3	– 4.9	11.8	13.2	3.6
	1969	5.5	7.5	7.1	8.9	1.2	15.6	15.8	6.5
	1970	5.3	5.1	9.8	12.0	3.4	10.9	10.3	5.5
Canada	1968	4.5	3.8	– 0.1	– 2.9	13.5	12.1	9.4	4.9
	1969	5.6	3.2	4.5	2.7	12.1	7.6	11.1	5.1
	1970	2.0	9.6	1.1	4.2	–10.7	9.9	– 0.0	3.3
Denmark	1968	0.9	4.3	– 0.5	1.9	– 9.5	9.0	4.7	3.7
	1969	8.6	7.8	16.1	14.1	25.0	9.1	14.6	7.7
	1970	5.5	5.4	4.8	.	.	5.4	6.5	3.7
Finland	1968	– 0.2	5.9	– 3.6	– 3.9	– 2.7	11.6	– 2.1	2.3
	1969	9.3	5.0	11.1	10.6	12.6	17.6	22.5	9.9
	1970	6.1	6.3	11.7	10.0	17.5	8.3	18.1	7.3
France	1968	5.6	5.6	6.6	7.0	5.4	10.3	12.8	4.8
	1969	7.2	3.6	10.1	10.1	10.0	14.9	18.2	7.9
	1970	4.2	2.0	7.3	7.1	7.9	14.1	6.5	5.8
Germany	1968	4.0	0.0	8.0	10.7	– 0.4	13.0	14.6	7.2
	1969	8.0	4.2	12.1	15.7	– 0.2	12.6	16.7	8.1
	1970	7.3	2.9	10.7	12.7	2.8	9.0	16.1	4.9
Italy	1968	4.7	4.1	7.7	6.6	10.3	15.4	7.5	6.0
	1969	6.3	3.3	8.0	5.1	14.8	13.8	20.6	5.9
	1970	8.0	3.2	3.8	8.4	– 6.1	6.0	17.2	5.1
Japan.	1968	9.5	6.9	22.1	23.2	17.5	22.5	12.8	14.4
	1969	9.5	5.9	17.5	18.2	14.6	20.0	14.4	12.1
	1970	7.9	4.8	14.4	14.7	13.0	16.2	20.8	11.5
Netherlands. . .	1968	5.9	1.2	11.6	12.3	8.8	12.3	13.2	6.7
	1969	4.0	1.7	0.6	2.1	– 3.8	15.6	14.5	5.1
	1970	7.5	4.0	7.5	9.0	1.0	12.5	14.5	6.0
Norway	1968	3.9	4.6	– 9.3	–11.9	6.1	10.9	0.0	4.0
	1969	7.8	6.5	– 3.9	– 5.4	4.0	6.7	5.4	5.5
	1970	2.0	3.8	15.5	17.2	7.8	1.5	13.1	2.9
Spain	1968	4.2	4.1	2.7	1.6	8.3	22.1	6.4	5.7
	1969	6.6	2.9	13.9	14.6	10.5	13.8	16.4	7.4
	1970	5.0	3.2	24.1	.	.	24.1	9.8	6.6
Sweden	1968	4.5	5.7	– 0.3	– 0.7	1.3	8.8	8.7	4.0
	1969	4.5	5.4	3.7	3.7	3.5	12.8	13.9	5.7
	1970	3.5	5.3	0.8	2.5	– 5.0	7.6	10.0	4.4
Switzerland . . .	1968	3.2	0.8	4.3	4.4	3.9	10.8	8.1	4.2
	1969	4.9	4.9	7.8	6.9	11.1	12.9	13.0	5.9
	1970	5.1	4.1	8.8	8.0	11.5	7.4	13.3	4.3
United Kingdom .	1968	2.3	0.3	5.5	5.7	5.0	10.7	7.9	3.2
	1969	0.4	– 1.0	– 2.7	– 0.8	–10.1	9.8	3.0	1.9
	1970	2.9	1.5	1.4	4.0	– 9.9	4.6	6.0	2.0
United States . .	1968	5.2	6.3	5.1	3.1	13.9	8.6	16.4	4.7
	1969	3.4	0.5	3.4	4.1	0.8	6.1	7.6	2.8
	1970	2.0	– 3.8	– 4.4	– 2.6	–11.7	7.4	3.1	– 0.4

Governments sterilised a combined total of DM 2.5 milliard in a counter-cyclical reserve fund.

By increasing the discount rate to 7½ per cent. and the lombard rate to 9½ per cent. in March 1970, the Bundesbank raised the cost of domestic credit, but this set off capital inflows. In July, after the fiscal action taken and with interest rates abroad falling, the Bundesbank reduced its rates by half a percentage point, but by this time the inflows had already begun to accelerate. To help offset these additions to liquidity, the authorities relied largely on increases in minimum reserve requirements. Towards the end of the year the Bundesbank refrained from offsetting as much of the inflow as it had done previously, and in November and December it lowered the discount rate in two steps to 6 per cent. and the lombard rate to 7½ per cent. These moves, though still primarily aimed at discouraging capital inflows, were viewed as consistent with the slight easing of domestic demand pressures. However, the divergence between domestic and foreign monetary conditions continued to induce German borrowers to circumvent the Bundesbank's restrictive policy by raising funds abroad. Not only did long-term capital exports decline from DM 22.9 milliard in 1969 to DM 4.4 milliard, but short-term inflows, including unrecorded items, totalled DM 23.9 milliard, or slightly more than the 1970 rise in official exchange reserves.

During the first few months of 1971 aggregate demand ceased to weaken. An exceptionally mild winter, the reinstatement in February of the degressive scale for depreciation allowances, the growth of public expenditure and private consumption, all contributed to a certain recovery in economic activity. Though continuing to ease somewhat, monetary conditions remained tighter than abroad and foreign exchange inflows accelerated despite a cut in the discount rate on 1st April from 6 to 5 per cent. With exports also rising again, the prospective level of total demand seemed unlikely to help combat cost inflation. The year-to-year rise in unit labour costs was around 10 per cent. in the first quarter of 1971. In April wholesale and consumer prices were respectively 5.2 and 4.9 per cent. higher than a year earlier.

Faced with these developments, in late April the authorities considered new stabilisation measures. As the contemplated policy options were scarcely concealed, a speculative tide of foreign funds flooded into Germany, leading the authorities on 10th May to permit the Deutsche Mark to float upwards. To back up this move, a ban was imposed on interest payments on non-residents' deposits and non-residents were barred from acquiring certain money-market instruments. A cut in Federal expenditure and the sterilisation of public funds with the Bundesbank were envisaged. In so far as the Deutsche Mark remains above its former level, this should help to dampen economic activity both directly through its impact on net foreign demand and indirectly by allowing a more autonomous monetary policy.

United Kingdom.

For the past eighteen months the United Kingdom has been in the grip of a strong inflationary spiral started and sustained by trade-union bargaining power. The absence of demand pressure when the upsurge began in the autumn of 1969 was clear. Domestic expenditures were being kept on a tight rein by fiscal and monetary measures; and while exports had risen sharply, bringing the balance of payments into surplus, real output in the second half of 1969 was only 1.8 per cent. higher than a year previously. Job vacancies had levelled off and unemployment was rising.

In this situation the explosion of wage demands partly reflected dissatisfaction at the small advance of real wages over the previous year, when resources were being shifted into the balance of payments. Partly also it was attributable to a longer-standing discontent with three years of incomes policy and to the fact that the loosening of the policy itself made possible, if it did not positively encourage, larger demands. Several wage settlements towards the end of 1969 had gone far beyond the guide-lines; and in the early months of 1970, amid a rash of strikes, increases in the 10–15 per cent. range were common. This compared with an average of 5–5½ per cent. per annum over the previous five years.

Even apart from the coming general election, the climate was not one in which the authorities felt able effectively to reimpose wage restraint. However, only moderate relaxation of fiscal and monetary policy was announced in the April budget, because the growth of wages was itself regarded as a significant expansionary factor in the demand outlook. The government accounts were to remain in overall surplus and domestic credit was to expand by not more than £900 million in the financial year 1970–71. Even so, total final expenditure was expected to grow by 4 per cent. in real terms between the first halves of 1970 and 1971. Allowing for some acceleration in the rise of imports, a 3.5 per cent. increase in the gross domestic product was projected, together with a substantial continuing surplus in the balance of payments.

After the general election in June the Conservative Government confirmed the restrictive stance of monetary and fiscal policy, while announcing its intention to undertake longer-term reforms, particularly in the fields of government spending, taxation and industrial relations. The guide-lines for bank lending fixed at the time of the budget were that clearing-bank credit to the private sector other than for exports and shipbuilding under the medium-term fixed-rate schemes could expand gradually by not more than 5 per cent. during the financial year. By mid-July the figure was already close to 4 per cent., partly because there was little borrowing by industry on the long-term capital market and partly because of a surge in lending to individuals. The banks were then urgently requested to limit their lending. Although the import deposit requirement was reduced from 30 to 20 per cent. in September and abolished altogether in December, a further call was made late in October for special deposits from the banks in order to maintain the credit squeeze. At the same time cuts were announced in corporation tax and income tax to take effect from January and April 1971, but these were to be fully offset by economies in government spending, including unemployment and sickness benefits, agricultural and industrial support programmes and capital outlays of nationalised industries.

On the wages problem the new government from the start forswore any recourse to a statutory incomes policy and abolished the institutional remnants inherited from its predecessor. Powers to impose a three-month standstill on wage and price increases were allowed to lapse and the National Board for Prices and Incomes was wound up.

Great importance was attached, however, to a major legal reform of the system of industrial relations and collective bargaining. Previous law on these matters in

Britain was essentially confined to the Trade Disputes Act of 1906, which, while freeing trade unions from civil liabilities, basically enshrined the view that industrial relations were none of the law's business. The new Industrial Relations Bill and that of the Labour Government differ from one another in major points of detail. There appears to be a broad consensus on the need for a new approach. Both bills draw heavily on the report of the Donovan Commission on Trade Unions and Employers' Associations and both are designed, by providing for the legal enforcement of collective agreements and in other ways, to alleviate the characteristic British problems of unofficial strikes, demarcation disputes and leapfrogging wage claims. Compared with the law in other countries the present bill is not very far-reaching; but, if fully enforced, it will represent a big step forward.

During the autumn of 1970 and the early months of 1971 it became increasingly apparent that the strategy of restrictive demand management combined with a certain aloofness towards private-sector wage settlements was not slowing down the inflationary spiral. Despite the significant degree of slack in the economy, earnings early in 1970 were 14 per cent. higher than a year before. In November a six-week strike by local-authority manual workers was settled when a committee of inquiry awarded a pay rise of 15 per cent. This brought a shift in the government's attitude, which now stressed the importance of resisting exorbitant wage demands and of achieving a gradual de-escalation in the size of pay awards. The authorities rejected high wage claims by the power workers in December and the postal workers in January, and on both occasions strike action was first taken and then called off in favour of an official inquiry which led to 9 per cent. increases in both cases. In the private sector, however, there were several major settlements in the 16–17 per cent. bracket. The Ford Motor Company was even obliged to concede a 16 per cent. increase for two years running. As the company was concerned about its competitive position, this result shows how hard it is for private industry to resist a strike successfully without active support from the government in the form of incomes policy and perhaps in other ways.

The other aspect of the situation was that the growth of national product projected at the time of the 1970 budget did not materialise. Every major component of expenditure except stock-building fell short of expectations. Total fixed investment rose very little and house-building, under the influence of fiscal and monetary restraint, actually declined by 8 per cent. in real terms between the second halves of 1969 and 1970. Exports of goods and services gained a mere 0.5 per cent. in volume over the same twelve months, while imports, partly reflecting the high level of stock-building in the second half of 1970, showed a large increase of 7.7 per cent. There was a modest rise in public consumption; and private consumption expanded by 3.3 per cent. as against the 4 per cent. projected, mainly because the personal savings ratio rose for the second year in succession from its low level in 1967–68. Altogether the gross domestic product increased by only 1.8 per cent. and the margin of unused resources in the economy widened. The trend continued in the first quarter of 1971, with industrial investment showing signs of weakness and the failures of Rolls-Royce and Vehicle and General Assurance adding to uncertainty in the business climate. In April registered unemployment reached 800,000 — 3.3 per cent. of the labour force — and unfilled vacancies fell to under 200,000.

The unfavourable movement of export and import volumes was not matched by an equal deterioration in the balance of payments on current account. This was because, with import prices steady after the first quarter of 1970 and the rise of export prices accelerating, the UK terms of trade improved by no less than 7 per cent. between May 1970 and January 1971. While the stronger competitive position dating from the 1967 devaluation gave some scope for a movement of this kind, its continuation would inevitably lead to a recurrence of the old payments weakness. The current-account surplus for 1970 came to £631 million (compared with £437 million in 1969) and in the first quarter of 1971 was still running at an annual rate close to £400 million.

On top of this there was a massive net inflow of funds, due partly to payments surpluses in the overseas sterling area and partly to the differential in interest rates and credit availability between Britain and the United States. Sterling lending by clearing banks to the UK private sector not merely ceased to expand but actually declined somewhat between September and March, as British firms borrowed substantial amounts in foreign currencies instead. In January the authorities announced a ban on foreign currency borrowing for domestic use for terms of less than five years, and also on all borrowing of sterling from non-sterling-area residents. The object was both to reinforce the credit squeeze and to lessen the volatile element of the increase in official exchange reserves. The inflow of funds continued at a high rate, however, because of the backlog of previously approved applications for Euro-currency borrowing and also because foreigners were buying UK bonds in the expectation of a decline in interest rates. As these expectations gathered strength both at home and abroad, the authorities were able to sell very substantial amounts of gilt-edged with little movement in prices.

Altogether, the balance-of-payments surplus enabled nearly £2,000 million of official external debt to be repaid between December 1969 and March 1971, leaving only IMF drawings of £683 million still outstanding.

With a favourable position on the balance of payments and significant under-employment in the economy, the authorities decided to lessen somewhat the emphasis on demand management as a means of stopping wage-push. The 1971 budget was designed to give some stimulus to output and revive business confidence. Along with the tax cuts announced previously, certain personal tax allowances were raised, corporation tax was reduced by another 2½ per cent. to 40 per cent. and selective employment tax rates were halved with effect from July. As a result of these changes, and correcting for the impact of the postal strike on the timing of tax receipts, the central government's overall financial balance was expected to swing from a surplus of £300 million in 1970–71 to a deficit of nearly £900 million in 1971–72.

The guide-lines for bank credit were also relaxed somewhat. However, the reduction of Bank rate by 1 per cent. to 6 per cent. two days after the budget was not intended to add to the easing of monetary policy, but rather, following a similar move by the Bundesbank, to stem the inflow of funds.

With the stimulus of the new measures, total final expenditure was expected to grow by 4 per cent. in real terms between the first halves of 1971 and 1972. The forecast was for a 5.3 per cent. rise in consumer spending, little change in private investment and a 2 per cent. rise in public-sector outlays on goods and services. With imports expected to grow faster than final expenditure, an increase of just over 3 per cent. was projected in gross domestic product. Expansion at this rate would not imply a narrowing of the economy's margin of spare capacity. In fact, the government has declared that if there is no let-up in the wage/price spiral there may be some further increase in unemployment.

France.

The adjustment of the franc and DM parities and the domestic stabilisation measures adopted during 1969 contributed promptly and decisively to restoring balance-of-payments equilibrium and checking internal demand pressures. At the beginning of last year the main objective was to consolidate these gains and to slow down wage and price increases.

Exports continued to advance rapidly in the first half of 1970, assisted by rising output and prices in EEC markets. Private investment, though expanding less than in 1969, was still running at a high level, stimulated by the sharp increases in wage costs since 1968 and continuing pressures on capacity. Moreover, the impact of the credit restrictions seems to have been mitigated by borrowing abroad and inter-company financing. But public spending was held in check and, as the growth of private consumption slowed down, overall demand eased.

With wage increases at an annual rate of over 10 per cent. boosting personal incomes, the long pause in consumption was somewhat unexpected. But fiscal and credit restraints were severe, activity was decelerating and there had been a spending boom a year earlier. Improved incentives to savings and especially the maintenance of high deposit rates have also played a part.

In these circumstances, credit controls were modified cautiously. Hire-purchase restrictions were liberalised selectively in stages between February and October. Quantitative credit limitations were relaxed in the spring, first for export credits and then for medium-term investment credits. They were terminated for most rediscountable medium-term equipment credits in June and for all other types of credit in October.

In view of the persistent wage and price pressures, however, the authorities sought to avoid sharp declines in domestic interest rates and also to limit the effect on bank liquidity of inflows of short and long-term funds in the spring and summer by raising first the coefficient for the banks' minimum holdings of medium-term paper and then their compulsory reserve ratios. The ratio applicable to the banks' compulsory dollar deposits at the Bank of France, introduced early in 1969, was reduced from 100 to 50 per cent. of any bank's net credit position in foreign currencies vis-à-vis non-residents and the requirement was terminated in July. Inflows were checked in July by exchange-control amendments restricting domestic enterprises' short-term borrowing abroad. Eventually, as interest rates abroad declined further, the Bank of France's discount rate was reduced from 8 to 6½ per cent. in three stages in August and October 1970 and January 1971.

Budgetary policy remained rather restrictive throughout the year. In the summer the government announced the first of a series of releases of investment project authorisations blocked during 1969 and early 1970, but took care to keep the 1970 budget in balance. The government's 1971 budget was also presented in balance, though a small deficit now seems likely.

After the devaluation exports at first expanded strongly against a background of capacity shortages and rising economic activity abroad. The foreign currency prices of French exports fell very little and there was an appreciable increase in export profitability. But export growth slowed down in the summer as a result mainly of cyclical developments abroad. The external deficit on current account, which had exceeded $2 milliard in 1969, was eliminated but, reflecting also an upturn in imports associated mainly with restocking, the surplus realised last year was small. However, foreign trade results for early 1971 were still satisfactory and the basic position appears sound. There has been a selective relaxation of exchange controls, notably on French enterprises' investments abroad and foreign travel.

Private consumption quickened somewhat from the autumn onwards with a revival of spending on durables, but overall demand still grew modestly. Strains on resources were considerably reduced by late 1970 and early 1971, but after many months of deterioration the employment situation has recently improved slightly, with substantial shortages of skilled labour in certain sectors.

The pace of wage and price increases has been rather slow in responding to the easing of demand conditions. Hourly wage rates advanced by some 3 per cent. in the first quarter of 1971, bringing the rise over the twelve-month period to over 10 per cent. Key wage settlements in the public sector in early 1971 provided for comparatively moderate increases but introduced a cost-of-living and a productivity adjustment element. Adaptation to devaluation and price developments abroad generally made the task of stabilising prices more difficult last year, whilst structural problems and persistent excess demand in some sectors helped to perpetuate inflation. Price increases are still under government surveillance, and selective reductions in value added tax have been employed to limit the upward movement in consumer prices.

In the spring of 1971 policy was still directed at avoiding too sharp a resurgence of domestic demand. By intervening in the money market at rates lower than the discount rate and in line with Euro-dollar rates, the Bank of France helped to limit inflows of funds. Compulsory reserve requirements against increases in outstanding credits were introduced in April, and raised in May, along with rises in the reserve ratios against domestic and foreign deposits and a raising of the discount rate to 6¾ per cent.

Italy.

At the beginning of 1970 the Italian economy was faced with three major problems: to contain the wage/price spiral, to restore the balance of payments to a sustainable position, and to revive the growth of production and productivity after the serious output losses recorded in the second half of 1969 as a result of the "hot autumn" strikes.

During the first quarter an increasing rate of inflation and a deterioration in the overall balance-of-payments deficit seemed to indicate that these were the most serious difficulties that would have to be faced in the course of the year, since industrial activity showed good signs of recovery, climbing to new record levels. Monetary policy was thus initially held to a fairly restrictive stance, while various ad hoc measures were taken both to prevent capital outflows and to encourage foreign borrowing.

However, from the spring onwards the situation began to change. On the one hand, industrial production stopped expanding, to remain practically stationary for the rest of the year. On the other hand, the acceleration in the price rise came to a halt, and a more appropriate balance-of-payments situation was achieved in the sense that a reduced surplus on current account was accompanied by a significant improvement in the balance on capital flows, largely policy-induced.

The stagnation in production was not initially due to a deficiency in aggregate demand, but to a disappointingly low response of the economy, and more specifically to a marked slow-down in productivity growth. With producer-price rises fairly contained, the very high wage increases — hourly wage rates in industry in June were nearly 21 per cent. above their level a year earlier — and significant rises in raw-material costs were absorbed by enterprises' accepting lower profit margins. This implied a reduced capacity for self-financing and a scaling-down of investment projects, the latter being also partly due to the limited availability and the high cost of external finance. In these circumstances, while the restrictive monetary policy adopted had probably had a significant effect on both the balance-of-payments situation and the evolution of prices and wages, it became apparent that more comprehensive action on the part of the authorities was needed, not least in view of the fact that the public sector's deficit was threatening to assume unsustainable proportions. The unexpected slow-down in the momentum of growth was beginning to cause shortfalls in revenue, while the already high rate of expenditure would have had to be stepped up to finance structural reforms of certain key sectors.

At the end of August fiscal measures were taken — consisting mainly of increases in indirect taxes and social security contributions. This fiscal action, which was expected to produce an overall yield of about 1 per cent. of gross national product, was intended to influence the allocation of global expenditure, i.e. to limit private consumption and make way for social consumption outlays. At the same time monetary policy was relaxed — a move that was also warranted on external grounds. After a short-lived speculative run on the lira in July, which brought the spot quotation down to the lower intervention point and gave rise to a forward discount of 17 per cent. at an annual rate against the dollar, the overall balance-of-payments position continued to improve as a result of heavy capital inflows. Thus, with interest rates on the international markets falling, it was possible to allow domestic rates to move gradually downwards, while still retaining a differential to encourage capital inflows and discourage outflows.

At the end of the third quarter there were general expectations of a substantial quickening of the momentum of economic activity, with productivity gains finally taking place. In September official sources were still anticipating an overall growth in real gross national product in 1970 of nearly 7 per cent. It should be pointed out that this result would in itself have been only moderately satisfactory, since it was based on a comparison with 1969, when the economy had suffered from production losses estimated at 2 per cent. of gross national product in real terms. However, the results for the final quarter, and consequently for the year as a whole, fell short of these forecasts. Investment spending failed to pick up, and industrial production, after recovering at the beginning of the year from the strikes, remained practically at the same level. In particular, GNP growth came to only 5.1 per cent. in real terms. In the early months of 1971 industrial production actually declined, and by March it was some 5 per cent. below the level of twelve months before.

Two main factors appear to have been holding back growth in production and productivity since the first quarter of 1970. Labour difficulties rank first. On the one hand, intermittent strikes, general labour unrest and absenteeism were a characteristic feature of economic developments during 1970 and early 1971; on the other hand, the cut in working hours and the virtual banning of overtime as from the end of the 1969 strikes substantially reduced the short-term productive potential of the economy. The second factor is that since late 1970 the situation has gradually evolved towards a slackening of aggregate demand, with consumer spending and, especially, productive investment levelling off and house-building continuing in its recessionary phase.

The need to improve labour relations and to reactivate output and productivity growth and capital spending hardly requires emphasising. In fact, only if the economy goes back to a satisfactory growth pattern does the expensive programme of social reforms to which the government is committed appear feasible.

Japan.

Having chalked up an average real growth rate of 12½ per cent. over the four years 1966–69, the Japanese economy finally slipped into recession — Japanese style — in the last quarter of 1970. The growth rate fell to 8.3 per cent.! Nevertheless, over the year as a whole the economy expanded by 11.5 per cent.

Restrictive monetary measures had been adopted in the autumn of 1969 to cool down the overheated economy, but for six months afterwards the boom continued headlong. From the spring of 1970, however, the effects of the measures began to be felt and by the autumn there were unmistakable signs of a slackening in business activity. Plant and equipment investment declined and sales of some durable consumer goods, notably cars and household appliances, fell off. Industrial production, which had been rising at an annual rate of nearly 18 per cent. up to July, showed no further growth for the rest of the year and in fact declined in the final quarter.

Although during 1970 as a whole most sources of demand were weaker than in the previous year, exports and plant and equipment outlays continued to give a strong expansionary impulse; both went up in real terms by around 15 per cent., compared with 20 per cent. the year before. Housing construction, too, increased by 13 per cent., very little less than in the previous year, while the rise in private consumption was reduced to 8 per cent. from the 10 per cent. of 1969. Stocks expanded substantially, reflecting the fall-off in sales of finished goods in the second half of the year.

Little progress was made in 1970 in checking the inflationary spiral of prices and wages which had started the year before. It is true that the rise in wholesale prices was halted, but no such tendency was discernible in the course of consumer prices. At the end of 1970 they stood over 8 per cent. higher than a year earlier. Wages, which had increased by 16½ per cent. in 1969, went up by 17½ per cent. in 1970. In the last quarter, however, there were signs of easing in the rate of advance, and this trend may have begun to moderate the rise in consumer prices in the early months of this year.

Faced with a sharper deceleration of activity than had been expected, the authorities took major steps in the autumn of 1970 to ease monetary conditions. The permissible growth of city-bank lending, which had gradually been raised during the year, was increased further in the final quarter, and at the beginning of 1971 the ceiling was removed completely; the discount rate was reduced twice, by a total of half a percentage point; and government expenditure policy was geared to allow greater flexibility, with the help of additional bond issues, in order to counteract, if necessary, any persistent recessionary tendencies. The budget for the fiscal year 1971–72, although basically neutral, provides for an increase of 18½ per cent. in general-account expenditure, compared with a forecast rise of 15 per cent. in nominal gross national product.

In a year when domestic activity declined, one preoccupation of the authorities was to avoid an increase in the already large overall balance-of-payments surplus. And, in fact, the overall surplus fell from $2.3 milliard in 1969 to $1.4 milliard last year. The major change took place on long-term capital account; a net outflow of only $0.2 milliard in 1969 expanded into one of $1.6 milliard last year with the help of official measures. On current account, which had actually improved during the inflationary boom of 1969, the large surplus continued during 1970, and indeed began to increase as the strain of domestic demand eased. Despite measures to damp down exports and encourage imports, the trade surplus grew from $3.7 milliard to over $4 milliard. Exports, after having risen by 23 per cent. in 1969, went up by a further 21 per cent. in 1970, while imports, which rose by 17 per cent. in 1969, expanded by 25 per cent. last year. However, with the decline in domestic activity in the second half of the year, the rate of growth of imports slackened appreciably, while that of exports accelerated.

Official reserves, which had risen by $0.8 milliard in 1969, went up by $1 milliard last year and, including the first allocation of SDRs, stood at $4.8 milliard at the end of the year. They would have been higher still had not the Bank of Japan in mid-year encouraged the repayment of foreign borrowing by making yen loans to the banks at favourable rates. With interest rates abroad and in the Euro-dollar market declining, the banks' net foreign position, which had improved by as much as $1.5 milliard in 1969, improved by only a further $0.4 milliard in 1970.

It is hoped that the removal of credit restrictions from the beginning of 1971 will quickly stimulate the economy to resume a higher growth path. However, in the first quarter of this year there were few signs of a pick-up. Bank lending was accelerating and exports were continuing to surge ahead. But a sharp fall of nearly 25 per cent. in new orders for machinery in the last quarter of 1970 points to no quick recovery in business equipment investment; this is confirmed by surveys of investment intentions, particularly in the motor, electrical machinery and iron and steel industries. Undue delay in the reaction of the economy to the expansionary measures taken so far would be liable to push up the already large current-account surplus; but then further stimulating measures by the authorities would be likely. Owing to exchange controls and the firm stand of the authorities against revaluation, Japan has not had a substantial speculative inflow of funds.

Canada.

At the beginning of 1970, despite some slowing-down in the pace of inflation, the policy of the Canadian authorities was still to give top priority to curbing the wage/price spiral. However, with unemployment rising sharply, monetary and fiscal restraint was gradually relaxed, initially to prevent a fully-fledged recession from taking place, but subsequently, when the price situation appeared to be under much better control, to steer the economy back to growth in line with its potential.

Relaxation of monetary policy started gradually towards the end of the first quarter of 1970, with monetary aggregates beginning to show a considerably higher rate of increase from April onwards. However, owing to relatively weak overall demand for funds, interest rates had already begun to decline in January, and the downward drift continued until the first quarter of 1971. Despite their fall, Canadian short-term rates stayed above the corresponding US rates for the first quarter of 1970, checking short-term capital outflows. At the same time a large volume of new bond issues abroad led to an increase in the already heavy inflow of long-term capital. Simultaneously, and somewhat unexpectedly, there was a substantial improvement in the balance of payments on current account. The Canadian dollar went close to the upper intervention point and the authorities had to purchase large amounts of foreign exchange. This trend continued in the second quarter, when huge short-term capital inflows occurred and the current-account balance strengthened further. The resultant reserve growth posed serious problems for domestic monetary management, since it was felt to be entailing a degree of expansion of internal liquidity that was not appropriate at that time. At the end of May the Canadian authorities consequently decided to let their currency float. At the same time they lowered Bank rate, mainly in order to discourage possible speculative inflows and hence to avoid exchange uncertainties. The dollar soon appreciated by approximately 4 per cent. relative to the previous official parity, and continued to rise slowly to reach near-parity with the US dollar by the end of the first quarter of 1971.

The shift towards an expansive economic policy which took place in 1970 was clearly reflected in fiscal action. Already in the first quarter government expenditure in both nominal and real terms showed a considerable increase compared with the year-earlier level and remained high throughout the year, partly as a result of the expansionary measures taken in the March budget. The Federal Government sector thus shifted from a surplus of \$775 million on a national-accounts basis in 1969 to virtual balance in 1970. In fact, the high level of public expenditure was one of the two main factors which prevented a serious recession from occurring in 1970, the other being the pull exerted by foreign demand. The supplementary budget presented in December 1970 indicated further expansion in 1971 notwithstanding the extension of the 3 per cent. surtax on personal and corporate incomes until the end of the year.

The loss of momentum in economic growth in the first part of 1970 was reflected in particular in a high and rising level of unemployment. The seasonally adjusted unemployment rate, which stood at 4.7 per cent. at the beginning of 1970, increased steadily until September to reach a peak of 6.8 per cent. Thereafter it gradually came down to 6.2 per cent. in January 1971.

Despite the considerable under-utilisation of labour resources, the real growth in gross national product for 1970 as a whole, at 3.3 per cent., was relatively high and accelerated in the second half of the year. The annual rate of growth between the fourth quarter of 1969 and the second quarter of 1970 was 1.7 per cent. In the third quarter of 1970 real gross national product expanded at an annual rate of 2 per cent., and in the fourth quarter of the year the rate of growth rose to 6 per cent., in spite of the impact of the strike in the motor industry, which lasted even longer in Canada than in the United States.

Some success was, in fact, achieved in 1970 in the fight against inflation. This is brought out particularly clearly by the behaviour of the consumer-price index, which, after rising steeply between February 1969 and August 1969, increased at the rate of 3 per cent. until July 1970, and finally showed an actual decline of over 1 per cent. on an annual basis between July and December 1970. It is true that the striking development of this index was influenced by special favourable factors which affected, in particular, food prices. However, other price indicators also showed clear signs of deceleration during the year. The GNP deflator, for instance, went up at an annual rate of only 1.8 per cent. from the second to the fourth quarter of 1970, the increase being concentrated almost exclusively in the third quarter.

Concern must, however, be expressed as regards wage increases. Averaging about 8 per cent. during the year, these remained well above productivity gains and showed no signs of abating in spite of the high and rising level of unemployment and the attempts of the Prices and Incomes Commission to bring them down. The Commission had been set up at the end of 1969 with the object of introducing a prices and incomes policy. It achieved some success in 1970 on the price front by securing the co-operation of business in moderating price rises, but it failed to obtain the collaboration of the trade unions in accepting guide-lines on wage increases. The scissor-like movement of prices and wages caused the business community to withdraw its support from the Commission late in 1970, so that the experiment of introducing an incomes policy was more or less abortive. Productivity gains — usually strong in the phase of recovery following a slow-down in economic activity — are likely to go some way towards offsetting wage increases in the near future. Nevertheless, the need gradually to moderate wage rises appears in Canada, as elsewhere, to be a prerequisite for achieving sustainable and balanced growth.

In the spring of 1971, although some consolidation of the pace of growth seemed to have taken place — with aggregate demand boosted by government expenditure, housing and consumer spending — unemployment was still a serious cause for concern and prices were again showing a marked upward tendency.

Belgium.

Following a strong cyclical upswing in 1969, which quickly pushed the Belgian economy to the stage of overheating, the expansion of aggregate demand continued last year, though at a less rapid pace. At the same time supply became easier, so that Belgium was able in 1970 to achieve more or less all the main objectives of economic policy. On the domestic side, the growth rate of the gross national product at constant prices remained high and a satisfactory level of employment was attained, while on the price front the upward movement slowed down so that in this respect Belgium achieved, if not real stability, at least a position at the lower end of the international scale of inflation. Externally, the overall balance of payments moved closer to equilibrium, the surplus being reduced to some $100 million last year.

The moderate cooling-down of the economic temperature to a more normal level was reflected in a decline in the growth rate of real gross national product from 6.5 per cent. in 1969 to 5.5 per cent. in 1970. The expansion, however, received an even stronger boost than before from fixed capital investment, which rose by almost 10 per cent. in real terms. During the first half of 1970 private consumption increased only modestly. This was largely the after-effect of the earlier anticipatory buying when it was expected that the value added tax would be introduced on 1st January 1970; in fact, its introduction was postponed for a year. After the middle of the year private consumption accelerated with the growth of disposable income and in renewed anticipation of the value added tax.

The imminent introduction of the value added tax also had an impact on stocks of finished products: after tending to rise during the first three quarters of the year, they were generally run down in the last quarter of 1970, both in industry and in certain branches of trade. Altogether, additions to stocks last year were only about half those in the preceding year. Two further factors contributed to the easing of boom conditions in Belgium. On the one hand, public consumption rose less strongly than in 1969. On the other hand, foreign demand, which had played a decisive rôle in the economic upswing of 1969, expanded more slowly during the following year.

Industrial production (excluding construction) started to stagnate in the second quarter of 1970. Consequently, its year-to-year rate of increase slowed down from 11 per cent. in the first quarter to about 5.5 per cent. in the third. Towards the end of the year, however, a renewed upswing was apparent. The average degree of capacity utilisation declined only marginally and order books remained well-filled, reaching a level of 4.3 months' output at the end of January 1971. In the building sector activity was very brisk throughout the year.

The downward trend in unemployment came to a standstill early in 1970, when a very low level had been reached, but there was a further modest decline in January 1971. The current level of unemployment is largely structural. After reaching a peak in the first quarter of last year, unfilled vacancies remained on a high plateau until the end of July and showed a slight, gradual decline during the following months. Owing to the tight situation on the labour market and the high level of economic activity, the rise in wages accelerated. Hourly earnings of workers in industry rose by 11.2 per cent. between December 1969 and December 1970. Profit margins in industry were noticeably reduced by the strong advance in wage costs and fuel prices, which the modest improvement in productivity was insufficient to offset.

From the beginning of the second quarter of 1970 onwards a gradual deceleration of the rise in industrial wholesale prices became apparent, their year-to-year growth rate slowing down from an average of 6.6 per cent. in the first quarter to 4.3 per cent. in the fourth quarter. A similar tendency was observable in the development of consumer prices; their comparable rate of growth declined from 4.3 to 3.3 per cent. The introduction of the value added tax on 1st January 1971 has so far affected consumer prices to only a limited extent, owing to preventive measures taken by the government towards the end of 1970. In April 1971 consumer prices were 3.9 per cent. higher than a year before.

As the slackening of expansion could not be interpreted as the first sign of a reversal of the basic economic trend, the central bank did not, up to the autumn of 1970, alter the general direction of its policy of restraint which had been introduced in 1969. But during the final months of 1970, in view of the more moderate economic climate at home and the downtrend in short-term interest rates abroad, it turned to a less restrictive policy. Quantitative credit restrictions were eased and the discount rate was lowered in two steps from 7.5 to 6.5 per cent. Short-term interest rates remained fairly high during the first half of 1970; they subsequently fell when a more ample supply of funds on the domestic market began to exceed demand. The upward movement of long-term interest rates continued until October, when they reached a peak of over 8 per cent. Thereafter they declined in line with developments abroad.

With the changeover to the value added tax, and with the danger of the rise in costs becoming more acute, the possibility could not be ruled out that a more rapid increase in prices might compromise economic equilibrium. It was therefore decided towards the end of 1970 to maintain the quantitative credit restrictions up to the end of March 1971 in the case of credits that might easily be used for the financing of stock-building and consumption. On 25th March 1971 the central bank again lowered the discount rate, by half a percentage point to 6 per cent., in order to guard against an inflow of foreign funds, and at the same time it prolonged the ceiling on credit expansion up to September. The measures taken by the government at the end of last year in connection with the changeover to value added tax, in particular the restraints imposed on price increases, were generally prolonged in early April. During the May 1971 exchange crisis the authorities modified their dual exchange-market system, which had been in force for many years, instead of allowing the franc to float on the official market. With effect from 10th May the two exchange markets were completely separated: the official market was reserved for current-account transactions and the free market for all other transactions. Additional measures announced on the same day included a ban on the opening by banks of deposit accounts in favour of non-residents the balances on which would be convertible on the official exchange market and the prohibition of interest payments on non-residents' convertible sight accounts.

Netherlands.

In spite of tighter fiscal and monetary policies, inflation was again the predominant feature of economic developments in the Netherlands last year. But compared with 1969 there were some important changes in the underlying forces. In 1969 the sharp rise in domestic prices was triggered off by the introduction of the value added tax, reinforced by subsequent wage increases. In addition to rising wages, inflationary pressures in 1970 were strengthened by a sharp increase in import prices and by the strong expansion of domestic demand.

The accelerated growth of demand came from both the household and the business sectors. A continuing increase in wage income in the region of 10 per cent., combined with ever rising social security benefits, enabled households last year to raise consumption by more than 10 per cent. in nominal terms. As regards the enterprise sector, a favourable development of profits — prior to the phase of accelerated wage rises — plus the pressure of demand itself, explains the 20 per cent. increase in demand for investment goods. Demand from abroad was also expansionary again, while residential building and government investment were damped down by policy restraints. All in all, aggregate domestic demand considerably exceeded the supply of goods and services in 1970, although domestic production proved surprisingly elastic. After increasing by more than 5 per cent. annually in the years 1967–69, real gross national product expanded again last year by 6 per cent., although pressure on resources, particularly on labour, had already built up early in 1969. As the year went on, however, production grew more slowly.

Apart from the growth of production, supply was augmented by a sharp increase in imports that exceeded the simultaneous rise in exports. As a result, the external current account deteriorated considerably and showed, on a transactions basis, a deficit of Fl. 1,660 million, against approximate balance in 1969.

Over the past year or so increases in price indexes have no longer been a very reliable indicator of the real strength of the domestic inflationary forces in the Netherlands. On the one hand, substantially higher import prices have a heavy weight in the indexes. On the other hand, upward pressure on prices from domestic sources is not fully reflected, as price control regulations provide that only increases in specified "external" costs — but not, in principle, wage rises — may be passed on in prices. Nevertheless, the cost of living increased by 5½ per cent. last year and showed clear signs of acceleration from the summer onwards. Under these circumstances, and in view of a planned increase in the standard rate of value added tax from 12 to 14 per cent. in January 1971, price control was tightened in November and extended until March 1971. This measure was supplemented in December by the limitation of newly-negotiated wage rises to 4 per cent. during the six months following the expiry of existing contracts.

In addition to this direct action, taxes on income and consumption were raised in January 1971 and planned government expenditure was cut back. Moreover, consumer credit was tightened and government credit guarantees were limited.

In the monetary field, the restrictive policy was continued and the granting of short-term credit to the private sector remained subject to ceilings which for the year as a whole allowed an increase of 9½ per cent., or slightly less than in the year before. The banks kept within their ceilings; however, credit limitation lost most of its braking power in view of the heavy inflow of capital from abroad. At Fl. 3.7 milliard (against Fl. 0.6 milliard in 1969), the inflow was twice as large as the external current deficit and thus contributed substantially to monetary expansion. The financing of local authorities' deficits was, once again, expansionary, whereas the central government succeeded in repaying some of its short-term debt and thereby reducing the inflationary impulses originating in the public sector.

In view of persisting inflationary pressures, credit ceilings for the first four months of 1971 were again fixed somewhat below the corresponding figures for last year. However, if inflation is to be brought under control, budget restraint measures additional to those which came into effect in January seem to be needed. To help hold down wage demands, one step taken recently by the government was to prolong price control for an indefinite period.

The cut in the discount rate — from 6 to 5½ per cent. — early in April was practically dictated by international developments. But, since this reduction promised to help reduce the inflow of funds from abroad, and because it was backed up by domestic credit ceilings, it seemed also appropriate as a measure of anti-inflationary policy. Though it ran counter to the needs of the external current account, the floating of the guilder in early May, prompted by Germany's similar move, should help to curb capital inflows and domestic inflationary pressures.

Sweden.

In Sweden several features stand out. Overall demand pressures reached a peak in the late spring of 1970 and then gradually began to recede. External payments problems began to seem a little less pressing and foreign exchange reserves were progressively reconstituted. On the other hand, wage inflation intensified and there was a spread of industrial unrest.

Most components of overall demand were at high levels in the first half of 1970. But the boom was marked particularly by unusually extensive inventory accumulation, which brought an upsurge in imports before the turn-round in the late spring. Export growth was checked partly by capacity shortages, investment in plant and equipment grew slowly and there was a decline in housing activity, which in Sweden is largely determined by central-government decisions. Hence, the growth of real gross national product in 1970 slowed down to 4.4 per cent., compared with 5.7 per cent. in 1969.

Credit policy had been tightened considerably in the face of the previous upswing, with a series of measures to restrict bank liquidity; most of these remained in force last year. To supplement the effect of the higher interest rates resulting from two increases in the discount rate during 1969, the expansion of bank credit other than for housing in 1970 was made subject to a ceiling of 4 per cent. As a result of these measures bank lending was kept tightly in check until the turn of the year. Output growth had by then slowed down, and the authorities aimed from the beginning of 1971 to stimulate investment in manufacturing. Banks were asked to give priority to credits for this purpose and the credit ceiling was removed. To help conserve foreign exchange reserves, however, the Riksbank's discount rate was held at 7 per cent.

The slight easing of monetary policy was facilitated by the shift to fiscal restraint in the course of last year. The previous 10 per cent. value-added-tax rate was increased first to 14 per cent., for cars in particular, in February 1970, then to 15 per cent., for cars and household appliances in November and for other goods in January 1971. Part of the increase was designed to offset revenue losses due to a reduction in tax on low incomes as from 1971. But, in addition, the government sought last year to slow down its spending and postponed some ordering from the private sector. A tax of 25 per cent. was imposed on non-priority building started between May 1970 and July 1971, which brought such activity almost to a standstill. In October further restrictive measures were announced, including increases in the tax on petrol, spirits and wines and a rise with effect from January 1971 from 1 to 2 per cent. in the payroll tax. As a result, the budget deficit, estimated at about S.kr. 2 milliard for the year ending June 1971, is expected to be virtually eliminated in 1971–72.

The slow-down in activity during the year was accompanied by a decline in imports in the summer and, with exports still advancing, there was a progressive reduction in the external current-account deficit, culminating in a move into surplus in the last quarter of 1970. The previous adverse shift in the terms of payment was reversed and, with the help of inflows of commercial credits induced by domestic credit restraint, official foreign exchange reserves were restored by early 1971 to the levels recorded prior to the buffetings of 1969. Consolidation of the improvement is being sought by diversion of labour and investment from public consumption and housing to industrial investment. New measures announced in January included a tax-free allowance for 10 per cent. of machinery and equipment investment undertaken in 1971.

Credit for investment became more readily available in the spring of this year, but interest rates remained high. To encourage a reduction in lending rates, once developments abroad permitted, the Riksbank's discount rate was lowered from 7 to 6½ per cent. in March, then to 6 per cent. in April.

Both domestic developments and price rises abroad contributed to inflation last year. Rising export prices boosted profits and weakened resistance to wage increases, though overall demand pressures eased. Average hourly earnings went up by 10.6 per cent. over the year as a whole, with rising costs becoming the main inflationary force.

Besides tightening fiscal policy, the government took direct measures to brake the wage/price spiral and adopted a firmer stance in wage negotiations. With the object, initially, of forestalling price increases in anticipation of the rise in value added tax and of providing a stable base for wage negotiations, it introduced a price freeze for food products in August and extended it to all goods and services in October.

The task of slowing down wage increases was aggravated by outbreaks of wild-cat strikes. This was largely a reaction against rising prices and higher taxation. In early 1971 protracted strikes of civil servants took place in support of substantial wage claims. The government met the situation by lock-outs and then a six-week ban on strike activity, with the object of avoiding settlements that could set off a general wage explosion.

Switzerland.

The growth of demand, which had begun to accelerate in the latter part of 1969, continued to rise in the first half of 1970. But the weight of expansionary forces shifted gradually from exports to domestic investment demand, stemming from both the industrial and housing sectors. A speed-up of private and public consumption also contributed to a rise in overall demand that clearly exceeded the economy's productive potential. As the economy had already been working practically at full capacity late in 1969, the possibilities for increasing production were rather limited in 1970, especially in view of the strict ban of March 1970 on the entry of new foreign workers.

Since the summer of last year, however, the expansion of demand has decelerated somewhat: exports have levelled out and planned investment seems to have decreased; this is indicated by a decline in the issue of building permits and a stabilisation in the inflow of orders to the engineering industry. Nevertheless, for the year as a whole total nominal demand has been 12 per cent. — for fixed investment even 21 per cent. — above the 1969 level, which had already been 11 per cent. higher than in the year before. The growth of the real gross national product, on the other hand, came to only about 4.3 per cent. last year, as compared with 5.9 per cent. in 1969. The widening gap between demand and supply led to the build-up of inflationary forces and a pronounced increase in imports that far outstripped the rise in exports. Thus, the trade deficit doubled to Sw.fr. 5.7 milliard in 1970, and prices and costs recorded their sharpest rise in the post-war period. With clear signs of acceleration after the summer, consumer prices rose by 5½ per cent. in the twelve months up to December last, reflecting in part, however, substantially higher import prices. In fourth-quarter comparisons, the rise in industrial wage rates speeded up from 4.1 per cent. in 1969 to 8.2 per cent. in 1970. But, here again, the increase included an "external" element, the influence of appreciably higher wage rises in surrounding countries. Particularly important were those in Italy, the main source of foreign labour for Switzerland.

Although such a situation called for restrictive measures, no decisive new steps were taken by the authorities after the spring of 1970. Their attitude reflected to some extent the view that the most propitious time for curbing the boom had been missed. But it was also due to the fact that appropriate policy instruments were not available. Because of this, the government is now aiming at developing the constitutional basis for a more adequate set of fiscal and monetary policy tools. As far as the National Bank's policy is concerned, reasonable results have been achieved by the quantitative limitations on the banks' credit-granting that were introduced on the basis of a voluntary agreement in September 1969. By December 1970 the annual growth rate of domestic credit-granting had come down to 7.4 per cent. (approximately at the ceiling rate), compared with 12.6 per cent. in August 1969. In addition, the central bank aimed at maintaining interest rate differentials vis-à-vis foreign currencies to give an incentive for the export of funds. However, this policy has come up against increasing difficulties since the latter part of 1970, when the fall in interest rates on Euro-markets brought some of the rates down close to Swiss domestic rates. Swiss non-banks began to repatriate funds on a larger scale in order to take advantage of the — by Swiss standards — high yields on domestic bonds. But as these funds were to a large extent rechannelled abroad by the banks, an undue increase in the money supply was averted.

In view of the risk of disturbing monetary influences from abroad and the persistence of strong domestic inflationary forces in February, the National Bank, in agreement with the Bankers' Association, extended the quantitative credit controls for one year until July 1972.

As a first step towards updating the legal framework for economic policy, a revised Monetary Law was enacted in April. The main aim was to terminate the anachronistic situation in which a decision on the parity of the Swiss franc had to be taken by Parliament and could be made subject — within a three-month period — to a general referendum. Under the new law this power was transferred to the government, which could now, after consultation with the National Bank, make a speedy decision in case of need. The need was not long in coming. The forewarning was a huge inflow of dollars into Switzerland prior to the closure of various exchange markets, followed by Germany's decision to permit the Deutsche Mark to float upwards. Moreover, having not been in a position to follow the Deutsche Mark revaluation in October 1969, Switzerland now had reason to act more definitively, and the franc was revalued by 7.07 per cent. on 9th May. The step is expected to help strengthen monetary control and to mitigate the domestic impact of price rises abroad.

Austria.

Austria's economic growth in 1970 was the highest for ten years. In addition, price and wage inflation was less than in most other countries and the balance of payments continued in comfortable surplus. The real gross national product expanded by 7.1 per cent., after a rate of 6.2 per cent. in 1969, and the price rise was 4.6 per cent.

The rapid economic growth for two years running can be ascribed mainly to gains in industrial production per man-hour of 8.3 per cent. in 1969 and 7.6 per cent. in 1970. Unemployment was the lowest ever and labour shortage was the most common bottleneck. To relieve pressures on the labour market, the quota for foreign workers was raised and their numbers increased by almost 40 per cent. to 75,000, or 3 per cent. of the labour force.

Hourly wage rates in industry went up on average for the year 1970 by 10.1 per cent.; there was, however, a widening wage drift. Unit labour costs increased by 4 per cent., after having fallen in the previous two years, but profits remained high. Early in the year price developments were strongly influenced by rising import prices, though selective tariff measures had been taken after the German revaluation; in March 1970 import unit values were 15 per cent. higher than a year earlier. The year-to-year rate of increase of wholesale prices reached 5.8 per cent. in May and declined to 4.2 per cent. at the end of 1970; but in March 1971 it was as high as 6.1 per cent. On the average for 1970, and also in March 1971, consumer prices were 4.4 per cent. higher than a year earlier.

In response to active domestic demand, imports of goods and services rose by over 15 per cent. in real terms, compared with 9 per cent. the year before. Notwithstanding the cyclical downswing abroad, the growth of merchandise and invisible exports edged down only slightly to 15.5 per cent., with strong support from tourist receipts. The deficit on trade account increased by more than one-half to Sch. 18.8 milliard, but the current account changed far less, from a Sch. 2.6 milliard surplus to a negligible deficit; this and a small deficit on capital account were more than balanced by unrecorded inflows, so that the overall balance-of-payments surplus, excluding the SDR allocation, amounted to Sch. 1.7 milliard, viz. to about Sch. 1 milliard less than in 1969.

With its balance of payments in surplus under domestic boom conditions, Austria emerged from the currency crisis in May 1971 by appreciating the par value of the schilling by 5.05 per cent.; in addition, it decided to make full use in future of the margin of fluctuation of 1 per cent. on either side of the parity allowed under the Articles of the IMF. The revaluation was aimed more at preventing a further upsurge of import prices — commodity imports from Switzerland, Germany and the Netherlands account for over 50 per cent. of Austria's total import bill — than at dampening exports. It was also important to avoid a labour drain, to southern Germany in particular. In case a marked cyclical downturn should materialise, provision was made earlier in the 1971 budget for contingency expenditure that would raise the growth rate of budgetary outlays from 9 to 12.5 per cent.

Spain.

If the attainment of policy aims is the criterion, 1970 must be judged a successful year for Spain. The economy appears to have given a neat demonstration of how to pass from a situation of excessive expansion and a serious balance-of-payments problem to one of a strong external position without an unduly severe depression of domestic demand.

Corrective measures in both the monetary and fiscal fields were taken towards the end of 1969 and in the early months of 1970. Largely through their liquidity-squeezing effects, these measures successfully and quickly cooled the economy and redressed the balance of payments. Industrial production continued to expand strongly up to mid-year at an annual rate of around 10 per cent., although this was slower than the 13 per cent. average for 1969. In the second half of the year, however, as the restrictive measures began to bite, the growth of output slowed down significantly to attain only a 5 per cent. rate in the last quarter. Over the year as a whole real gross national product rose by 6½ per cent., compared with 7½ per cent. in 1969. The growth of gross investment showed the largest decline, falling from 13½ to 5½ per cent., but private consumption also slackened. However, aggregate demand was buoyed up by a 24 per cent. rise in exports.

Notwithstanding the slackening of domestic demand, prices and wages rose strongly. Wages, which had risen on average by 12 per cent. in 1969, maintained this rate of increase in the first half of 1970, but shot ahead in the third quarter to show a gain of 20 per cent. on the year-earlier level. The course of the cost of living was similar: having risen by only a little over 2 per cent. in 1969, it showed an average rise of 5½ per cent. last year, and in the last quarter was 7½ per cent. higher than a year earlier. The main reason for these movements was that a start had been made in 1969, and was taken further in 1970, in relaxing the wide-ranging system of wage and price controls introduced with devaluation in November 1967.

The balance of payments improved dramatically in 1970 on both current and capital account. Although the trade deficit was reduced only slightly, the surplus on services and transfers increased sharply as a result of higher receipts from tourism and labour remittances, so that there was a $730 million improvement on current account. The net inflow of long-term capital was larger than in 1969, and the outflow of short-term capital in that year was replaced last year by a small inflow, reflecting higher Spanish interest rates and the domestic liquidity squeeze. The result was that the overall balance swung from a deficit of $220 million in 1969 to a surplus of $820 million, and net official assets doubled, rising from $885 million to $1,750 million excluding the initial allocation of SDRs.

With the economy still showing signs of contracting at the end of 1970, the stance of official policy in early 1971 was definitely expansionary. Government expenditure postponed in the previous February had already been unfrozen in mid-1970. At the same time the liquidity effect of an import deposit scheme, which had been introduced at the beginning of the year, had begun to wear off as new deposits were matched by repayments, and from the beginning of 1971, in view of the improved balance-of-payments position, the rate of deposit was halved. Partly to counteract this addition to liquidity the commercial banks were required to observe, from 1st March 1971 onwards, a minimum cash ratio of 7½ per cent., but this was likely to have little effect on their lending capacity. The rediscount rate was reduced twice, in January and April, and further expansionary measures, including an easing of hire-purchase terms, were introduced. In the spring of 1971, therefore, the stage was set for some acceleration of the rate of growth together with the maintenance of a satisfactory external position.

Eastern Europe.

The *Soviet Union* recorded not only very good crops but also a large gain in output per worker in industry and an increase in construction activity; as a result the growth of national income accelerated to about 8.5 per cent. from 4.8 per cent. in 1969. The expansion of fixed investment recovered from 3.5 per cent. to 9 per cent. The priority given, especially in 1969, to completion of investment projects helps to explain the pick-up in industrial production to 8.3 per cent. in 1970; the increase of 1.2 per cent. in employment in industry was only half that recorded in the preceding year. Reorganisation of the construction industry at the beginning of 1970, including a change in the system of management, yielded good results. Foreign trade increased in value terms by about 11 per cent., i.e. somewhat more than in 1969. The rise in real per capita income was again around 5 per cent.

About the same rate of per capita income growth as in the Soviet Union was achieved in *Bulgaria,* where efforts to contain domestic demand centred on fixed investment, for which virtually no increase was allowed for in either 1969 or 1970 after its disproportionate expansion in earlier years. Another aim was to strengthen the trade account. In fact, a small surplus had already been achieved in 1969, and in 1970, with exports up by 12 per cent. and imports by only 4 per cent., the surplus rose to roughly $200 million. The increase in industrial production edged downwards parallel with productivity, to 9.3 per cent. The growth in national income produced was 7 per cent., compared with 7.9 per cent. in 1969.

In *Poland* the rise of 6 per cent. in national income produced compares with one of 2.9 per cent. in 1969. With a 1.5 per cent. rise in employment, the increase in output per worker was well above the previous average, particularly in industry. Total industrial production went up by 8.3 per cent. In the producer-goods sector the advance came to 9 per cent., while consumer-goods output increased by 7 per cent., though food processing rose by only 1.6 per cent., largely because of the depressed state of agricultural production, which expanded by 1.9 per cent. after declining in 1969. Much of the increase in aggregate output in 1970 went into exports and investment. The growth of exports accelerated from 10 per cent. in 1969 to 13 per cent. in 1970 — and was particularly striking vis-à-vis western Europe and in the foodstuffs sector — while that of imports remained unchanged at over 12 per cent. Gross investment expanded by 11 per cent.; about half of the gain was accounted for by stock accumulation. Private and public consumption combined increased by 4 per cent., private consumption alone going up by 3.5 per cent. Real income per wage-earner rose by 1.2 per cent. and as a result the accumulation of savings deposits and, particularly, of cash holdings slowed down markedly. To overcome structural difficulties in agriculture, incentives for more efficient production were initiated in the spring of 1971.

Aggregate economic growth in *eastern Germany,* at 5.2 per cent., was virtually unchanged in 1970. Analysis of the components of supply and demand, however, reveals strains that have been building up over the past few years. Production slowed down from a 7.0 per cent. increase in 1969 to 6.4 per cent., with productivity rising less than in any other eastern European country. As in Poland, agricultural results were unfavourable for the second year running. Construction, too, was affected by bad weather conditions, but also by supply bottlenecks. The growth of fixed investment, at 7.0 per cent., was about half that in 1969. The rise in retail sales fell off from 6 to 4.2 per cent. but was greater than that in money incomes. The trade balance turned round from surpluses of about $400 million and $200 million in 1968 and 1969 respectively to a deficit of $150 million.

Czechoslovakia succeeded in 1970 in restoring internal balance, while maintaining a roughly balanced trade account. A price freeze was introduced early in 1970 and incomes were kept under strict control; as a result nominal wages went up by no more than 2.6 per cent. after the rise of 7.4 per cent. the year before. Real wages and also private consumption showed an increase of 1 per cent., compared with 6.1 per cent. and 7.5 per cent. respectively in 1969. The savings ratio improved for the first time in three years, while the rise in fixed investment, another source of inflation in past years, was cut back by more than half to 6 per cent., partly by means of a more

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

Countries	National income produced[1]			Global industrial output			Global agricultural output		
	1968	1969	1970	1968	1969	1970	1968	1969	1970
	real annual increases, in percentages								
Albania	11.0	11.0	6.0	19.0	11.0	7.7	2.5	10.0	5.0
Bulgaria	6.4	7.9	7.0	10.2	9.9	9.3	— 7.3	2.2	4.0
Czechoslovakia . .	8.4	6.5	5.0	5.5	5.2	7.7	5.5	1.0	1.3
Eastern Germany .	5.3	5.1	5.2	6.1[2]	7.0[2]	6.4[2]	1.0	— 6.3	.
Hungary	5.0	7.2	5.0	5.3	3.0	7.4	0.5	5.2	— 5.0
Poland	9.0	2.9	6.0	9.4	8.9	8.3	4.4	— 4.7	1.9
Rumania	6.8	7.9	6.6	11.6	10.8	11.8	— 3.6	3.1	— 5.4
USSR.	8.3	4.8	8.5[3]	8.3	7.1	8.3	4.5	— 3.3	8.7

[1] Net material product. [2] Excluding work in progress. [3] Domestically distributed national income.
Source: UN Economic Commission for Europe, *Economic Survey of Europe in 1970.*

restrictive credit policy. As a result of higher productivity gains, the increase in gross industrial output accelerated, though final deliveries slowed down from a rise of 8.9 per cent. in 1969 to one of 7.0 per cent. in 1970. Agricultural production remained slack, exceeding the previous year's level by 1.3 per cent., and the growth of national income produced fell off from 6.5 per cent. in 1969 to 5 per cent. last year.

In order to spur productivity and after two years of rapid rise in employment in industry, *Hungary* introduced a payroll tax on newly-hired labour at the beginning of 1970. As a consequence, employment in industry increased by no more than 0.6 per cent. At the same time the expansion of industrial production accelerated from 3.0 to 7.4 per cent. It thus provided strong support for the growth of national income, which slowed down only from 7.2 to 5 per cent. in spite of a decline of 5 per cent. in agricultural production to about its 1968 level. Grain production suffered particularly severely as a result of bad weather and floods, whereas livestock production was well maintained. On the whole, domestic production followed internal and external demand patterns and was supplemented by a rise in imports of 30 per cent. in value terms. At the same time the growth of exports slowed down and the trade balance swung round by \$350 million to a \$190 million deficit. Foreign exchange earnings from tourism continued to develop satisfactorily. Personal incomes and consumption rose at a faster pace than the year before; per capita consumption went up by 6 per cent. Stocks that had been depleted in 1969 were rebuilt and, at a rate of 15 per cent., the expansion of fixed investment more than doubled. To finance investments, export-orientated industries had recourse to foreign credit markets. Early in 1971 new fiscal measures to encourage further economic development were taken and, as regards credit policy, new credit is to be primarily directed to the most profitable firms and to the investment-goods and export industries.

Economic developments in *Rumania* also reflected adverse weather conditions in 1970. Agricultural production declined by 5.4 per cent., following three consecutive years of virtual stagnation. Industrial production, on the other hand, rose by close on 12 per cent. as a result of the highest productivity increase recorded by any eastern European country, partly due to a high rate of completion of investments. The rise in fixed investment was 9.3 per cent., one-third higher than the year before. The expansion of imports accelerated from 8.2 to 12 per cent., while export growth edged up to 13.5 per cent. The trade deficit declined slightly to approximately $96 million. Recently a reform of the foreign trade organisation was initiated. In principle, producers are to be brought into more direct touch with export markets, while imports are to be more closely scrutinised from the standpoint of their impact on the efficiency of the domestic economy. Moreover, co-operation between domestic and foreign firms in Rumania and abroad is envisaged.

In *Albania* economic growth slowed down in 1970 to a 6 per cent. increase in the net material product from a rate of 11 per cent. in each of the previous two years.

In *Yugoslavia* price inflation — caused by the earlier sharp rise in labour costs — continued in 1970 as excess demand emerged and the trade account deteriorated. Investment expenditure, one-third higher than the year before, and private consumption, boosted by an increase of one-quarter in households' incomes and an over-expansion of consumer credit, contributed to an upsurge in demand. At the same time the growth of domestic supply weakened. The increase of 9 per cent. in industrial production compares with one of 11 per cent. the year before, and agricultural output also fell, largely because of flood damage, so that the growth of the gross national product declined from 9.8 to 5.5 per cent. In these circumstances, the authorities restricted credit expansion and in July introduced a special import tax. This was followed in October by a price freeze, a tightening of hire-purchase terms and the introduction of an import deposit scheme. Then, in December a ceiling was imposed on wage increases. During 1970 the cost of living increased by around 11 per cent. Since imports went up by 35 per cent. and exports by 14 per cent., the trade deficit almost doubled to $1.2 milliard; consequently, in spite of a steep rise in invisible earnings — remittances and earnings from tourism alone totalled $775 million — the National Bank's net foreign position fell and the banks' external indebtedness increased sharply.

In January 1971 the dinar was devalued by 16.7 per cent. Subsequently, the import deposit scheme was abolished and the import tax reduced. The devaluation was backed by a tightening of credit policy and the blocking of budgetary funds. In the spring of 1971 a package of longer-term stabilisation measures was under consideration. During this period price inflation continued and there was a further increase in the trade deficit.

II. MONEY, CREDIT AND CAPITAL MARKETS.

From late 1969 onwards, as demand inflation was stopped or weakened in one country after another, the forces making for cost inflation continued to show strong momentum. The stabilisation rôle of budget policy varied rather widely as between countries, while that of incomes policy was discernible in only a few cases. From the monetary point of view, therefore, broad differences emerged in the weight of emphasis given to domestic and external policy considerations. Because of its slack economy, the United States led the march towards lower interest rates, but these rates were manifestly inconsistent with the country's external requirements. In western Europe and Japan the movement towards lower interest rates was accepted in varying degrees and often with much reluctance. These attitudes reflected wide differences not only in domestic and external situations but also in the degree of monetary autonomy provided by each country's armoury of policy instruments. Policy conflicts became more widespread in the first quarter of 1971 as the easing of US monetary policy was stepped up and the decline in interest rates steepened.

By the early spring of 1971, however, interest rate differentials were beginning to narrow again. The US monetary authorities put upward pressure on short-term rates and also took limited measures to compensate the outflow of funds. In western Europe, beginning in late March, a new round of discount rate reductions occurred, including cuts of one percentage point by Germany, the United Kingdom and Sweden, half a point by Belgium, the Netherlands, Italy and Denmark, and a quarter of a point by Spain. However, these measures were not enough to forestall the welling tide of capital inflows which culminated in the exchange crisis of early May. Whatever their other merits, the resulting exchange adjustments should help to strengthen domestic monetary autonomy in the countries concerned. In wider perspective, with the outlook for costs and prices in most countries still rather dismal, recent tendencies towards monetary relaxation may now have to be checked somewhat or even reversed.

Liquid-asset formation and bank credit.

Developments last year again show how difficult it can be to keep money and credit conditions under control in the face of major domestic or external disturbances. Except in North America, credit-restraint efforts were continued for most of the year in practically all countries. But the persistent cost inflation almost inevitably necessitated a larger growth of money and quasi-money (i.e. time and savings deposits) than in the previous year. Severe monetary restraint under these circumstances would not only have put pressure on the solvency of business firms but more generally would have had difficult political and social consequences. In several cases, too, when fears of a general liquidity crisis became widespread, priority had to be given, at least for a time, to maintaining orderly conditions in credit markets. Last but not least, the massive capital flows which occurred over the past year often added greatly to the problems of monetary management.

The banking system: Monetary survey.

Countries	Years	Annual changes in main assets			liabilities		Change in money and quasi-money[1]	Gross national product	
		Net foreign assets	Credit to public sector	Credit to private sector	Money	Quasi-money		volume change	price deflator
		In milliards of national currency units					In percentages		
Austria	1968	4.12	3.45	11.16	3.87	11.99	*9.8*	*4.6*	*1.4*
	1969	3.26	3.90	19.74	4.69	16.59	*12.0*	*6.2*	*3.6*
	1970	3.45	3.53	23.65	4.29	20.66	*12.5*	*7.1*	*4.6*
Belgium	1968	— 11.00	31.60	27.30	26.00	18.30	*15.7*	*3.6*	*2.4*
	1969	7.50	28.50	16.10	9.80	29.50	*21.9*	*6.5*	*3.6*
	1970	11.10	20.70	12.80	32.40	13.10	*8.0*	*5.5*	*4.3*
Canada	1968	0.33[2]	0.83	2.06	1.64	1.86	*14.8*	*4.9*	*3.5*
	1969	0.07[2]	— 0.89	2.05	— 0.69	1.41	*2.6*	*5.1*	*4.7*
	1970	1.48[2]	0.38	1.08	1.66	1.59	*11.6*	*3.3*	*4.1*
Denmark	1968	— 0.04	0.94	6.11	3.59	2.42	*14.2*	*3.7*	*5.4*
	1969	— 0.61	— 1.00	6.76	3.05	1.96	*10.4*	*7.7*	*5.6*
	1970	0.29	— 1.26	3.88	— 0.34	2.26	*3.6*	*3.7*	.
Finland[3]	1968	1,006	— 419	911	486	1,176	*12.4*	*2.3*	*10.7*
	1969	204	— 50	2,096	472	1,478	*13.0*	*9.9*	*3.2*
	1970	340	— 109	2,682	818	1,962	*16.4*	*7.3*	*3.1*
France	1968	— 15.72	3.26	35.95	15.84	13.77	*11.6*	*4.8*	*4.6*
	1969	— 9.35	3.51	22.99	0.76	16.64	*6.1*	*7.9*	*7.0*
	1970	13.71	— 1.33	44.13	23.41	21.62	*15.0*	*5.8*	*5.4*
Germany	1968	10.70	11.17	30.90	5.53	34.56	*17.1*	*7.2*	*1.6*
	1969	— 2.98	1.59	51.22	5.96	33.76	*10.1*	*8.1*	*3.5*
	1970	14.65	6.97	44.04	8.79	31.26	*9.3*	*4.9*	*7.4*
Italy	1968	346	1,484	2,902	2,282	1,736	*12.1*	*6.0*	*1.5*
	1969	— 756	1,186	4,278	3,382	1,104	*12.1*	*5.9*	*4.1*
	1970	305	2,467	4,138	6,802	— 518	*15.1*	*5.1*	*6.2*
Japan	1968	403	759	5,094	1,786	3,270	*14.8*	*14.4*	*3.7*
	1969	802	500	7,336	3,128	4,119	*18.5*	*12.1*	*4.1*
	1970	399	185	8,790	3,077	4,761	*16.9*	*11.5*	*6.3*
Netherlands. . .	1968	— 0.31	1.25	2.40	2.17	2.00	*14.1*	*6.7*	*3.8*
	1969	0.85	0.58	2.66	1.57	2.19	*11.1*	*5.1*	*6.0*
	1970	2.02	0.23	2.63	2.70	— 0.12	*6.9*	*6.0*	*4.6*
Norway	1968	1.03	1.32	1.96	1.86	2.14	*12.2*	*4.0*	*3.2*
	1969	— 0.38	1.27	3.17	1.15	2.57	*10.1*	*5.5*	*3.7*
	1970	1.12	2.73	3.03	1.94	4.28	*15.4*	*2.9*	*12.0*
Spain.	1968	4.88	28.82	219.73	66.30	159.54	*18.8*	*5.7*	*4.6*
	1969	— 17.21	16.97	271.02	89.41	178.88	*18.8*	*7.4*	*3.5*
	1970	46.47	28.22	226.73	41.24	214.49	*15.1*	*6.6*	*5.6*
Sweden	1968	— 0.07	1.83	5.26	2.30	4.55	*15.1*	*4.0*	*2.3*
	1969	— 1.77	0.36	1.48	— 0.64	1.26	*1.2*	*5.7*	*3.2*
	1970	0.66	0.31	2.00	1.48	1.40	*5.5*	*4.4*	*6.1*
Switzerland . . .	1968	2.55[4]	0.95	8.10	4.08	5.64	*13.4*	*4.2*	*3.5*
	1969	0.57[4]	1.42	11.20	4.30	11.53	*19.3*	*5.9*	*2.7*
	1970	3.04[4]	0.61	8.87	4.57	8.85	*13.7*	*4.3*	*4.6*
United Kingdom[3]	1968	— 1,089	1,406	685	1,052	—	—	*3.2*	*3.9*
	1969	642	— 761	553	445	—	—	*1.9*	*5.0*
	1970	722	— 146	1,355	1,495	—	—	*2.0*	*7.3*
United States . .	1968	0.90[2]	13.80	30.40	11.90	20.60	*8.9*	*4.7*	*4.0*
	1969	1.30[2]	— 5.70	19.30	7.80	— 12.40	*—1.2*	*2.8*	*4.7*
	1970	— 2.50[2]	25.50	13.40	8.10	44.60	*13.4*	*—0.4*	*5.3*

[1] December to December. [2] Monetary authorities only. [3] In millions of national currency units. [4] National Bank only.
Source: IMF, *International Financial Statistics.* For Belgium, France, Germany, Japan and Spain, national statistics.

The almost universal pattern of a slow-down in real GNP growth and an acceleration in price rises and in the expansion of the money supply shows up clearly in the accompanying table. The money supply, narrowly defined, increased at a faster rate in all countries except Austria, Denmark, Japan and Spain, where its expansion in the previous year had been substantial. The pattern was less pronounced for the banking system's quasi-monetary liabilities, which tend to be significantly affected by changes in the structure of interest rates. In Germany and the Netherlands the slow-down in the formation of quasi-money was associated with a shift to market instruments bearing higher interest rates. A similar shift occurred in Belgium, where interest rates on large time deposits, virtually the only short-term financial asset available to non-residents, were adjusted downwards as a means of regulating inflows of funds. The shift in Italy was more from savings to demand deposits, and quasi-money actually fell. Elsewhere, however, quasi-money grew quite rapidly, frequently reflecting a build-up of liquidity in the personal sector in a year of hesitant consumer expenditure. A significant factor in the United States was the easing of interest rate controls on large time deposits, which enabled the banks again to compete for funds.

A reduction in credit to the private sector was the immediate object of credit restrictions in many countries last year, and it was here that the most striking results were achieved. In the United States and Canada, however, the weakening of demand for bank credit had already begun to reflect the decline in economic activity, while in Belgium it occurred in conjunction with exchange inflows. But in Denmark, Germany, the Netherlands, Norway and Switzerland monetary restraint was a major factor in the slow growth of bank claims on the private sector. Elsewhere, too, restraint measures helped to keep the expansion of credit to the private sector within reasonable bounds. In fact, in most western European countries (excepting mainly Germany and Italy) and in Japan such credit was subject to quantitative limitation for all or most of 1970. In the United Kingdom, where the banks' sterling lending was limited by guide-lines, the recorded rise in total credits to the private sector largely reflected foreign currency credits taken up through the banks. In Sweden the growth of credit to the private sector was a reflection not so much of lending to business, which grew very slowly, but rather of the banks' subscriptions to housing bonds in order to satisfy compulsory reserve requirements. In France the sharp expansion of bank credit to the private sector partly represented the substitution of bank credit for credit from other sources after the quantitative ceilings on bank lending were lifted in October. In Finland credit policy was eased somewhat once the main weight of restraint could be placed on the build-up of blocked anti-cyclical deposits at the central bank.

Claims of the banking system on the public sector last year grew more slowly or fell faster than in 1969 in most countries. The sharpest change occurred in France, where expenditure restraints helped the central government to achieve a financial surplus. In the United Kingdom, although the public sector as a whole experienced a major improvement in its net financial position for the third consecutive year, the net repayment of indebtedness to the banking system was less in 1970 than the year before. In Denmark the central government's cash surplus increased substantially and was used mainly to improve its net position with the central bank. In Belgium, Finland, Japan, the Netherlands and Sweden the change reflected in varying degrees a reduction in the central government's borrowing requirement due partly to the boost to tax revenues caused by inflation but also in many cases to the introduction, often belatedly, of tax increases and public-spending restraints. In Italy the central government had a larger deficit, to some extent a result of the postponement of payments and loss of revenue consequent upon the strikes of late 1969, and financed it almost entirely from the central bank. In Germany central and local-government financing requirements were unexpectedly large, but against the rise to nearly DM 7 milliard in borrowings from the banking system must be set the accumulation of almost DM 4.1 milliard of public-sector deposits with the central bank, which consisted mainly of the temporarily blocked proceeds of a refundable income-tax surcharge and the anti-cyclical reserve fund. In the United States and Canada the increase in banks' claims on the public sector partly reflected a deterioration in the budget situation

Changes in official discount rates since 1969.

Country and date of change	Official discount rate in %
Austria	
26th October 1967	3¾
11th September 1969	4¾
22nd January 1970	*5*
Belgium	
19th December 1968	4½
6th March 1969	5
10th April 1969	5½
29th May 1969	6
3rd July 1969	7
18th September 1969	7½
22nd October 1970	*7*
10th December 1970	*6½*
25th March 1971	*6*
Canada	
18th December 1968	6½
3rd March 1969	7
11th June 1969	7½
16th July 1969	8
12th May 1970	*7½*
1st June 1970	*7*
1st September 1970	*6½*
12th November 1970	*6*
15th February 1971	*5¾*
24th February 1971	*5¼*
Denmark	
29th August 1968	6
31st March 1969	7
12th May 1969	9
20th January 1971	*8*
15th April 1971	*7½*
Finland	
28th April 1962	7
1st June 1971	*8½*
France	
13th November 1968	6
14th June 1969	7
9th October 1969	8
27th August 1970	*7½*
20th October 1970	*7*
8th January 1971	*6½*
13th May 1971	*6¾*

Country and date of change	Official discount rate in %
Germany	
12th May 1967	3
18th April 1969	4
20th June 1969	5
11th September 1969	6
9th March 1970	*7½*
16th July 1970	*7*
18th November 1970	*6½*
3rd December 1970	*6*
1st April 1971	*5*
Greece	
25th June 1968	5
1st February 1969	5½
1st July 1969	6
15th September 1969	6½
Italy	
7th June 1958	3½
14th August 1969	4
9th March 1970	*5½*
5th April 1971	*5*
Japan	
7th August 1968	5.84
1st September 1969	6.25
28th October 1970	*6*
20th January 1971	*5¾*
8th May 1971	*5½*
Netherlands	
20th December 1968	5
9th April 1969	5½
4th August 1969	6
5th April 1971	*5½*
Norway	
14th February 1955	3½
27th September 1969	4½

Country and date of change	Official discount rate in %
Portugal	
1st September 1965	3
25th April 1970	*3½*
6th February 1971	*3¾*
Spain	
27th November 1967	4½
22nd July 1969	5½
23rd March 1970	*6½*
22nd January 1971	*6¼*
5th April 1971	*6*
Sweden	
11th October 1968	5
28th February 1969	6
11th July 1969	7
19th March 1971	*6½*
23rd April 1971	*6*
Switzerland	
10th July 1967	3
15th September 1969	3¾
United Kingdom	
19th September 1968	7
27th February 1969	8
5th March 1970	*7½*
15th April 1970	*7*
1st April 1971	*6*
United States	
18th December 1968	5½
4th April 1969	6
13th November 1970	*5¾*
4th December 1970	*5½*
8th January 1971	*5¼*
22nd January 1971	*5*
19th February 1971	*4¾*

but also a rebuilding by the banks of their government security portfolios as private credit demand weakened. In Norway banks acquired substantial amounts of government securities in order to meet higher reserve requirements.

In both Belgium and the Netherlands the central government's lower financial requirement was accompanied by substantial borrowing on the domestic capital market, the difference being used in Belgium for repayment of indebtedness previously incurred abroad via the banks, and in the Netherlands for strengthening the government's net position vis-à-vis the central bank. In the United Kingdom the authorities had to make net purchases of government stock from the non-bank public in March–September 1970, but later in the year net sales commenced.

With domestic credit expansion generally under restraint, the external surpluses which developed, partly in conjunction with the easing of monetary conditions in the United States, contributed significantly to liquidity formation in virtually all other countries last year. Whereas in Denmark, France, Germany, Italy, Norway, Spain and Sweden a decline in the banking system's net foreign assets had taken place during 1969, this was sharply reversed in 1970. And in Austria, Belgium, Canada, Finland, Japan, the Netherlands, Switzerland and the United Kingdom, where increases had been recorded in 1969, the further accumulation of foreign assets in 1970 was, except in Japan, larger than in 1969, sometimes substantially so. Attitudes towards these exchange inflows differed from country to country, but for some — particularly Germany, the Netherlands and Switzerland — monetary management was clearly made more difficult.

Domestic capital markets.

The picture presented by new-issue activity in 1970 was one of sharp contrasts. In the United States and Canada the return to monetary ease was accompanied by a large volume of bond issues by enterprises and public authorities alike. In the case of enterprises this was prompted mainly by the urgent need to consolidate short-term debt and rebuild liquid assets. However, the heavy borrowing in the face of only moderate declines in long-term rates suggests that inflationary expectations may also have motivated borrowers' behaviour. The marked increase in bond issues by local authorities was in both countries a reaction to the low volume of issues during the restraint phase. In the United States the government sector's issue activity reflected a continued large volume of borrowing by federally-sponsored credit agencies in support of mortgage lending for housing purposes, while that in Canada stemmed largely from the need to finance the growth in exchange reserves.

New issues were also substantially higher in Belgium, France, Japan and the Netherlands. In the first three countries a turn during 1970 towards easier monetary conditions as budgets improved facilitated this development. In France and Japan the growth in issues of both bonds and shares was accounted for by private enterprises, whereas in Belgium borrowing by public and semi-public credit institutions was predominant. In the Netherlands bank credit restrictions were maintained, but the Dutch capital market attracted a large volume of funds from abroad. Though these were absorbed mostly by private-sector capital issues, the central government, despite

Domestic capital markets: Net issues.

Countries	Years	Public sector: State	Public sector: Local authorities and public bodies	Private sector: Shares	Private sector: Bonds	Foreign bond issues	Total	Private sector and foreign issues	Total net issues
		in milliards of national currency units						as percentages of GNP	
Belgium	1968	18.56	24.75	22.27	30.59	0.93	97.10	5.2	9.4
	1969	17.46	26.60	20.11	24.07	2.12	90.36	4.0	7.9
	1970	11.11	37.47	19.52	39.26	.	107.36	4.7	8.5
Canada	1968	0.91	1.32	0.52	0.57	0.01[1]	3.32	1.5	4.7
	1969	0.25	1.22	0.79	0.56	—	2.82	1.7	3.6
	1970	1.22	1.90	0.31	1.22	—	4.65	1.8	5.5
Denmark	1968	−0.12	.	0.13	6.85	—	6.86	7.6	7.4
	1969	−0.14	.	0.32	8.20	—	8.38	8.1	8.0
	1970	−0.10	.	0.26	6.83	—	6.99	6.0	5.9
France	1968	−0.94	0.84	3.63	5.80	—	9.33	1.5	1.5
	1969	−1.00	0.58	7.54	6.97	—	14.09	2.0	1.9
	1970	−1.05	1.13	8.68	10.40	—	19.16	2.4	2.4
Germany	1968	1.24[2]	2.46	3.15	13.85	5.16[3]	25.85	4.1	4.8
	1969	0.06[2]	0.27	2.80	12.15	6.18[3]	21.46	3.5	3.6
	1970	0.36[2]	1.42	3.59	12.09	2.50[3]	19.96	2.7	2.9
Italy	1968	554	660[4]	473	1,835	44	3,565	5.0	7.5
	1969	353	1,113[4]	681	1,865	12	4,024	4.9	7.7
	1970	245	619[4]	1,011	1,738	− 2	3,612	4.7	6.2
Japan	1968	581	163	478	1,536	—	2,758	3.9	5.4
	1969	372	173	547	1,769	—	2,861	3.9	4.8
	1970	351	183	1,027	1,936	—	3,497	3.8	4.6
Netherlands	1968	0.26	0.71	0.24	0.39	0.03[1]	1.64	0.7	1.8
	1969	0.83	0.64	0.20	0.30	—	1.97	0.5	1.9
	1970	0.66	0.63	0.17	0.78	0.02[1]	2.26	0.9	2.0
Sweden	1968	2.15	0.38	0.49	6.27	0.05	9.34	5.1	7.0
	1969	1.71	0.35	0.84	7.83	—	10.73	5.9	7.3
	1970	0.73	0.18	0.45	7.23	—	8.59	4.7	5.3
Switzerland	1968	0.16	0.61[5]	0.49	2.05[5]	0.82[6]	4.13	4.5	5.6
	1969	0.19	0.44[5]	0.81	1.90[5]	0.74[6]	4.08	4.3	5.1
	1970	0.03[5]	0.71[5]	0.52	2.36[5]	0.45[6]	4.07	3.8	4.6
United Kingdom	1968	−0.51[7]	0.12	0.36	0.27	−0.04	0.21	1.4	0.5
	1969	0.18[7]	0.07	0.21	0.41	−0.01	0.87	1.3	1.9
	1970	−0.27[7]	0.10	0.09	0.19	−0.01	0.09	0.5	0.2
United States[8]	1968	12.50[9]	9.40	4.00	14.00	1.90[1]	41.80	2.3	4.8
	1969	−4.00[9]	5.00	10.40	13.80	1.30[1]	26.50	2.7	2.8
	1970	15.00[9]	8.00	9.80	23.40	1.40[1]	57.60	3.5	5.9

[1] Gross. [2] Change in market holdings of bonded loans and medium-term notes. [3] Gross foreign issues plus the part of international issues handled by domestic banks. [4] Includes indirect Treasury borrowing. [5] Includes privately-placed issues. [6] Includes part of international issues handled by domestic banks. [7] Change in marketable debt with a maturity of over one year in public hands. [8] Based on Federal Reserve flow-of-funds data, excluding mortgage loans. [9] Direct issues, including agency issues and participation certificates.

a lower borrowing requirement, issued bonds on a substantial scale as a means of absorbing liquidity.

In Switzerland capital issues were about the same size as a year earlier, while in Germany they fell off quite noticeably. In both these countries foreign issues were for a time deliberately cut back as a means of easing capital-market strains. This allowed scope for larger bond flotations by domestic enterprises and the public sector. Share issues rose considerably in Germany but declined in Switzerland.

In Denmark, Italy, Sweden and the United Kingdom new issues were distinctly lower in 1970. The sharpest decline occurred in the United Kingdom, where the prevailing high level of long-term interest rates and the weakness of the share market acted as strong deterrents to company flotations. In the public sector the net reduction in government stock was more than accounted for by large net sales by the banking sector, which instead went in heavily for acquisitions of Treasury bills on the expectation of falling short-term rates. In Italy the marked reduction in new issues occurred in conjunction with a steep upward adjustment of domestic long-term rates to international levels over the twelve months to mid-1970. In these circumstances Italian public and private-sector borrowers took up on foreign and international capital markets nearly Lit. 1,100 milliard, against just over Lit. 100 milliard in 1969. Even so, as in 1969, the Bank of Italy purchased the equivalent of about two-fifths of the fixed-interest securities issued on the domestic market.

In Denmark the decline in new issues last year was to a large extent the aftermath of a concentration of new issues in 1969 brought about by changes in bond-market regulations. The Nationalbank was no longer a heavy net purchaser of securities, as it had been in the two preceding years, while the central government once again used its cash surplus partly to redeem outstanding securities. In Sweden the decline in government bond issues made a very substantial contribution to the reduction in the overall total.

Foreign and international bond issues.

At $4.8 milliard, total foreign and international bond issues last year were 10 per cent. below their 1969 figure and a full 25 per cent. below the exceptionally high level recorded in 1968. The decline as compared with 1969 was divided about equally between traditional "foreign" issues on individual national markets and "international" issues placed on a number of markets simultaneously. Thus the share accounted for by international issues, after growing rapidly from 1963 to 1969, remained at three-fifths last year. Total issues came to only $1,850 million in the first half of 1970, when capital-market conditions were generally very weak, but rebounded sharply in the second half to $2,915 million and accelerated further in early 1971.

Foreign issues. Last year's $250 million decline in foreign issues to $1.9 milliard was ascribable to developments in western Europe, where issues fell to $520 million from $820 million the year before. Issues in Germany dropped off to only $150 million, after averaging $465 million over the two previous years. In order to ease domestic capital-market strains, foreign issues were suspended for about four months in early 1970 and then resumed only on a moderate scale. In Switzerland, too, capital-market strains led the authorities briefly to suspend foreign issues in the late spring. However, new-issue authorisations were granted more liberally later in the year when an undesired repatriation of funds gave rise to increased demand for bonds.

In the United States, the largest single market for foreign bonds, issues rose slightly to nearly $1.4 milliard. A reduction in Canadian borrowing was more than offset by two issues of international institutions which had not tapped the US market the year before. In Japan a foreign issue — on behalf of the Asian Development Bank — was permitted for the first time.

International issues. Flotations of international issues fell back by about $300 million, to $2.8 milliard, in 1970. There was a considerable decline in issues by borrowers from the United States, Canada and Japan, but this was partly offset by an increase in borrowing from countries and institutions of western Europe. Thus the proportion of total issues accounted for by western European countries and institutions, after dropping as low as 25 per cent. in 1968 when US borrowing was exceptionally large, went up last year to 56 per cent., which compares with about 50 per cent. three years earlier.

The decline in issues by US corporations and their affiliates, as well as in those by Canadian borrowers, was partly attributable to the easing of monetary conditions at

Foreign and international bond issues: Public offerings and private placements.[1]

Borrowing countries or areas	Years	Foreign issues: markets of issue						International issues	Total issues abroad
		Europe				United States	Total		
		Germany[2]	Switzerland[3]	Other countries	Total				
		in millions of US dollars							
Western Europe . .	1967	—	77	5	82	—	82	937	1,019
	1968	99	104	14	217	—	217	792	1,009
	1969	69	123	6	197	3	201	1,317	1,517
	1970	—	111	12	123	—	123	1,471	1,594
Canada	1967	—	—	—	—	1,172	1,172	—	1,172
	1968	63	—	—	63	1,155	1,217	38	1,255
	1969	81	—	—	81	1,104	1,185	228	1,412
	1970	—	14	—	14	890	904	142	1,046
United States . . .	1967	22	49	—	71	—	71	527	598
	1968	35	139	—	174	—	174	2,059	2,232
	1969	25	134	66	225	—	225	1,032	1,257
	1970	—	98	—	98	—	98	742	840
Japan.	1967	—	—	—	—	15	15	—	15
	1968	—	14	—	14	—	14	180	193
	1969	—	—	—	—	9	9	246	255
	1970	—	12	—	12	—	12	108	120
Rest of the world .	1967	—	17	116	133	237	370	305	675
	1968	101	25	31	158	280	438	259	698
	1969	37	28	—	65	239	304	247	551
	1970	—	37	12	49	199	248	229	478
International institutions . . .	1967	—	14	100	114	510	624	120	744
	1968	218	50	138	405	470	931[4]	40	971
	1969	207	14	30	251	—	251	40	291
	1970	150	17	57	224	300	541[4]	143	684
Total issues placed	1967	22	157	221	400	1,933	2,333	1,889	4,222
	1968	515	331	184	1,030	1,905	2,991[4]	3,368	6,359
	1969	419	298	102	819	1,355	2,174	3,110	5,284
	1970	150	289	81	520	1,390	1,926[4]	2,836	4,762

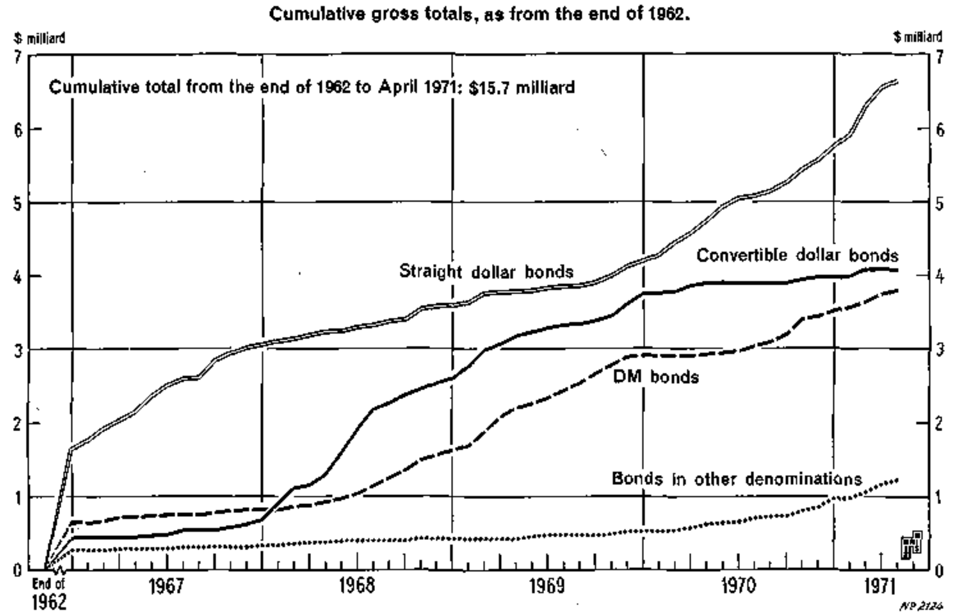
[1] Includes bonds and notes with average maturities of five years or more, but not loans and revolving credits obtained from banks. Company borrowing through foreign subsidiaries is normally treated as borrowing by the country of the parent company. [2] Excludes non-negotiable "Schuldscheindarlehen" (loans secured by certificates of indebtedness) placed privately. [3] Includes issues of foreign financial holding companies domiciled in Switzerland. [4] Includes small amounts placed in other areas.

home. In this context many US firms wishing to finance foreign investment were in a position to shift back to domestic sources of funds because of leeway accumulated under existing balance-of-payments guide-lines. It also appears that US and Canadian borrowers — and others as well — may have obtained appreciably more financing in 1970 by way of medium-term Euro-dollar bank credits. The decline in Japanese issues, on the other hand, may have had less to do with the easing of domestic monetary conditions than with the policy of keeping down the size of the external payments surplus. As from the spring of 1971 authorisations for foreign borrowing were to be granted only if the loan proceeds were intended for use abroad.

In western Europe the continuance of relatively tight monetary conditions during most or all of 1970 led borrowers to turn on a larger scale to international issues. This appears to have been the case in the United Kingdom, which accounted for $230 million, and also for another large borrower, France, which took up $245 million. In Italy, whose bond flotations more than doubled to reach $340 million, informal prompting by the authorities played a rôle. (Including medium and long-term credits and loans obtained from banks, Italian borrowing abroad last year came to nearly $2 milliard.) Next in importance were the Netherlands and Germany ($170 and 120 million respectively), the four Scandinavian countries and Ireland (with amounts ranging between $40 and 90 million). Issues by European institutions, which accounted for $125 million out of the $145 million taken up by all international institutions, were considerably above their 1969 level.

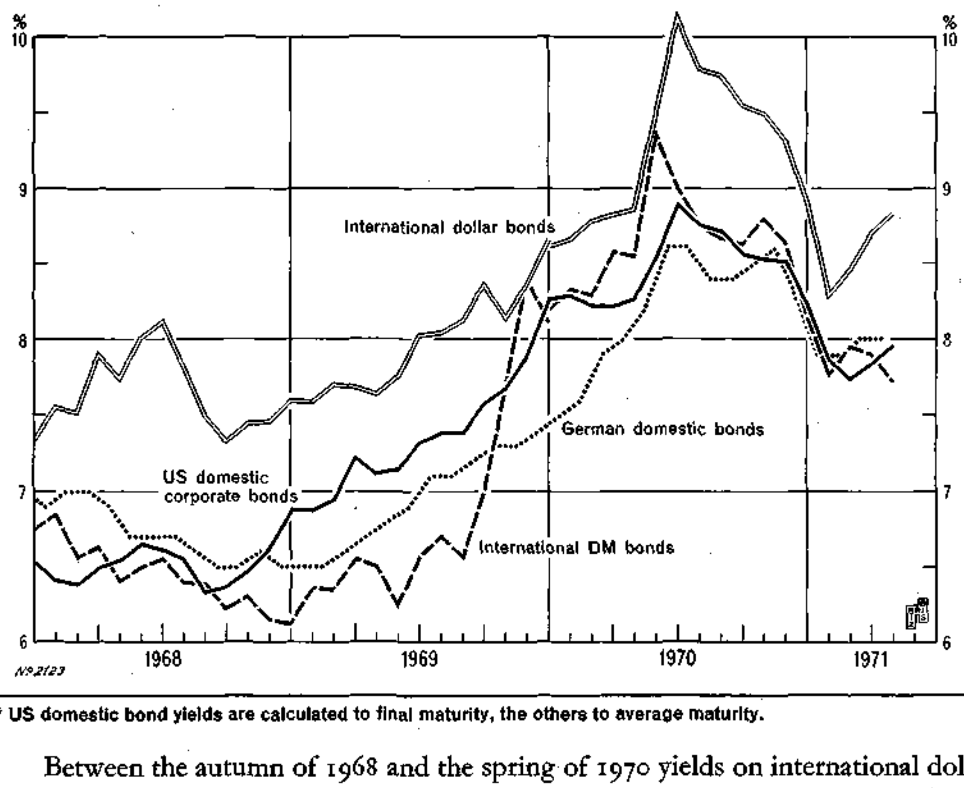
Balance-of-payments data suggest that purchases of international bonds by Italian residents were somewhat smaller, and those by German residents much smaller, in 1970 than in 1969. On the other hand, the decline in short-term Euro-currency rates probably led investors from a number of countries to shift into Euro-bonds.

International bond issues.
Cumulative gross totals, as from the end of 1962.



Turning to types of issues, the protracted decline in the US equities market from the beginning of 1969 up to the spring of 1970 contributed to a heavy curtailment in convertible dollar flotations. From their peak of over $1.9 milliard in 1968, they dropped to $1.1 milliard in 1969 and to only $220 million last year. In contrast, straight dollar issues, which had already come back into favour following the revaluation of the Deutsche Mark, grew considerably. At the same time, there was a virtual cessation of DM issues for some months after October 1969, but they began to appear again in the spring of 1970 and amounted for the year as a whole to $590 million, or 23 per cent. of straight bond issues. In addition, Dutch banks arranged the issue of some $320 million of five-year guilder notes, which, since they could be sold only to non-residents and the proceeds had to be used abroad, helped reduce large capital inflows to the domestic market. In 1970 investor interest in straight bonds appears to have been strengthened by several special factors: the growing importance of reinvestment demand related to redemption of older issues, the wider use of guilder notes and the introduction of variable-interest bonds and of bonds denominated in European monetary units. Another feature in recent years was the appearance of international equity issues, but these declined from $515 million in 1969 to only $125 million last year, mainly because investment funds virtually discontinued their issue activity.

Yields on international and domestic issues of US dollar and DM bonds.*



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

Between the autumn of 1968 and the spring of 1970 yields on international dollar bonds rose fairly steadily in line with those of US domestic corporate bonds. In the spring of 1970, with liquidity fears widespread, yields on international issues rose sharply, to above 10 per cent., and the margin over domestic bonds widened.

Subsequently, international yields came down rapidly, particularly around the turn of the year, and the gap between these and domestic bond yields narrowed. Yields on international DM bonds, which had risen sharply after the DM revaluation, hit their peak in the spring of 1970, at which time they came close to comparable dollar bond yields. After that, however, a gap again opened between yields on international DM bonds and those on dollar bonds — similar to, but not as large as, that existing prior to revaluation. In late 1970 and early 1971 yields on international and domestic DM bonds came into line and then moved closely together.

In the first four months of 1971 total foreign and international bond issues came to about $2.2 milliard, or more than half as much again as in January–April 1970. Reflecting heavy flotations by both US and European borrowers, international bond issues rose sharply to $1.5 milliard and accounted for close on 70 per cent. of total issues. In the early spring, however, new issues proceeded at a less hectic pace, and in May they slowed down still further under the influence of currency speculation and uncertainties about interest rates. These factors also made themselves felt in the secondary market for straight dollar bonds, where yields increased from about 8.3 per cent. in January to 8.8 per cent. in April. Yields on DM bonds were more stable, fluctuating over this period around a level just under 8 per cent.

Credit developments in individual countries.

United States. The gradual restoration of monetary ease from early 1970 onwards followed conventional lines for the most part. The Federal Reserve supplied new reserve funds more generously through open-market operations, and the official discount rate was brought down in five steps from 6 to 4¾ per cent. The monetary outcome, however, was significantly influenced by two new policy departures. One was the increased stress placed on controlling the "monetary aggregates", principally the money supply and bank credit, as distinct from the banks' free (i.e. excess minus borrowed) reserves and interest rates. The other consisted in measures to help the banks, which had suffered heavy losses of deposits in 1969, to compete more effectively for domestic funds.

The Federal Reserve's greater emphasis on the monetary aggregates did not involve any strict adherence to given rates of their growth but rather was meant to ensure that their behaviour was more regular and determinate than in the past. Thus in early 1970 the authorities aimed first at a "modest", and later at a "moderate", growth in the aggregates. On the other hand, from May to July, when market conditions were highly disturbed as a result of the incursion into Cambodia and the Penn Central railway failure, the aggregates became of secondary concern as policy concentrated on relieving financial strains. Subsequently, from August to October, primary attention was again given to achieving a moderate growth in the aggregates, combined with an easing of credit-market conditions. Towards the end of the year, when the General Motors strike caused the aggregates to fall short of the target, no immediate attempt was made to compensate this.

In practice, the authorities gave most attention last year to the money supply narrowly defined (currency plus demand deposits), especially since the other aggregates were temporarily distorted by regulatory changes. Over the year as a whole the money

United States: Changes in financial assets and liabilities.

Sectors	Years	Net acquisition of financial assets: Money[1]	Savings claims[2]	Credit and equity-market claims[3]	Other assets[4]	Total	*Less:* Net increase in financial liabilities	*Equals:* Financial surplus or deficit (—)
		in milliards of dollars						
Households	1968	11.1	48.4	5.8	0.3	65.6	34.8	30.8
	1969	5.9	33.6	18.0	— 1.8	55.7	30.7	25.0
	1970	3.5	55.7	9.5	— 0.4	68.3	20.2	48.1
Business firms	1968	1.8	1.9	7.4	16.2	27.4	53.3	—25.9
	1969	— 0.8	— 9.8	13.8	25.1	28.3	67.7	—39.4
	1970	0.3	12.6	— 1.0	11.1	23.2	54.4	—31.2
State and local governments	1968	0.7	3.2	0.4	0.7	5.0	10.5	— 5.5
	1969	3.2	— 5.9	6.1	0.6	3.9	9.0	— 5.1
	1970	1.2	9.9	— 3.8	0.4	7.7	12.8	— 5.1
Federal Government[5] . . .	1968	— 1.7	—	8.1	4.9	11.4	19.1	— 7.7
	1969	1.1	—	11.5	2.2	15.1	6.6	8.5
	1970	2.5	—	12.6	— 0.4	14.7	26.2	—11.5
Banking system[6]	1968	1.9	—	42.1	3.6	47.7	45.9	1.8
	1969	0.4	—	21.9	1.7	23.9	22.2	1.7
	1970	1.9	—	33.1	8.3	43.3	41.1	2.2
Other financial institutions .	1968	0.9	— 0.1	45.6	3.7	50.0	49.7	0.3
	1969	0.5	— 0.1	49.0	— 0.7	48.7	50.4	— 1.7
	1970	1.3	0.7	48.1	1.6	51.7	51.6	0.1
Rest of the world[7]	1968	1.5	— 0.3	2.4	4.9	8.5	7.6	0.9
	1969	— 0.7	1.0	1.3	8.7	10.3	6.7	3.6
	1970	1.1	— 1.9	11.0	— 5.0	5.2	4.6	0.6
Total	1968	16.2	53.1	111.8	34.3	215.6	220.9	— 5.3[8]
	1969	9.6	18.8	121.6	35.8	185.9	193.3	— 7.4[8]
	1970	11.8	77.2	109.5	15.6	214.1	210.9	3.2[8]

[1] Currency and demand deposits. [2] Fixed-value claims in the form of time and savings deposits, shares in savings and loan associations and credit unions, US savings bonds and equity in life insurance and pension funds. [3] Includes Federal obligations, State and local obligations, corporate bonds and shares, mortgages, consumer-credit claims, bank credit and other miscellaneous loans. [4] Includes trade credit, direct foreign investment and miscellaneous assets. [5] Includes Federally-sponsored credit agencies. [6] Comprises Federal Reserve System, and commercial banks and their affiliates. [7] Net change in financial assets or liabilities vis-à-vis the United States. [8] Statistical discrepancies.

supply rose by 5.4 per cent., against 3.1 per cent. under conditions of restraint in 1969. In view of the fact that gross national product at current prices rose by 4.9 per cent. but that unemployment at the year-end was running at 6.2 per cent., monetary expansion seems up to end-1970 to have been fairly moderate. At all events, it was markedly below the average rise of 7.2 per cent. that occurred in the years 1967–68 after the 1966 credit squeeze.

As to the second facet of monetary policy, some rechannelling of credit flows through the banks, following the "disintermediation" process of 1969, was facilitated by general monetary ease and falling market rates. But three particular measures helped the process. In January the Regulation Q ceilings for interest rates payable on large time deposits were raised by ¾–1¼ percentage points. As a result rates offered by the banks for longer-term deposits became competitive again from about late March onwards. A more important step came in late June, when the ceiling for large time deposits with maturities of 30–89 days was removed altogether. This action, prompted by the need to ease severe liquidity strains by increased bank lending, was followed by a rapid acceleration in the formation of time deposits. The third measure came in August, when it was decided to impose reserve requirements (5 per cent. on time funds and 17½ per cent. on demand funds) on resources raised by bank affiliates through issues

United States: Total net funds raised in the credit markets by non-financial sectors.

Credit instrument or sector	1967	1968	1969[1] 1st half	1969[1] 2nd half	1970[1] 1st half	1970[1] 2nd half	1971[1] 1st quarter
	in milliards of dollars						
Demand for funds							
US Government securities	13.0	13.4	− 7.5	0.3	9.5	16.1	− 5.3
Corporate equities	2.4	− 0.7	2.0	7.6	6.0	7.7	6.1
Corporate and foreign bonds	15.9	14.0	14.6	11.6	18.7	23.5	28.1
State and local-government securities	8.7	9.6	11.1	5.2	9.6	14.1	26.0
Mortgages	22.0	27.3	28.8	27.1	21.9	28.6	29.0
Consumer credit	4.6	11.1	10.5	8.2	5.5	3.2	4.2
Bank loans	9.6	13.4	18.1	13.0	8.3	− 2.8	1.9
Other	7.3	8.8	15.4	14.6	13.1	11.0	11.8
Total	83.5	96.9	93.0	87.6	92.6	101.4	101.8
Supplied directly by:							
Federal Government	5.1	4.7	1.9	3.7	4.2	4.5	5.6
Banking system	41.4	43.2	22.6	10.0	15.5	57.0	64.1
Other financial intermediaries	34.4	34.2	35.4	25.5	33.8	44.9	66.2
Private non-financial sector[2]	− 0.2	12.3	32.5	46.4	29.6	−17.4	−50.3
Foreign	2.8	2.5	0.6	2.0	9.5	12.4	16.2
Total	83.5	96.9	93.0	87.6	92.6	101.4	101.8

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

of commercial paper for purposes of refinancing bank loans. Since, at the same time, reserve requirements in respect of time deposits were reduced from 6 to 5 per cent., the banks could compete more effectively for deposits while ceasing to raise funds by other means domestically and through the Euro-dollar market.

The nature of monetary restraint in 1969 and of the return to monetary ease in 1970 led to enormous swings in the channelling of loanable funds. In 1968, under conditions of relative ease, lending by the banking system and other financial intermediaries accounted for over three-quarters of total net funds advanced in the credit markets. The remainder consisted of direct financial investment by non-financial sectors in such assets as securities, loans and commercial paper. In the second half of 1969, by which time monetary policy had become very restrictive, the proportion of total net credit advanced by financial institutions dropped to only two-fifths. Largely because of high market interest rates, private domestic non-financial sectors (including State and local governments) shifted away from bank deposits, increasing their direct investment in market instruments from only $12 milliard in 1968 to an annual rate of $46 milliard in the second half of 1969. By the second half of 1970 this process of disintermediation had more than reversed itself. The private non-financial sectors shifted back to deposits on a major scale, and lending by the banking system and other financial institutions accounted for practically all the total net funds advanced in the credit markets.

By comparison, the overall change in net funds raised on the credit markets was kept to fairly moderate proportions. Total net credit, after declining from $97 milliard in 1968 to an annual rate of $88 milliard in the second half of 1969, rose again to $101 milliard in the second half of 1970. The recovery in credit demand, however, was solely due to a changeover in the Federal Government's position from debt repayment at an annual rate of \$7.5 milliard in the first half of 1969 to borrowing of \$16 milliard in the second half of 1970. Total lending to all other sectors dropped from over \$100 milliard in the first half of 1969 to a low of \$83 milliard in the corresponding period of 1970 and stayed at this level in the second half of the year.

In view of previous liquidity strains, the easing of credit-market conditions in 1970 led borrowers greatly to increase their demand for long-term funds. Issues of corporate bonds and equities, plus State and local-government securities, rose to an annual rate of \$45 milliard in the second half of 1970 from a figure about half that size one year earlier. Mortgages, too, expanded significantly in the course of 1970. On the other hand, demand for bank loans fell off quite sharply, and the growth of consumer credit also continued to contract.

Viewed from another angle, the commercial banks (including their affiliates) saw their demand and time-deposit liabilities rise by \$43.8 milliard in 1970 after an actual decline of \$4.5 milliard in 1969. In contrast, demand for bank loans, including consumer credit, grew by only \$4.0 milliard, against a rise of \$21.1 milliard in 1969. The banks responded to this situation partly on the liabilities side, where they reduced their Euro-dollar and commercial-paper liabilities by \$8.7 milliard, after increasing them by \$11.2 milliard the year before. The remaining net growth in resources, amounting to about \$36 milliard, was used for the acquisition of government securities and open-market paper (\$11 milliard), State and local-government bonds (\$10.1 milliard) and miscellaneous other assets, including mortgages and company commercial paper. The main support for the mortgage market, however, came from the savings and loan associations and mutual savings banks, into which savings funds flowed on a much larger scale in the course of 1970.

In the first four months of 1971 the growth of the money stock accelerated to an annual rate of about 9 per cent., while time deposits at commercial banks surged ahead at a rate of 25 per cent. The economic rebound after the strike-affected fourth quarter had something to do with this, but it is much more likely to have reflected the authorities' increasing concern with the economy's underlying weakness. Business loan demand seemed seasonally stronger, but the banks' growing resources went mainly into securities, particularly those of State and local governments. In addition, the banks continued to reduce liabilities to their foreign branches and the volume of bank-related commercial paper. The three-month Treasury bill rate fell from about 4¾ per cent. at the end of 1970 to only 3.3 per cent. at the end of March 1971. These developments gave rise to increasing concern that monetary ease was being pushed unnecessarily far, thus storing up problems of monetary control in the future while also bringing undue pressures on other countries. In this setting the government began to consider the possible use of fiscal stimuli, and the monetary authorities began to apply market techniques designed to prop up short-term rates while putting downward pressure on long-terms ones. By mid-May the three-month Treasury bill rate had moved up to about 4¼ per cent., but yields on long-term bonds had also stiffened.

United Kingdom. In the spring of 1970, after nearly two years of severe restraint, monetary policy took a more moderate turn. Bank rate, which had been reduced from

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

Items	Years	Public sector	Overseas sector[1]	Persons	Industrial and commercial companies	Banks	Other financial institutions
		in millions of £ sterling					
Saving plus net capital transfers	1968	2,815		2,000	3,390	220	
	1969	4,035		2,085	3,530	160	
	1970	4,915		2,525	3,255	250	
Gross domestic capital formation (—)	1968	−3,850		−1,310	−3,215	−370	
	1969	−3,730		−1,200	−3,830	−475	
	1970	−4,095		−1,320	−4,230	−495	
Financial surplus or deficit (—)	1968	−1,030	305[2]	690	175	−150	
	1969	310	−435[2]	890	−300	−315	
	1970	820	−630[2]	1,200	−975	−245	
Corresponding changes in financial assets and liabilities							
Bank lending	1968	−80	−2,855	−40	−525	3,540	−45
	1969	155	−4,860	75	−615	5,225	20
	1970	−400	−2,595	−60	−1,065	4,200	−80
Notes and coin and bank deposits	1968	−220	2,625	755	285	−3,515	70
	1969	−130	4,725	380	−170	−4,980	175
	1970	−185	3,395	935	325	−4,690	220
Total currency flow[3]	1968	−1,410	1,410				
	1969	745	−745				
	1970	1,285	−1,285				
Overseas loans and investments	1968	205	−420		185		30
	1969	30	−145		135		−20
	1970	295	−195		−40		−65
Marketable government debt	1968	730	−75	−260	−40	−395	40
	1969	205	45	75	−10	−590	280
	1970	−280	15	−205	10	140	315
Non-marketable government debt	1968	−5	—	−40	55	−10	−5
	1969	−215	60	−235	380	15	—
	1970	320	−30	−40	−230	−20	10
Local-authority debt	1968	−585	−55	245	−30	260	165
	1969	−600	30	220	−85	320	115
	1970	−545	−40	−60	−120	485	280
Claims on other financial institutions[4]	1968		−105	2,455	25		−2,375
	1969		—	2,535	60		−2,590
	1970		15	3,300	−5		−3,315
Shares and securities[5]	1968	55	−125	−485	−120	70	605
	1969	15	135	−400	−135	35	355
	1970	5	−65	−860	205	65	645
Other domestic loans[6]	1968	275		−1,015	−330	25	1,045
	1969	165		−915	−270	−10	1,025
	1970	195		−1,235	−370	40	1,375
Unidentified	1968	—	−95	−925	670	345	
	1969	−50	320	−850	410	320	
	1970	130	155	−575	310	145	

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

Source: Bank of England.

8 to 7½ per cent. in early March, was cut to 7 per cent. when the new budget was introduced in mid-April. In addition, the quantitative ceiling on bank credit was modified, to be replaced by guide-lines which suggested a gradual one-year rise of 5 per cent. for the main deposit banks as a group and of 7 per cent. for other banks individually. On the other hand, special deposits, calculated on gross deposit liabilities, were raised by half a percentage point and it was indicated that this type of change would be used more flexibly as an instrument of credit policy. Priority was to continue to be given to credits for exports, productive investment and agriculture.

These changes occurred against a background of excess capacity and slow growth, tight company liquidity conditions, a continuing budget surplus and optimistic assumptions about future wage developments. It was expected that domestic credit expansion over the fiscal year would come to £900 million and that the broadly-defined money supply would rise by about 5 per cent. In the event, though the economy grew less than expected, the expansion of the money supply was much greater than foreseen.

The reasons for this errant movement are to be found mainly in developments in the company sector. While throughout most of 1970 their gross fixed investment was running well ahead of 1969 levels, industrial and commercial companies experienced a marked deterioration in their self-financing capacity, partly because of slack demand but mainly because of rising costs, particularly wages. As a result, their financial deficit rose steeply to £975 million, following one of £300 million in 1969 and a surplus of £175 million in 1968.

To some extent companies' large financial needs could be covered by easier access to sterling bank credit and by reimbursement of import deposits. It had been expected, moreover, that they would turn increasingly to long-term financing. However, after easing somewhat in early 1970, capital-market conditions began to tighten again in the spring, and remained unfavourable for the rest of the year, with yields on company bonds seldom falling below 10½ per cent. In the event, total net issues by industrial and commercial companies came in 1970 to only £194 million as against £512 million in 1969. The upshot was that companies looked elsewhere for funds. In the early stages, as advances had become cheaper through the Bank rate reductions, they increased their recourse to bank credit much faster than envisaged under the guide-lines relating to lending in sterling. Later, with exchange control authorisation, they greatly increased their borrowing in foreign currencies for domestic use. This borrowing, together with other exchange inflows last year, contributed to the unexpectedly large growth in the money supply.

The working-out of these tendencies, together with the policy responses to them, can largely be traced in the behaviour of "domestic credit expansion" (equal essentially to changes in the money supply adjusted for the effects of the balance-of-payments surplus or deficit). Total domestic credit expansion amounted in 1970 to £995 million, after recording a fall of £180 million in 1969. The principal dynamic element was bank lending to the private sector, which went up by £1,110 million, against a rise of only £480 million in the previous year. A considerable portion of the 1970 figure consisted of borrowing in foreign currencies converted into sterling for domestic use.

United Kingdom: Domestic credit expansion.

Items	1967	1968	1969	1970
	in millions of £ sterling			
Public-sector borrowing requirement*	1,825	1,315	— 475	10
Net sales of public-sector debt to non-bank private sector (—)*	— 625	— 75	— 340	— 150
Bank lending to private sector	540	530	480	1,110
Bank lending in sterling overseas	25	140	150	25
Domestic credit expansion . . .	1,765	1,905	— 180	995

* Public-sector borrowing less sales of public-sector debt to the non-bank private sector equals changes in the currency circulation plus the public sector's borrowing from banks and its net external financing.

The public sector's borrowing requirement, after dropping from £1,825 million to −£475 million over the two years to 1969, returned last year to a positive figure of £10 million. This reversal was not attributable to a deterioration in the sector's financial surplus (saving minus investment), which, on the contrary, rose from some £310 million in 1969 to £820 million. Rather, it largely reflected a changeover from the receipt of import deposits in 1969 to the repayment of them last year.

Although its borrowing requirement in 1970 was negligible, the public sector borrowed from domestic sources some £1,385 million and repaid external debt to nearly the same amount. Net sales of public-sector debt to the non-bank private sector (which figure as a negative item in domestic credit expansion) came to only £150 million, or less than half as much as in 1969. In addition, funds were obtained not only from the increase in currency circulation (£320 million) but also through borrowing from banks, which turned round from −£365 million in 1969 to £915 million last year. This swing was mainly associated with changes in the banks' government securities portfolio in conjunction with both exchange inflows and a high rate of deposit formation. Thus, after cutting back their government security holdings by £590 million in 1969, the banks made net purchases last year of £140 million, reflecting Treasury bill acquisitions of £550 million offset by reductions in gilt-edged holdings of £410 million. Moreover, in contrast to 1969, the Bank of England Banking Department added considerably to its government security holdings last year, and bank advances to local authorities and public corporations accelerated.

During the last three quarters of 1970 the monetary authorities experienced considerable difficulty in working to their objective of preventing an excessive expansion of domestic credit. After the April 1970 budget and prior to the June election, sentiment in the gilt-edged market weakened markedly because of fears of continuing strong inflation and uncertainties about external prospects. Although yields on long-term government bonds were allowed to rise to nearly 10 per cent. in June, the authorities took in some £85 million of gilt-edged securities from domestic non-bank holders. Sentiment improved after the election and the end of the dock strike, but another £170 million of gilt-edged stock was purchased from non-bank holders in the September quarter, when a large maturity fell due. In July the authorities had to admonish the banks for having already expanded sterling credit faster than implied by the guideline for the year. The continued rapid rise in wages had emerged as the most severe constraint on monetary policy. In October, with wage increases still charging ahead, the authorities announced that "Draconian" monetary measures were not envisaged, and the only action taken was to increase special deposit requirements by one percentage point so as to absorb liquidity. The policy of moderate restraint was again confirmed in January 1971, when the Chancellor announced that his aim was not passively to provide the amount of money needed to underwrite the current rate of inflation, but something less. The implication was that monetary restraint was not to be used on its own to counter wage inflation.

All in all, the money supply rose in 1970 by £1,520 million, or nearly 9½ per cent., compared with only 3 per cent. in 1969. This increase substantially exceeded domestic credit expansion, which amounted to £995 million, the difference being attributable to the external surplus.

In the first quarter of 1971 exchange inflows were particularly large, partly because of company foreign currency borrowing to meet seasonal liquidity needs and partly because of relatively high UK interest rates. To slow down company borrowing, it was stipulated in January that foreign currency credits must in future be for terms of five years or more, with exchange cover permitted only over the final six months. The inflows subsequently found their way, largely via financial institutions, into the gilt-edged market, where more generally the growing expectation of declining interest rates was attracting considerable buying interest. Official sales of gilt-edged securities may have totalled as much as £1,250 million in January–March. Moreover, the fact that a large proportion of these sales was made to non-banks helped to slow down the growth of the money supply and domestic credit expansion.

When introducing his new budget, the Chancellor announced a relaxation in the credit guide-lines so as to permit sterling advances to increase for the time being by 2½ per cent. a quarter. This would probably lead companies to turn from borrowing in foreign currency back to sterling credits, and the cut in Bank rate by a full percentage point at the beginning of April promised to reinforce this tendency. Moreover, the reduction in the corporation tax brought some relief to companies, which could also expect to benefit from higher consumption spending. The difficulty remains, however, that the money supply cannot be brought under effective control without considerable help from incomes policy.

In May the authorities outlined proposals calling for a far-reaching set of changes in monetary control techniques. In principle, these proposals would involve a shift away from quantitative credit ceilings, which have impeded competition and innovation, in favour of reliance on the price mechanism as a means of allocating bank credit. In future, therefore, the authorities "would seek to influence the structure of interest rates through a general control over the liquidity of the whole banking system". The cash and liquidity ratios currently applied to the London clearing and Scottish banks would be replaced by a unified reserve ratio applied across the entire banking system. Against this fixed ratio the "special" and "cash" deposit schemes would be unified and used more flexibly, together with policies to influence interest rates. The new reserve ratio would be set in relation to sterling deposit liabilities to non-banks, including sterling acquired by inward switching, and reserve assets would include cash and assets which the authorities would normally be prepared to convert into cash, notably money at call in the discount market, Treasury bills, eligible local-authority paper and (up to a certain proportion) commercial bills as well as government securities with a year or less to maturity. A further proposal is that the clearing banks should abandon their collective agreements with regard to interest rates, except those for savings deposits. In general, the proposals would put all banks in the United Kingdom on an equal competitive footing in respect of both sterling and Euro-currency activity. As part of the new monetary approach, but with immediate effect, the Bank of England changed its stance in the gilt-edged market. Whereas it had hitherto normally stood ready to buy gilts, though at a price of its own choosing, the Bank now no longer feels itself obliged to provide outright support for the gilt-edged market in stocks having a maturity of over one year. Thus, it will "not normally be prepared to facilitate movements out of gilt-edged by the banks, even if their sales should cause the market temporarily to weaken quite sharply".

Canada. Although demand conditions had eased some months before, continuing cost and price pressures led the authorities to keep to a restrictive monetary policy into the early months of 1970. Nevertheless, in line with US developments, interest rates had started to move down already around the end of 1969, and this drift continued up to early 1971. A clear relaxation took place from the second quarter onwards, when the impact of the surplus in the balance of payments was allowed to be reflected in increased liquidity of the economy. But the very large exchange inflows over this period threatened to disrupt the timing and degree of relaxation considered appropriate. Though the floating of the Canadian dollar at the end of May restored some monetary autonomy, the authorities were by then ready on domestic grounds to speed up the return to easier credit conditions. From May 1970 to February 1971 the official discount rate was reduced in six steps from 8 to 5¼ per cent. Lending support to this movement, the government's budget shifted from a surplus of $610 million in 1969 to a deficit of $165 million in 1970.

The new policy stance was reflected in a rapid rise in the banking system's total assets and liabilities, which went up at a seasonally adjusted annual rate of about 13.5 per cent. in the nine months to December 1970, compared with virtually no increase in the preceding nine months. Within this total, business loans grew more slowly than before, while personal loans, after remaining fairly level for a year, began to accelerate in mid-1970. Total loans went up during the last three quarters of 1970 at an annual rate of only 6.1 per cent., while liquid assets (mostly government securities) shot up by 31.5 per cent. and other security holdings also recorded a sharp rise. Thus, the chartered banks, after unloading close on $0.5 milliard's worth of securities in 1969, increased their holdings by almost $2 milliard in 1970.

Net new issues of securities (including those denominated in foreign currencies) amounted to nearly $6 milliard in 1970, approximately $1 milliard more than in 1969. Public issues took the lion's share, with a total of over $4 milliard. The central government, in particular, substantially increased its recourse to the market, borrowing nearly $2 milliard. Issues of corporate bonds also showed a large rise compared with 1969, but this was more than offset by a fall in new issues of equities and short-term paper. In view both of interest rate developments and of the authorities' direct prompting in favour of domestic finance, net new issues in foreign currencies went down to $600 million, against $1,710 million and $1,550 million in 1969 and 1968 respectively.

Domestic sales of securities increased from \$3 milliard in 1969 to \$5.1 milliard in 1970, mainly because of the banks' changeover to large net purchases of bonds.

From 1969 to 1970 the total of new funds raised by non-financial sectors in the credit markets declined by just over 5 per cent. Of the total funds raised by the government, three-quarters were required to finance the increase in foreign exchange reserves. Both consumer and mortgage debt grew more slowly last year. The financial deficit of corporations must have expanded as a combined result of increased investment, on the one hand, and the adverse effects on profits of wage inflation and the appreciation of the Canadian dollar, on the other hand. Still, they borrowed less and appear instead to have cut down on their short-term financial assets, foreign currency deposits in particular. But, to strengthen their liquidity positions, they reduced their recourse to new bank credit and to the issue of short-term paper, while increasing their long-term fixed-interest borrowing.

Canada: Total net funds raised in the credit markets by non-financial sectors.

Sectors	1968	1969	1970	Changes in net funds raised	
				1968–69	1969–70
	In millions of Canadian dollars				
Consumers	1,215	1,265	660	50	− 605
Mortgages[1]	1,230	1,595	1,330	365	− 265
Non-financial business[2]	2,650	3,765	2,600	1,115	−1,165
Provincial and municipal governments[3]	2,250	2,260	2,100	10	− 160
Government of Canada[4]	1,110	280	1,990	− 830	1,710
Total	8,455	9,165	8,680	710	− 485

[1] Excludes net mortgage lending by governments and their agencies. [2] Excludes agriculture. [3] Excludes loans from the central government but includes securities purchased by the Canada and Quebec Pension Plans. [4] Excludes net new foreign currency issues.

Early in 1971 policies remained expansive with a view to sustaining the pace of growth — which had already clearly quickened since the fourth quarter of 1970 — and to help reduce unemployment. Domestic credit conditions were further eased and a supplementary budget approved at the end of 1970 introduced new stimulatory measures.

Japan. In the fifth year of sustained expansion and against the background of a large external current-account surplus, credit policy was tightened as from September 1969. The official discount rate was increased and stricter guidance was given as to the net liquidity positions of city and long-term credit banks so as to avoid an unduly rapid rise in their lending. City-bank lending, which is most affected by credit restraint, thereafter slowed down, but lending by all financial institutions together continued to expand strongly until the summer of 1970. Then, primarily because excessive business inventories were beginning to depress output, steps were taken in the direction of monetary ease.

During 1970 the Bank of Japan gradually relaxed its guide-lines on the increase in city-bank credit, limits being set for the March quarter at 105 per cent., for the June quarter at 109 per cent., for the September quarter at 111 per cent. and for the December quarter at 116 per cent. of the increase in the corresponding period of 1969. From June onwards it provided the exchange banks with yen funds outside their central-bank borrowing quotas at the official discount and loan rates for use in financing imports in place of foreign exchange credits financed from abroad. Moreover, in view of the calming-down of economic activity, the official discount rate was lowered from 6.25 to 6.0 per cent. in October.

The central government substantially increased its financial surplus in 1970, using this partly to reduce its security issues and increase its own holdings of securities. Moreover, its position with the central bank attributable to the movement in its general fund accounts improved by Yen 515 milliard, which more than offset the effect on bank liquidity of the growth of official foreign exchange reserves. In this situation the Bank of Japan helped to supply the banks with additional reserves through its loans and security purchases, which, including funds provided to encourage a shift to yen financing, rose from Yen 885 milliard in 1969 to Yen 1,335 milliard in 1970. But, with bank liquidity remaining under pressure for most of the year, call-money rates stayed at 8¼–8½ per cent. until the autumn, then declined to 6½ per cent. by April 1971.

Japan: Changes in financial assets and liabilities.

Items	Years	Corporate sector	Personal sector	Central government	Public enterprises and local authorities	Banking system	Other financial institutions	Rest of the world[1]
		in milliards of yen						
Financial surplus or deficit (—)	1968	—2,910	4,670	80	—1,455			— 375
	1969	—3,455	5,180	380	—1,340			— 765
	1970	—4,495	5,750	1,050	—1,580			— 725
Corresponding changes in financial assets and liabilities[2]								
Money and time deposits	1968	1,990	4,870	— 995	155	—4,325	—1,700	
	1969	3,065	6,525	—1,190	220	—5,235	—3,385	
	1970	3,670	6,715	—1,400	210	—5,685	—3,510	
Insurance and trust claims	1968	130	1,515	— 235	5	—	—1,415	
	1969	165	1,815	— 280	5	10	—1,705	
	1970	185	2,175	— 360	10	25	—2,035	
Securities (net)	1968	— 370	620	— 380	— 890	600	565	
	1969	— 445	1,045	— 75	— 880	255	335	
	1970	— 770	1,420	340	— 820	125	— 65	
Loans	1968	—5,610	—1,865	1,505	— 635	3,650	2,960	
	1969	—7,865	—2,715	1,705	— 650	4,650	4,875	
	1970	—9,420	—3,240	2,115	— 965	5,700	5,810	
Official reserves	1968							— 320
	1969							— 220
	1970							— 280
Other foreign claims (net)	1968	— 55		90	— 50	115	—	— 90
	1969	— 210		165	— 20	525	—	— 595
	1970	— 95		170	15	220	10	— 515
Miscellaneous transactions[3]	1968	1,005	— 470	90	— 40	— 40	— 410	30
	1969	1,830	—1,485	55	— 20	— 200	— 120	50
	1970	1,930	—1,315	185	— 30	— 385	— 210	70

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

Source: Bank of Japan.

The growth of deposits with financial institutions slowed down last year. With large inventory accumulation and reduced profitability, the corporate sector had a much bigger financial deficit in 1970. Its borrowing through loans was well maintained, and it raised appreciably more than before through security issues. In the personal sector, which again recorded a sizable increase in its financial surplus, the deceleration of deposit growth was associated mainly with a shift to security investments. The slow-down was most marked for demand deposits and was partly a response to increases in the spring in security yields and, for the first time in nine years, in time-deposit rates.

Total bank lending increased in 1970 by 17 per cent., somewhat faster than in 1969, while that of other financial institutions, after accelerating sharply in 1969, rose at nearly the same rate last year. This was because the slower growth of deposits could be cushioned — for the banks by increased funds from debenture issues and by a smaller rise than in 1969 in their net foreign positions, and for the other institutions by a reduction in their security acquisitions. With an increased supply of funds from the personal sector and from abroad, total security issues rose to Yen 3,800 milliard last year, compared with Yen 3,100–3,300 milliard in each of the previous four years. As, moreover, public-sector issues were cut back last year, banks and industrial companies were able to raise substantially more on the market, the growth in corporate stock issues being particularly pronounced.

In early 1971 the main objective of monetary policy was still to provide some domestic stimulus while taking account of external developments. From the beginning of 1971 the system of target limits for increases in city-bank credit was terminated. In January the Bank of Japan lowered its discount rate for commercial bills from 6 to 5¾ per cent. and cut the interest rate it charges on loans secured by other bills, including import bills, by half a percentage point. Moreover, in March and late May the authorities took steps to provide the banks with a combination of facilities for the specific purposes of replacing foreign funds in the financing of imports and of assisting in the provision of cheaper forward cover to exporters. On 8th May the official discount rate was brought down to 5½ per cent.

Germany. More than in any other country, monetary restraint in Germany over the past year was undermined by large inflows of funds from abroad. These inflows resulted primarily because a restrictive policy was applied over the entire period — though with diminishing intensity as time went on. But, in combination with this, Germany's predilection for a fully convertible Deutsche Mark, together with its use of monetary techniques which operate indirectly through bank liquidity and interest rates, paved the way for substantial recourse to foreign funds by business firms and, to a lesser extent, banks. Monetary restraint was gradually made effective, but its impact was felt much more through high interest rates than through limited credit availability.

In default of stronger measures of budget policy, the Bundesbank in March 1970 sharply raised its discount rate from 6 to 7½ per cent. and moved the already high lombard rate from 9 to 9½ per cent. To discourage the banks from borrowing abroad, a special reserve requirement of 30 per cent. was imposed as from April on any growth in liabilities vis-à-vis non-residents. Following the introduction of new fiscal restraints in July, the discount rate was brought down to 7 per cent., primarily on external grounds. But it was then kept at this relatively high level until the late autumn; in November and early December, with external considerations still playing a major rôle, it was reduced in two stages to 6 per cent.

After starting early in the year, inflows of funds remained modest during the spring, when the decline in US short-term interest rates was temporarily reversed, but picked up speed from June onwards. Up to about September 1970 the exchange inflows were largely sterilised, but thereafter they were permitted to have a fuller impact on bank liquidity. In July reserve requirements were raised by 15 per cent. across the board. Subsequently, with effect from September, the Bundesbank introduced a rather severe set of additional reserve requirements — 20 per cent. for savings deposits and 40 per cent. for sight and time deposits — applying to increments in resident and non-resident liabilities alike. However, these requirements did not work very satisfactorily and as from December they were replaced by an increase of 15 per cent. in reserve requirements on total deposits outstanding. At the same time, the 30 per cent. requirement on the growth of foreign liabilities, superseded in September, was reintroduced.

On a national-accounts basis the financial surplus of the public sector as a whole turned out at some DM 8.7 milliard. Although this was slightly higher than in 1969, it conceals a substantial increase in the social insurance sector's surplus (from DM 1.5 to 7.1 milliard), offset by a decline in that of public authorities (from DM 6.9 to 1.6 milliard). The public authorities supplemented their resources by borrowing DM 8.7 milliard from banks and other financial institutions. On the uses side, in addition to their normal lending for housing and other purposes, the public authorities deposited with the Bundesbank DM 2.5 milliard in the anti-cyclical reserve fund plus another DM 2.2 milliard deriving from the temporary income-tax surcharge.

Over the year as a whole the market factors making for an increase in bank liquidity added up on a net basis to some DM 21.8 milliard, of which the influx of exchange alone accounted for DM 20.2 milliard. Over four-fifths of this increase was sterilised through policy action. The public authorities' special anti-cyclical deposits (including the reimbursable tax surcharge), plus the sterilised proceeds of a small bond issue, came to DM 4.9 milliard. In addition, DM 9.8 milliard was absorbed through increases in reserve requirements and another DM 3.0 milliard through open-market operations and cuts in rediscount quotas. As a percentage of total deposits, the credit institutions' liquid assets dropped from 6.8 in December 1969 to 5.3 in March 1970, but rose thereafter to reach 7.8 in December.

The strength of credit demand came largely from the enterprise sector (excluding housing), whose financial deficit again rose sharply, to DM 39.6 milliard from DM 29.1 milliard in 1969 and DM 9.1 milliard in 1968. Reflecting the effects of the 1969 revaluation and of cost pressures, retained earnings actually declined, while capital investment, though slowing down during the year, was substantially higher on average than in 1969. Altogether, enterprises raised funds in the amount of DM 63.7 milliard, of which one-third is estimated to have been taken up abroad. In earlier periods of restraint this proportion had never been higher than 20 per cent. Domestic borrowing mainly took the form of loans from credit institutions, but bond and share issues recovered,

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

Items	Years	Private house-holds	Housing	Enter-prises	Public sector	Foreign coun-tries[1]	Credit insti-tutions[2]	Other financial insti-tutions[3]
		in milliards of Deutsche Mark						
Net saving plus capital transfers	1968	35.50	8.20	27.85	13.00		3.30	0.50
	1969	42.00	5.15	22.55	28.45		– 0.05[4]	0.25
	1970	46.30	6.45	22.00	34.15		7.90	0.35
Net investment (–).	1968		–21.90	–36.90	–18.00		– 1.05	– 0.55
	1969		–22.40	–51.65	–20.10		– 1.35	– 0.75
	1970		–26.25	–61.65	–25.45		– 1.45	– 0.70
Financial surplus or deficit	1968	35.50	–13.70	– 9.05	– 5.00	– 9.95[5]	2.20	–
	1969	42.00	–17.25	–29.10	8.35	– 2.10[5]	– 1.45[4]	– 0.50
	1970	46.30	–19.80	–39.65	8.70	– 1.65[5]	6.45	– 0.40
Corresponding changes in financial assets and liabilities[6]								
Money, time and savings deposits	1968	24.45	0.15	12.65	5.35	6.20	–50.65	1.80
	1969	26.15	0.10	11.95	7.90	7.25	–54.85	1.55
	1970	26.70	0.15	16.05	7.50	11.55	–63.65	1.75
Claims on non-bank financial institutions	1968	9.05	–	1.10	0.15	0.05	0.10	–10.35
	1969	11.05	–	1.45	0.05	0.05	0.10	–12.70
	1970	12.70	–	1.30	0.15	–	0.10	–14.25
Money-market paper	1968	–	–	0.10	– 0.75	1.20	– 0.45	– 0.15
	1969	–	–	– 1.15	6.25	0.10	– 5.20	–
	1970	–	–	0.20	1.90	1.40	– 3.50	–
Bonds and shares: Purchases	1968	4.65	–	2.70	0.50	0.70	15.70	3.65
	1969	8.75	–	3.85	0.40	– 0.75	11.10	3.00
	1970	10.95	–	3.60	0.70	1.00	3.45	2.20
Sales.	1968	–	– 0.10	– 3.80	– 2.50	– 6.75	–14.70	– 0.05
	1969	–	– 0.05	– 2.95	0.45	–10.80	–12.95	– 0.10
	1970	–	– 0.05	– 4.70	– 0.75	– 3.65	–12.55	– 0.20
Bank credit	1968	– 2.75	– 9.85	–14.55	– 8.15	– 9.35	44.65	–
	1969	– 3.75	–11.00	–37.65	– 8.60	–13.45	74.75	– 0.25
	1970	– 3.10	–11.20	–31.55	– 8.15	– 4.10	58.60	– 0.45
Other loans	1968	– 0.20	– 3.20	– 1.25	– 0.45	–	–	5.10
	1969	– 0.10	– 5.65	– 1.55	– 0.65	–	–	7.95
	1970	– 0.35	– 8.15	– 1.55	– 0.55	–	–	10.60
Other claims and liabilities .	1968	– 0.25	– 0.70	– 6.00	0.90	5.55	–	–
	1969	– 0.10	– 0.60	– 3.05	2.60	1.15	–	–
	1970	– 0.55	– 0.50	–22.95	7.85	16.15	–	–
Gold and foreign exchange .	1968					– 7.55	7.55	
	1969					14.40	–14.40[4]	
	1970					–24.05	24.05	

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

rising from DM 2.95 milliard in 1969 to DM 4.7 milliard last year. Interestingly, the enterprise sector's liquid financial assets expanded appreciably more than in the preceding year.

The growth of the money supply, conventionally defined to include sight deposits but not (as is usual in Germany) short-term time deposits, came in 1970 to 8.8 per cent.

(6.4 per cent. in 1969) and was thus well below the 12.6 per cent. increase in nominal gross national product. Adding to this all deposit claims with maturities of up to four years, the expansion of money and quasi-money amounted to 10.5 per cent., or only fractionally more than in 1969. Thus monetary restraint took its toll, though at the expense of a huge sterilisation of funds and accumulation of official reserves. The credit institutions' lending to domestic non-banks increased by DM 51.0 milliard, or about 11 per cent., compared with some 13 per cent. the year before. The proportion accounted for by the public sector rose from 3.0 per cent in 1969 to 13.7 per cent. last year.

Net recourse to the capital market, after declining from a peak of DM 27.8 milliard in 1968 to DM 26.2 milliard in 1969, fell further to DM 21.6 milliard last year. However, residents' net purchases of foreign securities (including new issues of foreign and international bonds placed in Germany) dropped even more, from DM 11.8 milliard in 1969 to DM 2.6 milliard in 1970. In these circumstances, and despite capital-market strains, domestic borrowers were able to increase their net issues from DM 15.2 to 17.9 milliard. On the supply side, net purchases of fixed-interest-bearing securities by credit institutions declined from DM 10.0 milliard in 1969 to DM 2.4 milliard last year, while those by households, attracted by favourable interest rates, increased from DM 5.4 to 9.3 milliard.

In the first quarter of 1971 monetary conditions, though becoming easier, remained tight relative to those elsewhere, and non-bank residents continued to take up funds abroad. In February interest rates on current-account credits of less than DM 1 million averaged 10.6 per cent., or not much less than their peak of 11.6 per cent. in May 1970. In the early spring the demand for bank credit showed considerable strength. On 1st April the official discount rate was brought down from 6 to 5 per cent. and the lombard rate to 6½ per cent., but the move was prompted only by the need to ward off heavy inflows of short-term funds from abroad. Simultaneously, in view of persisting wage/price pressures, the Bundesbank cut the banks' rediscount quotas by 10 per cent. and announced its intention to step up open-market operations. A mounting flood of exchange from abroad brought the policy conflict to a head in the first week of May. By opting in these circumstances for a floating exchange rate, together with a virtual ban on interest payments on non-resident deposits, the authorities showed a determination to increase, rather than relax, their control over domestic monetary conditions. In early June, in order partially to sterilise recent inflows, reserve requirements were substantially raised — quite drastically in the case of non-resident deposits.

Italy. In early 1970 monetary policy was kept fairly restrictive for both domestic and external reasons, with interest rates continuing their steep adjustment to international levels. To speed up this process the official discount rate was raised in early March from 4 to 5½ per cent., with the supplementary margin of 1½ percentage points for excessive borrowing at the central bank being retained. Following the introduction of fiscal measures in August, however, monetary policy turned expansive with the aim of encouraging investment spending. But this move, too, was consistent with external developments in the light both of declining international interest rates and of the improvement that had already occurred in the balance of payments.

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

Items	Years	Public sector	Public enterprises[1]	Other enterprises and housing	Household sector	Banks and financial institutions	Overseas sector[2]
		in milliards of lire					
Saving (including capital transfers)	1968	— 600	555	5,170	5,560	390	
	1969	— 680	720	5,690	6,385	495	
	1970	— 880	660	6,920	6,480	550	
Gross domestic capital formation (—)	1968	—1,410	—1,300	—6,530		— 160	
	1969	—1,510	—1,425	—8,005		— 195	
	1970	—1,795	—2,170	—9,045		— 220	
Financial surplus or deficit	1968	—2,010	— 745	—1,360	5,560	230	—1,670
	1969	—2,190	— 705	—2,315	6,385	300	—1,475
	1970	—2,675	—1,510	—2,125	6,480	330	— 500
Corresponding changes in:							
Financial assets							
Liquid assets	1968	115	5	1,670	2,915	40	— 15
	1969	305	120	1,480	3,075	245	95
	1970	— 165	— 80	2,180	4,205	615	— 90
Fixed-interest securities	1968	— 10	—	15	1,255	1,555	5
	1969	— 20	5	— 5	1,100	1,440	—
	1970	— 10	— 5	20	785	1,360	—
Other net lending	1968	385	40	115	1,465	4,725	645
	1969	320	85	165	2,030	6,165	1,755
	1970	530	35	230	1,275	8,055	2,870
Shares and participations	1968	465	40	225	100	35	235
	1969	315	15	335	280	40	245
	1970	290	15	385	345	75	380
Financial liabilities (—)[3]							
Short-term liabilities[4]	1968	—1,070	10	—1,285	— 175	—4,910	—1,180
	1969	—1,855	— 135	—2,300	— 105	—6,550	—1,620
	1970	—3,115	— 660	—1,620	— 130	—8,295	—2,520
Long-term liabilities	1968	—2,055	— 555	—1,850	—	—1,180	—1,125
	1969	— 995	— 605	—1,615	—	—1,070	—1,605
	1970	— 900	— 655	—1,860	—	—1,480	— 905
Shares and participations	1968	—	— 285	— 480	—	— 105	— 210
	1969	—	— 190	— 645	—	— 55	— 335
	1970	—	— 165	— 925	—	— 155	— 240
Statistical discrepancy	1968	160	—	230	—	70	— 25
	1969	— 255	—	270	—	85	— 15
	1970	695	—	— 535	—	155	10

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

Financial and monetary developments for 1970 as a whole were dominated by two main factors: the government's large and growing borrowing requirement, on the one hand, and the unsettled state of the capital market, on the other. As regards the latter, the worst point was reached during the third quarter, when long-term yields reached peaks ranging between 8 and 11 per cent. and redemptions exceeded new bond issues by Lit. 80 milliard. For 1970 as a whole net issues of fixed-interest securities amounted to Lit. 2,600 milliard, compared with Lit. 3,345 milliard a year earlier. But, excluding central-bank security purchases, net issues taken up by the banks and the public dropped off to Lit. 1,510 milliard from Lit. 2,130 milliard in 1969 and Lit. 2,875 milliard in 1968. The decline was partly made up for by larger share issues, which rose to Lit. 1,010 milliard from Lit. 680 milliard in 1969. But, largely because of informal prompting on the part of the authorities, borrowers were also able to meet their financing requirements by turning abroad for funds, where they took up Lit. 1,080 milliard in 1970, against only Lit. 105 milliard in 1969.

The government's borrowing requirement in 1970 came to Lit. 3,230 milliard, compared with Lit. 1,690 milliard in 1969. The huge increase was to some extent attributable to the wave of strikes late in 1969, which shifted some government expenditure forward into 1970. Nevertheless, the record deficit of Lit. 1,370 milliard in the fourth quarter of 1970 — mainly due to the upward trend of current expenditure — underlines the difficulty of the situation. Since recourse to the capital market had to be greatly curtailed, 85 per cent. of the overall borrowing requirement was covered by the Bank of Italy. The proportion financed by the central bank had been 68 per cent. in 1969 and 25 per cent. in 1968, while in 1966 and 1967 the Treasury had actually reduced its indebtedness to the central bank. More generally, there was a distinct deterioration in the financial position of the public sector as a whole (including public enterprises), whose financial deficit rose steeply from Lit. 2,895 milliard in 1969 to Lit. 4,185 milliard last year. This deterioration was largely ascribable to a stepping-up of investment expenditure, which rose by over Lit. 1,000 milliard to Lit. 3,965 milliard and thus went up from 26 to 30 per cent. of total domestic capital investment.

During the first three quarters of 1970 the Treasury's impact on liquidity was largely offset by the combined effects of the substantial first-quarter balance-of-payments deficit, special measures applied temporarily to sterilise the proceeds of foreign borrowing undertaken by special agencies, and the banks' more limited access to central-bank credit. But the situation changed in the fourth quarter when the Treasury's record borrowing coincided with an again sizable balance-of-payments surplus. Moreover, the authorities had decided in September to allow banks' existing reserve requirements to be met by end-December 1970 to the additional extent of Lit. 250 milliard by means of bonds issued by special credit institutions. All these factors combined to produce a sharp increase in the liquidity of the economy. A further factor which directly improved banks' liquidity was the raising from 3¾ to 5½ per cent., as from 1st October 1970, of the rate of interest on banks' current-account deposits with the Bank of Italy and on Treasury bills held as compulsory reserves.

For the year as a whole the growth in deposits came to Lit. 5,600 milliard, or 16 per cent., against 12 per cent. in 1969. Mainly owing to a shift in relative interest rates, the increase in total deposits took the form of a 35 per cent. rise in current-account deposits, while savings deposits actually declined by 3 per cent. On the other hand, the growth of domestic bank loans came to Lit. 3,330 milliard, or 14 per cent., compared with about 15 per cent. in 1969. A significant change took place, as already mentioned, in credit institutions' net purchases of securities, which went up by Lit. 810 milliard, or approximately 9 per cent., against 15 per cent. in 1969 and 24 per cent. in 1968. In view of the somewhat weak demand for bank credit at still high lending rates, the banks used their growing resources in the latter part of the year partly to rebuild their short-term assets and partly to repay debt to the central bank. Thus, the ratio of liquid assets to total deposits, which was 3.2 per cent. at the end of 1969 and reached a historic low of 2.2 per cent. at the end of May 1970, climbed again to 3.7 per cent. at the end of the year. Borrowed reserves declined, against the seasonal trend, in late 1970. Relative to total liabilities, they fell from 6.4 per cent. at the end of 1969 to 3.1 per cent. a year later.

In the early months of 1971, with production and productivity remaining sluggish and with excess capacity increasing, monetary policy continued on an easy course and interest rates declined further. The Bank of Italy reduced its basic rate for advances against security from 5½ to 5 per cent. in January and lowered the official discount rate, also to 5 per cent., at the beginning of April. Another move that helped to bring interest rates down was a new bank cartel agreement on deposit rates, which became effective early in 1971 and was followed by a concerted lowering of lending rates at the beginning of May.

France. The stabilisation policies introduced in 1969, together with a return to budgetary equilibrium last year, brought a good measure of domestic and external stability. Monetary restraints were relaxed somewhat, and direct credit controls were terminated in favour of instruments influencing bank liquidity. Short-term intervention rates were adapted to Euro-currency rates. In the spring of 1971, with renewed economic strains in evidence, monetary policy turned towards greater caution.

Direct credit controls were relaxed gradually during the spring and summer of 1970, but the authorities sought to maintain an appropriate degree of monetary restraint by limiting the formation of bank liquidity. Consumer-credit restrictions were eased slightly in February and again for certain goods in May and June. Credit generally remained subject to quantitative limitations, but with effect from February certain foreign currency loans were exempted and increases of up to 1½ per cent. per month in export credit were permitted outside the ceilings (2 per cent. as from July). The limits were raised selectively for certain types of medium and long-term investment credits in April and for export and construction credits in June, when medium-term rediscountable equipment credit was freed from restriction. In April, however, the ratio for banks' minimum holdings of medium-term paper was put up from 15 to 16 per cent. Furthermore, as inflows from abroad were adding substantially to bank liquidity, compulsory reserve requirements were raised in June and July, by a total of two percentage points, to 7½ per cent. for demand deposits and 2½ per cent. for time and savings deposits. In cases of credit-granting excesses, liquidity was reduced at first by penalty cuts in rediscount ceilings but then, as from May, by deposits required to be held with the central bank. Up to the summer interest rates on international markets remained substantially above the Bank of France's discount rate. But the margin was eventually eliminated and in August the discount rate was lowered from 8 to 7½ per cent.

Credit to the economy expanded only very moderately during the first three quarters of 1970 and demand deposits grew slowly. On the other hand, time and savings deposits, particularly those of individuals, rose very sharply, as in 1969. This reflected strong competition between banks for large and longer-term deposits, on which rates are not controlled, but also higher interest rates and other incentives to saving introduced by the authorities in 1969 and March and July 1970.

In October the discount rate was lowered to 7 per cent. and, as some easing then seemed appropriate domestically, consumer-credit restrictions were liberalised for a wide range of goods, including cars, and it was decided to remove all quantitative limitations on credit. On the other hand, the banks' rediscount ceilings were cut, with effect from November, by 10 per cent. for amounts of up to Fr.fr. 30 million and by 20 per cent. for amounts in excess of this. Moreover, to limit rediscounting of new medium-term credits, a premium charge over the discount rate was introduced in respect of the tranche coming to maturity within 1–2 years.

For its part, the government continued effectively to underpin monetary restraint by holding down expenditure and aiming at restoration of budgetary equilibrium. In fact, although some of the previously blocked investment programme authorisations were released in July and other supplementary expenditure was incurred, buoyant revenues enabled a surplus of Fr.fr. 3.4 milliard before debt redemption to be achieved in 1970, compared with a deficit of the same size in the previous year. Consequently, and despite a slower growth of correspondents' balances held with the Treasury, the government substantially reduced its indebtedness to the banking system and stayed away from the capital market. Despite some income-tax concessions, the government's 1971 budget proposals again envisaged the achievement of overall balance.

Consumption and housing finance seems to have been most affected by the credit restrictions. Though they appeared to economise on stocks, enterprises were able to finance a continued high level of fixed investment as a result of bigger profits and increased recourse to the capital market. Share issues, which had risen sharply to Fr.fr. 7.5 milliard in 1969, went up further to Fr.fr. 8.7 milliard, and bond issues by private enterprises came to Fr.fr. 5.0 milliard, compared with Fr.fr. 2.9 milliard in 1969. Other borrowers also increased their bond-market activity and yields remained generally high, with only a slight easing towards the end of the year.

Medium and long-term credits continued to expand moderately throughout the year, but short-term bank credit and money accelerated very sharply after the quantitative limitations were terminated. In the last quarter credits to enterprises and individuals expanded by some 12 per cent., bringing the growth for the year to 19 per cent., while total demand deposits, which had gone up by only about 2 per cent. up to September, rose by about 12 per cent. Some of the expansion of the banks' activities merely replaced direct lending transactions between final borrowers and lenders — often with bank guarantees — which had sprung up under the restrictions, as well as short-term borrowing abroad, which had been checked by exchange control amendments in July. But the situation seemed to require caution.

The discount rate was cut to 6½ per cent. in early January 1971. It was subsequently kept at this level as a guide for the fixing of other domestic rates, while exchange inflows were avoided by bringing the Bank of France's money-market intervention rates down, in line with Euro-dollar rates, below the discount rate from late January onwards. The continuance of this novel rate relationship, which soon entailed a substantial shift from discount to open-market accommodation of banks, also constituted a step towards unifying and permitting more flexibility in the cost of central-bank credit. As a precaution, the upper limit to which the Bank of France may increase reserve ratios against deposits was raised in February from 10 to 15 per cent. In a new policy departure, with effect from April, all credits to the economy granted by banks and financial institutions were made subject to a reserve requirement, set at ¼ per cent. of the amount exceeding 80 per cent. of the level at the end of 1970. By fixing the new requirement in relation to assets rather than liabilities, the authorities' main object was to extend influence over credit-granting and liquidity formation to a broader range of financial institutions. Concurrently the ratios applied to deposits were reduced by a quarter of a percentage point. Subsequently, however, they were raised by two percentage points in early May. In addition, for domestic reasons, the new reserve ratio in respect of credit was put up to ½ per cent. and the discount rate was raised to 6¾ per cent. At the same time, to avoid unwanted inflows, the reserve requirement against foreign currency deposits of correspondents abroad was raised to 9¼ per cent.

Belgium. An improvement in the central government's budget position, combined with moderation on the wages front and a high rate of personal saving, resulted in a reasonably satisfactory demand/supply situation last year. With the external current account moving into substantial surplus, short-term interest rates were brought down in line with those abroad, and monetary policy was eased somewhat in the autumn. In early 1971, however, measures were taken to guard against new strains.

In the spring and summer of 1970 monetary policy was still directed mainly at restricting the overall growth of credit to the domestic economy. Because a reflux of funds from abroad at the turn of the year had made the ceilings previously laid down for March and June 1970 unrealistic, they were replaced by a 5.5 per cent. limitation on the growth of credits other than those for exports during the first nine months of 1970. In addition, the coefficients for banks' rediscount and visa ceilings, which had been progressively reduced from 14 per cent. in September 1969 to 10 per cent. by March 1970, were cut to 9 per cent. in two stages in June and September. Over this period, too, new approval procedures with respect to rediscounts were adopted by the central bank with a view to keeping the ceilings restrictive.

As some easing seemed appropriate by the autumn, a fairly generous limit of 6 per cent. was set for the expansion of controlled credit in the final quarter of 1970. Banks were asked to give priority to finance for investment, export production and productivity improvement but, in view of the impending introduction in January 1971 of the value added tax, to avoid any expansion of credit for consumption. In December investment credits were exempted from limitation and a ceiling of 8 per cent. was placed on the expansion of other credits in the first quarter of 1971. As a separate requirement, credit for consumer instalment sales and to finance companies was not to exceed the September 1970 level by more than 5 per cent. at the end of March 1971. The ceilings on credits opened by public credit institutions, private savings banks and insurance companies were also progressively prolonged.

To keep inflows under control, the authorities began in August to reduce certain of their buying rates for money-market paper representing foreign trade credits, the financing of which could easily be transferred abroad. Subsequently, as liquidity conditions eased, money-market rates came down more generally and the official discount rate was lowered from 7½ to 6½ per cent. in two equal stages in October and December. Although the authorities generally sought to limit the decline in domestic deposit rates so as to encourage savings, the rates on large time deposits, virtually the only short-term placement available to non-residents, were adjusted downwards with those on international markets.

In 1970 the government's net financing requirement came to only B.fr. 23.8 milliard, compared with B.fr. 28.1 milliard in 1969. However, by raising a substantial amount of long-term funds on the domestic market, the government was able last year to reduce its indebtedness abroad, following an increase in 1969, and to cut back its recourse to the banking system.

As their lending ceilings were relaxed, the banks expanded their credits to the private sector in 1970 by B.fr. 25.2 milliard, or by 12.3 per cent., compared with about 5½ per cent in 1969. Consumer credit grew more slowly in 1970 but bank lending to business and for housing accelerated. On the other hand, at the high interest rates prevailing, demand for longer-term credits weakened. Reflecting also the less rapid growth of their resources and the restrictions in force since 1969 on new credits opened, the lending of the non-bank financial institutions increased more slowly. With their deposit liabilities rising quite substantially last year, the banks were able to increase their security subscriptions and their recourse to rediscounting fell to levels comfortably inside the ceilings.

The government's 1971 budget proposals, presented in October, envisaged an increase in the financing requirement to B.fr. 30.2 milliard. Moreover, in early 1971 the banks increased their holdings of liquid money-market assets by borrowing abroad and began to approve new credits at a faster rate. But by this time the economic situation was beginning to change. In March, to limit inflows of funds, the official discount rate was reduced from 6½ to 6 per cent. and the banks were requested to exercise restraint in operations likely to bring about, or to increase, a deficit in their net positions abroad. Moreover, with the risk of new strains appearing, the credit ceilings were prolonged, with a limit of 6 per cent. on the expansion of controlled credit during the six months to September. On this basis total bank lending, including unrestricted export and investment credit, is expected to expand at a seasonally adjusted annual rate of about 15 per cent., while the twelve-month limit for consumer-credit expansion was set at 12 per cent. In support, the coefficients for the banks' rediscount ceilings were reduced to 8 per cent. in three stages in March, April and May. To limit inflows following the floating of the Deutsche Mark, the authorities relied on a stricter separation of the official and free exchange markets, together with restrictions on new non-resident time-deposit accounts and on the payment of interest on non-resident sight deposits.

Netherlands. Over the past year the further intensification of both demand and cost pressures, combined with a slowing-down in industrial production from the spring onwards, was associated with a sharp increase in credit demand. In these circumstances ceilings on short-term lending to the private sector, fixed by the Nederlandsche Bank in agreement with the banks, were tightened so as to allow an expansion of only 9½ per cent., against 10 per cent. in 1969. Longer-term lending was again linked to the growth of corresponding bank resources, credit to local authorities was restricted as before and a ceiling was maintained on personal loans. On the external flank, exchange controls could be counted on up to a point to limit recourse by resident borrowers to credit from abroad. None the less, capital imports, consisting mainly of trade credit and security purchases, rose sharply from only Fl. 0.6 milliard in 1969 to Fl. 3.7 milliard in 1970, thereby leading to net exchange inflows which very largely undermined the effects of domestic monetary restraint.

Thanks mainly to a package of tax measures introduced in the 1970 budget, together with restraint on public investment, the central government's financial requirement dropped from Fl. 2.2 milliard in 1969 to Fl. 1.2 milliard last year. At the same time, the government took up Fl. 1.9 milliard in the capital market, compared with Fl. 2.2 milliard in the previous year. A resulting liquidity surplus of Fl. 560 million was mostly sterilised through an improvement in the government's position vis-à-vis the central bank. However, the favourable turn in central-government finances was largely nullified by an increase in the local authorities' financial deficit from Fl. 1.9 milliard in 1969 to Fl. 2.7 milliard in 1970. Just as in 1969, a little over three-fifths (Fl. 1.7 milliard) was covered in the capital market and the remainder by liquidity creation. All in all, therefore, the financing requirement of the public sector as a whole, at Fl. 3.9 milliard, was only slightly below that in 1969. As a compensation for the sharp increase in private-sector credit demands, this change was of negligible significance, though the mode of financing helped to restrain liquidity formation.

Last year the personal and business sectors' financial deficit on a transactions basis leapt to Fl. 10.0 milliard from Fl. 7.2 milliard in 1969 and Fl. 4.9 milliard in 1968. Because of quantitative credit restrictions, the expansion of short and medium-term bank credit was only slightly greater than in 1969, amounting to just over Fl. 2.7 milliard. On the other hand, new borrowing on the capital market, including private placements and mortgage loans, went up by some Fl. 1.3 milliard to almost Fl. 5.7 milliard. Moreover, under the influence of monetary restraint, recorded and unrecorded credit and capital inflows from abroad, together with other unidentified sources of funds, came to about Fl. 4.4 milliard, compared with Fl. 2.8 milliard the year before.

Total net funds raised on the capital market (including private placements and mortgage loans) rose in 1970 to Fl. 11.7 milliard, or by 16.5 per cent., against only 1.6 per cent. in 1969. A striking change occurred in net security transactions with foreigners; whereas the latter had made net sales of Fl. 390 million in 1969, there were net purchases of Fl. 720 million last year. Though such purchases amounted to less than 7 per cent. of total funds supplied, the swing from 1969 accounted for over two-thirds of the year-to-year overall percentage increase. Relative interest rates had something to do with this. The yields on certain government bonds rose to a peak of about 8½ per cent. in the spring of 1970 and remained above 8 per cent. until the turn of the year. But the strength of the guilder added to the attractiveness of Dutch securities.

The money supply plus secondary liquid assets (including Treasury paper) rose last year by 10.5 per cent., which was the same rate as in 1969. This increase was only slightly less than that in the gross national product of nearly 11 per cent., of which more than half reflected a rise in prices. Thus, despite efforts to apply monetary restraint, actual monetary conditions were no more than mildly restrictive, mainly because of the large capital inflows. To forestall an even larger influx, the authorities consented to a substantial volume of international issues of notes denominated in Dutch guilders, which could be offered only to non-residents and the proceeds used only abroad. In addition, to ensure the re-export of funds brought in mainly for seasonal reasons, the Nederlandsche Bank engaged in three-month swap transactions with the banks in October for an amount of Fl. 620 million.

For 1971 the system of credit ceilings is being maintained, with the growth of short-term credit to the private sector limited to 4 per cent. in the first four months, against 5 per cent. in 1970. To deter inflows of funds, the Nederlandsche Bank reduced its discount rate from 6 to 5½ per cent. in April. In early May the guilder was, like the Deutsche Mark, permitted to float upwards, and subsequently certain banks ceased to pay interest on non-resident sight deposits in guilders. Though an upward float may aggravate the country's external current-account deficit, it should help to counteract the continuing severe demand and cost inflation.

Switzerland. The building-up of demand pressures in the later months of 1969 called forth new restrictive monetary measures early in 1970. In February the permissible rate of bank credit expansion — under a voluntary agreement an average credit growth of 9.7 per cent. had been allowed for the period August 1969–July 1970 — was reduced with the consent of the banks to 8.25 per cent. At the same time the system of ceilings was prolonged until July 1971. By helping to keep interest rates low relative to those abroad, the direct control of credit gave support to the National Bank's efforts to deter net capital inflows. Towards the same end, the National Bank kept the discount rate at 3¾ per cent. and adopted a restrictive attitude towards rediscounts and advances. Temporary liquidity shortages which might have led to repatriations of foreign assets were bridged by providing sizable National Bank swap facilities. In addition, by cutting back approvals, the authorities saw to it that the volume of domestic bond issues was geared to the market's absorptive capacity. When strong tensions nevertheless developed, foreign issues were suspended over the summer months. However, bank lending abroad was authorised liberally in order to help offset the inflow of foreign capital.

Consistent with domestic policy requirements, Swiss interest rates moved upwards in the first half of 1970, while remaining well below those prevailing abroad. In the second half of the year, however, monetary policy began to encounter increasing difficulties, as international short-term rates continued to fall sharply and long-term ones also turned downwards. The yield on Swiss Government bonds, after rising by more than 1 percentage point over the twelve months to June 1970 to a peak of 5.9 per cent., fell back only to 5.3 per cent. by April 1971. And the banks' three-month deposit rate, which rose against the international trend from 5 to 5½ per cent. from January to October, then had to be adjusted downwards, primarily on external grounds, to 3½ per cent. by April 1971.

On the other hand, interest rates of major domestic importance, such as those on banks' medium-term cash certificates, savings deposits and mortgages, were generally adjusted upwards over the period. Particular significance attaches to the rates on cash certificates — which for domestic reasons were raised with the National Bank's consent in the autumn — since the narrowing of the gap between these and comparable international rates is believed to have been a factor in increasing repatriations of funds held abroad by Swiss non-bank residents. At all events, the banks re-exported a large part of the foreign exchange inflows which occurred. To help offset inflows and to limit liquid-asset formation, foreign capital issues on the Swiss market were approved more liberally in the later months of the year.

Taking the year as a whole, the banks' balance sheets bear much more the mark of the successes than of the weaknesses of monetary policy. Domestic bank lending, which had gone up by 12 per cent. in 1969, expanded last year by 7.4 per cent. and was thus well within the ceilings. This development contributed to a slow-down in the rate of bank deposit formation (including non-resident deposits) from 21.6 to 12.7 per cent. Within this total, time deposits and cash certificates recorded comparatively small increases over the year, leading the banks to raise long-term funds of Sw.fr. 1.2 milliard, as against only half that figure in 1969. Part of the incentive to do so may have come from the attractiveness of placements abroad; the banks improved their net foreign position over the twelve months to September 1970 by some Sw.fr. 1.5 milliard.

The total of net security issues, at Sw.fr. 4.1 milliard, was about the same as in 1969, a decline in share issues being offset by a rise in bond flotations. Including Swiss-domiciled financial holding companies of non-resident firms, non-resident issues came to nearly Sw.fr. 1.3 milliard in 1970, or about the same amount as in 1969, with a small volume up to mid-year being compensated for afterwards.

In view of persisting inflation, the agreement on the limitation of bank lending was prolonged in the spring of 1971 for a further year until July 1972. However, as a concession to house-building and infrastructural investment, ceiling allowances for mortgage loans and advances to public authorities were raised somewhat. Thus, in addition to the permitted credit expansion of 8.25 per cent., approximately Sw.fr. 500 million may be granted for these special purposes in the year beginning August 1971. In a wider context, however, the level of international interest rates in the early spring threatened, by encouraging a further repatriation of funds held abroad, to continue to impair the effectiveness of Swiss monetary policy. Moreover, there was an acute awareness that any action taken to halt the heavy inflow of funds into Germany would put the Swiss franc in the firing line. Thus, when the Deutsche Mark was floated in early May, Switzerland immediately revalued the franc.

Austria. A mildly restrictive tuning of monetary policy helped to keep Austria on a course of balanced expansion in 1970. The economic setting had altered very little from the year before; the balance-of-payments surplus was somewhat smaller, while the government's budget deficit was more or less unchanged but was financed less than before by monetary means. In January 1970 the National Bank raised its discount rate from 4¾ per cent. to 5 per cent. In February, to absorb liquidity deriving from the external surplus, it placed Sch. 1.5 milliard of cash certificates with the banks. Two-thirds of these were repaid ahead of schedule in May, largely because the external accounts had for a time turned into deficit. The rest were redeemed in August, as earlier agreed. Under the pressure of domestic demand for credit and in view of declining interest rates abroad, the banks met their liquidity needs primarily from external sources. Their foreign liabilities expanded by considerably more than their foreign assets, particularly in the latter part of the year, while at the same time they curtailed their borrowing from the central bank.

Domestic bank credit expanded by nearly 17 per cent., or at about the same rate as in the year before. Banks' purchases of bonds and Treasury paper amounted to Sch. 1.8 milliard, or roughly the same as in 1969. In total, lending to the private sector accelerated somewhat, while government borrowing slowed down a little. At 14.4 per cent., the growth of total deposits with the credit institutions was slightly higher than in 1969, while issues of bank bonds came to Sch. 3.6 milliard, or one-quarter more than in the previous year. The money supply (currency and sight deposits) increased by 6.7 per cent., compared with 7.8 per cent. the year before. Bond issues, net of redemptions, totalled Sch. 5.7 milliard, against Sch. 4.2 milliard in 1969. In relative terms, gross issues by public authorities and banks declined somewhat, while those of other borrowers increased from one-fifth to one-quarter of the total. Despite the substantial interest rate movements abroad, yields on government bonds went up only from 7.6 per cent. in January 1970 to 7.9 per cent. in the second quarter, declining again to 7.8 per cent. by March 1971.

In 1970 domestic monetary policy was not significantly disturbed by inflows of funds from abroad. The international exchange crisis in early May 1971 brought a brief speculative flare-up, but this quickly ended when Austria, influenced by the moves of Germany and Switzerland, revalued the schilling.

Denmark. A quickening of exports and investment in 1969, followed by an unexpectedly sharp upturn in personal consumption, increased strains on resources in early 1970 and brought the external current account further into deficit.

Monetary and fiscal restraint was intensified in the spring and summer. The changeover to a withholding system in January 1970 substantially increased income-tax revenues and the government used its growing surplus to improve its position with the central bank. In March, in agreement with the Nationalbank, the commercial and savings banks undertook to avoid for six months any expansion of their lending other than for social housing, and in August the agreement was prolonged indefinitely. In addition, the government postponed most of its new building and construction projects until the autumn and later extended this until the end of 1970. Further fiscal restraints announced in May included an increase in the value added tax from 12½ to 15 per cent. with effect from mid-year. To help keep down prices, the government undertook to compensate employers for half of the cost-of-living wage adjustment required of them in the final quarter of 1970 and the first quarter of 1971. Then, in October, it introduced a temporary general price freeze.

Domestic demand eased somewhat in the autumn and imports slowed down, but the external current account remained in substantial deficit. The government's 1971–72 budget proposals, presented in November, provided for a surplus of D.kr. 3.6

milliard, compared with a revised surplus for 1970–71 of D.kr. 2.5 milliard. As the resulting drain on bank liquidity was already severe, the Nationalbank cushioned the situation from November onwards by bond purchase operations and special credit facilities.

Non-priority lending showed no increase after the autumn, and in 1970 as a whole total commercial and savings-bank lending expanded by less than 7 per cent., compared with 15 per cent. in 1969. Moreover, the growth of total bank deposits came to only 4½ per cent. last year, compared with 10½ per cent. in 1969. On the bond market net issues totalled D.kr. 6.7 milliard, against D.kr. 8.1 milliard in 1969, when the Nationalbank had made substantial net purchases. A change in July in the mortgage credit law was designed to bring about a substantial decrease in the net call on the market, but only after a transitional period.

Following declines in interest rates abroad, the official discount rate was lowered from 9 to 8 per cent. in January 1971. In April it was reduced further to 7½ per cent., and the Nationalbank indicated that it would undertake bond purchases to provide sufficient liquidity to sustain a level of bank lending consistent with the ceilings, which, slightly modified, remained in force. At the same time, it terminated the requirement introduced in 1965 that banks should make deposits with the central bank in relation to the growth of their deposit liabilities, and announced a first repayment of existing deposits for July.

New national wage agreements concluded in March provided for an immediate 4½ per cent. increase in wages, apart from cost-of-living adjustments. Soon afterwards the government announced the replacement of the price freeze by regulations laying down that only such wage increases as were provided for in collective agreements, and not "wage drift", might be passed on in prices. At the same time, limitations were imposed on dividends and the capital gains tax was increased. It remains to be seen to what extent these arrangements will help in bringing about the urgently needed improvement in the external current account.

Sweden. The severe credit squeeze introduced in 1969 was backed up last year by fiscal restraints. In the course of the year demand pressures eased, the external balance improved, and at the beginning of 1971 monetary policy was relaxed so as to give a selective stimulus to investment.

Following a renewed acceleration of bank lending in early 1970 the authorities and the banks concluded in April a new agreement under which the commercial banks were to meet the stricter reserve requirements and the obligation, also introduced in 1969, to make cash deposits with the Riksbank to the equivalent of 1 per cent. of their deposit liabilities. Moreover, they undertook to fulfil the government's housing credit guide-lines and to limit the total expansion of their other credits by December 1970 to 4 per cent. of the end-1969 level. As the utilisation of approved credit lines had been increasing, outstanding overdraft limits were now generally to be cut by 20 per cent. by the end of June 1970. Subject to the banks' adherence to all the guide-lines, the Riksbank offered to pay interest on the compulsory deposits placed with it by the banks, and penalty conditions for central-bank credit were to be applied in cases of non-compliance.

Under these arrangements bank lending stopped rising and, with the external deficit running into the second year, deposits grew very slowly. Commercial banks continued to increase housing credits in compliance with the guide-lines, while purchases of mortgage bonds by other banks and private insurance companies fell back. The commercial banks also added to their holdings of mortgage bonds (which count as liquid assets), though by less than in 1969 and at the expense of a substantial reduction in government security holdings. In addition, their credits to business fell continuously during the summer and autumn and, showing no net increase for 1970 as a whole, remained well within the ceiling.

Budget policy was tightened progressively, if belatedly, mainly through increases in value added taxes and spending economies. In 1970 the government's cash deficit was reduced to S.kr. 3.2 milliard, compared with S.kr. 3.8 milliard in 1969. Moreover, the amount financed at long term outside the banking system rose, so that the government's net call on monetary financing fell to S.kr. 1.9 milliard in 1970 from S.kr. 3.0 milliard in 1969. As the commercial banks reduced their holdings of government securities, the government took up S.kr. 1.2 milliard of short-term funds from the Post Office Savings Bank and the National Pension Fund and borrowed S.kr. 1.6 milliard from the Riksbank.

The sharp swing from net purchases of bonds by the banking system in 1969 to net sales last year was only partly counterbalanced by a substantial fall in government issues. With the slowing-down of housing construction, issues of mortgage bonds also fell in 1970, while the volume of industrial issues remained down after their sharp contraction in 1969.

Sweden: Net credit flows.

Lenders	Years	Borrowers				
		Government	Local authorities	Housing sector	Business sector	Total
		in millions of Swedish kronor				
Riksbank	1968	1,230	10	110	30	1,380
	1969	1,510	—	− 10	− 20	1,480
	1970	1,600	—	30	—	1,630
Commercial banks	1968	260	20	2,000	3,390	5,670
	1969	1,530	220	1,180	650	3,580
	1970	− 840	110	1,990	− 30	1,230
Other banks	1968	510	650	2,090	980	4,230
	1969	− 10	350	2,560	680	3,580
	1970	1,090	330	1,640	900	3,960
Public insurance institutions	1968	530	490	2,780	1,890	5,690
	1969	590	600	2,810	1,610	5,610
	1970	760	670	3,270	2,030	6,730
Private insurance institutions	1968	190	110	890	600	1,790
	1969	− 280	160	1,340	630	1,850
	1970	370	60	750	710	1,890
Others	1968	650	50	10	450	1,160
	1969	460	− 10	—	690	1,140
	1970	230	10	20	320	580
Total	1968	3,370	1,340	7,880	7,330	19,920
	1969	3,800	1,320	7,880	4,240	17,240
	1970	3,210	1,180	7,700	3,930	16,020

The increase in total net lending on the credit market fell to S.kr. 16.0 milliard in 1970, compared with S.kr. 17.2 milliard in 1969 and S.kr. 19.9 milliard in 1968. The decline in total commercial-bank lending from S.kr. 3.6 milliard in 1969 to S.kr. 1.2 milliard in 1970 was partly offset by an increase in the lending of the National Pension Fund and, to a lesser extent, in that of other banks. Business-sector borrowing from domestic sources came to only S.kr. 3.9 milliard in 1970, compared with S.kr. 4.2 milliard in 1969 and S.kr. 7.3 milliard in 1968, but continued monetary restraint induced business to take up trade credits abroad on a larger scale last year. The tight financial position of local authorities in 1970 induced many of them to raise their taxes, thereby intensifying the constraints on the private sector.

With their deposits and liquidity benefiting late in the year from the shift of the external account into surplus, the commercial banks' borrowing from the Riksbank, which had been at very high levels throughout most of 1970, fell to S.kr. 574 million in December, compared with S.kr. 880 million in December 1969. At the beginning of 1971, with fiscal policy considerably tighter, the quantitative credit ceilings were abolished on the understanding that there should be no increase in credits for consumption. The banks were asked to give priority to industrial investment credits, and to facilitate this the terms and conditions governing banks' access to central-bank credit were made no longer dependent on observance of liquidity reserve and cash deposit requirements. A cut in the discount rate from 7 to 6½ per cent. in March was followed in April by the announcement of fiscal measures to give some stimulus to employment. Towards the end of April the discount rate was further reduced to 6 per cent.

Norway. Stimulated by an acceleration in fixed investment outlays, aggregate demand continued to increase strongly in 1970. But, with resources being used to nearly full capacity, demand pressure led to a deterioration in the external accounts and substantial price increases.

Fiscal policy was expansionary in 1970 for the first time for some years. The general tax reform in January 1970, with the shift from direct to indirect taxation, entailed a swing from an actual budget surplus (prior to loan transactions) of N.kr. 137 million in 1969 to a deficit originally estimated at N.kr. 1,215 million for last year. However, this change partly reflected a non-recurrent loss of revenue resulting from a change in the timing of tax collection, which had a counterpart in a substantial increase in business liquidity.

Monetary targets for 1970 envisaged total new credit-granting to the private sector and the municipalities of N.kr. 8.9 milliard, representing a rise of nearly N.kr. 2.4 milliard. Substantial amounts were expected to be raised abroad and domestic lending was to grow only marginally. The priority given to long-term financing through the state banks and the bond market implied that the growth of commercial and savings-bank lending should be reduced from 13 per cent. in 1969 to 8 per cent. in 1970.

To help ensure that these limits were observed, monetary policy was tightened in several stages. To offset the liquidity effects of the tax reform, banks were temporarily required in the spring to hold higher liquidity reserves and also to maintain a special reserve of primary liquid assets. When, in the summer, the lending targets seemed likely to be exceeded, the liquidity ratios were raised in stages, for the larger banks from 13 to 16 per cent. by October. In addition, credit-granting by finance companies was limited and penalty payments were introduced for excess lending.

Commercial and savings banks increased their credits in 1970 by N.kr. 2.6 milliard, or 10 per cent. — well in excess of the 8 per cent. ceiling. As deposits grew by N.kr. 4.9 milliard, or 15 per cent., the banks could easily fulfil the higher reserve requirements and at the same time reduce their central-bank borrowing. The increase in total domestic credit supply also exceeded the target, amounting to N.kr. 8.6 milliard, against the stipulated N.kr. 7.3 milliard, while borrowing abroad fell short of expectations.

With consumer prices rising faster from the summer onwards, policies were made more restrictive later in the year. Following a rise in down-payments for the hire purchase of cars, taxes on certain beverages and mineral oils were increased in November. With the help of cyclically buoyant revenues, the actual budget deficit for 1970 turned out at N.kr. 346 million, against the original estimate of N.kr. 1,215 million. The government budget for 1971 was designed to achieve a surplus (before loan transactions) of N.kr. 200 million. Under the national budget the growth of commercial-bank lending is to be restricted, in principle, to 8 per cent. and, to promote compliance, supplementary reserve requirements equivalent to half of any lending excess have been reintroduced. In addition, new measures in December provided for the post-ponement of public construction, a 10 per cent. cut in both private building quotas and the lending quotas allocated to the state banks, more stringent regulations for bond issues and borrowing abroad and, finally, a temporary freeze on prices and a ban on wage increases in excess of collective agreements. Although this set of restrictive measures covers a wide field, the danger remains that demand pressure will generate excessive wage and price increases.

Finland. Continuing the sustained growth under way since late 1968, aggregate demand increased in 1970 by 14 per cent. But with exports levelling off and home demand expanding under conditions of increasing capacity strains, the external current account changed from a small surplus to a deficit. Hence, within the framework of national stabilisation agreements, policy was directed at damping down domestic demand.

As price controls and wage restraint had been extended to 1970, price increases were kept in the neighbourhood of 3 per cent. The government's budget for the year remained restrictive. Last year, moreover, under an agreement with respect to counter-cyclical deposits, about F.mk. 300 million was paid into blocked central-bank accounts by the private sector and another F.mk. 100 million by the government. In April 1970, after these payments had led to liquidity strains, ceilings linking bank lending to deposit growth were abolished. But at the same time the commercial banks' rediscount quotas were reduced and the banks were instructed to restrict consumer credit and other credit likely to increase imports and investment.

The continuing deterioration in the trade balance led to new measures in October. Since an inflow of funds from abroad had helped to ease bank liquidity, rediscount quotas were kept restrictive and banks exceeding or coming close to their rediscount limits were requested to cut certain of their credit commitments by 20 per cent. New investment projects to be financed with central-bank assistance were postponed. Restrictions were also imposed on foreign borrowing, and in November imports of most consumer goods were made subject to advance payments. Moreover, hire-purchase terms, already tightened in July, were made more stringent. Finally, as from 1971, penalty interest was imposed on borrowing from the Bank of Finland in excess of quotas.

In spite of the restrictive policy, monetary expansion continued unabated. The public's deposits with the various credit institutions went up by F.mk. 2.3 milliard, registering an increase of 14 per cent., against 13 per cent. in 1969. Credit institutions' total lending (excluding mortgages) rose by F.mk. 2.3 milliard, or 15½ per cent., compared with 14 per cent. the previous year. Half of the increase was accounted for by commercial banks, whose borrowing from the central bank rose to F.mk. 0.8 milliard at end-1970 from F.mk. 0.5 milliard a year earlier.

For 1971 national stabilisation agreements could not be carried forward on the same basis as before, because labour-market organisations failed to reach an understanding with respect to wage adjustments. In consequence, the authorities prolonged the system of price controls in only slightly modified form. In the strongly expanding wood-processing industry a counter-cyclical tax (F.mk. 125 million in 1971) was introduced as a substitute for new blocked deposits, and the government's cyclical reserve fund was increased by F.mk. 150 million. Strikes in opposition to the government's wage proposals led in some sectors to negotiated settlements much higher than envisaged. Consumer prices are expected to rise by about 6 per cent., after going up on average by only 2½ per cent. since the spring of 1968.

On 20th May, with a further deterioration in the trade balance in prospect, quantitative import restrictions on durable consumer goods were imposed pending the introduction of fiscal and monetary measures aimed at curbing imports. A day later the official rediscount rate was raised from 7 to 8½ per cent.

Spain. During the first part of 1970 the stance of both fiscal and monetary policy remained restrictive, following the measures adopted late in the previous year. However, the credit ceilings that had been resorted to in the fourth quarter of 1969 were not prolonged in 1970. Instead, the principal instrument of restraint used was the scheme introduced in mid-December 1969 requiring a six-month non-interest-bearing deposit of 20 per cent. in respect of all merchandise imports. This caused a very significant drain on domestic liquidity until approximately mid-year. Other supporting measures of credit restriction were taken early in 1970. Hire-purchase regulations were tightened and in March the discount rate was raised by 1 percentage point to 6.5 per cent. This led to a corresponding adjustment in the whole interest rate structure, as many rates had been directly linked to the discount rate in July 1969. In addition, on the fiscal side, budget investment expenditure carried over from 1969 was postponed.

In the second half of the year monetary conditions changed. On the one hand, the liquidity position improved because, in the first place, the monetary restraint resulting from the import deposit scheme ceased biting, as deposits had only to be rolled over, and, secondly, the authorities did not counteract the liquidity inflow due to the large balance-of-payments surplus. On the other hand, demand for new bank credit slackened.

For the year as a whole, growth of the money stock, narrowly defined, was very low by Spanish standards, namely 5.9 per cent., against 14.7 per cent. in 1969. This, however, was to a large extent due to the increase in interest rates, which caused a pronounced shift from demand to time deposits. Nevertheless, growth in money and quasi-money also came to only about 15 per cent., compared with 19 per cent. in each of the previous two years. The credit institutions' credits to the private sector increased in 1970 by 14.9 per cent. This, too, was a low rate for Spain, where the volume of credit has expanded on average by some 20 per cent. annually over the past five years. Moreover, the rate of increase went on declining in the course of the year, to reach a low of 12.6 per cent. in the fourth quarter. Since the growth of deposits accelerated sharply in the second half of the year, the banks took the opportunity both to repay debt to the Bank of Spain and to rebuild their liquidity positions, which had come under great strain early in the year. In particular, the commercial banks' cash ratio climbed from a low of 4.9 per cent. in February to 7.4 per cent. in December and 8.2 per cent. in February 1971.

On the securities market, net issues of the public sector declined sharply in 1970, totalling Pesetas 22 milliard, against Pesetas 45 milliard in 1969. Issues of the private sector, however, continued to increase at a fast pace, coming to Pesetas 118 milliard, compared with Pesetas 93 milliard in 1969.

Late in 1970 and early in 1971 both fiscal and monetary policies became clearly expansionary. Although a cash coefficient of 7.5 per cent. was established for commercial banks at the beginning of December, to come into force by 1st March 1971, this move was in line with the authorities' general policy since 1969 of introducing stricter control over the credit system by means of liquidity regulation. The measure was not, therefore, meant to have dampening effects, but mainly to keep within bounds the liquidity impact resulting from the halving of the import deposit requirement at the end of November. The discount rate was lowered in two steps, in January and April, to 6 per cent. Other expansionary measures taken at the end of January included the provision of new credit lines for exports and capital-goods industries, credit facilities for housing and farming, and an easing of hire-purchase terms.

Portugal. Last year the rise in output in industry and construction was more evident and the decline in agricultural production recorded in 1969 was largely reversed. Exports went up more than in 1969, while higher private investment and consumption also contributed to overall expansion. In these circumstances imports accelerated and rising prices remained a problem. The government's ordinary budget receipts grew at a faster rate than its expenditure. Its Development Plan outlays continued to go up at a good rate, but its other investment expenditure rose less than in 1969.

The private sector's money holdings, which had risen by 12 per cent. in 1969, went up by only 1½ per cent. last year, but its quasi-monetary claims increased by some 33 per cent., rather faster than in 1969, and the banks benefited from a continued rise in public-sector deposits. Reflecting a slow-down in bill credits, total bank credit to the private sector expanded by about 19 per cent. in 1970, compared with 22 per cent. in 1969. There was a marked rise in the banks' holdings of both private and public-sector securities. Moreover, the medium and long-term credit-granting of other credit institutions grew considerably. This shift to longer-term credits and deposits was encouraged by an adjustment of the whole structure of interest rates, as a result of which the differentials were increased in favour of privileged export and medium-term credits, on the one hand, and longer-term placements of savings, on the other. These changes were undertaken when the Bank of Portugal's rediscount rate was raised from 3 to 3½ per cent. in April 1970. Furthermore, as from May privileged medium-term credit facilities were offered on credits at up to seven (previously five) years, while in August credit institutions were authorised to assume the tax liability of depositors in respect of interest on deposits at more than 180 days.

The rise of 11 per cent. in total expenditure provided for in the government's 1971 budget includes a considerable increase in investment expenditure under the Development Plan. To encourage private investment, the industrial tax paid by companies was reduced from 18 to 15 per cent., but to compensate for the resulting loss in revenue taxes on wealth and urban land were increased. In February 1971 the Bank of Portugal's rediscount rate was raised to 3¾ per cent. Privileged rediscount rates remained unchanged but maximum rates on term deposits with financial institutions were increased. At the same time, to permit an increase in investment credit, banks' minimum reserve ratios were reduced from 14 to 12 per cent. in respect of sight deposits and limits were placed on the amount of their liquid resources which banks may hold in foreign currencies. More extensive measures recently put forward for promoting industrial development and improvements in agriculture include termination of prior authorisation requirements in respect of many types of investment, as well as the provision of new credit facilities, subsidies, special depreciation allowances and selective customs-duty concessions for new projects.

III. WORLD TRADE AND PAYMENTS.

Despite a slow-down in the real economic growth of the western industrialised countries from about 5 per cent. in 1969 to 2.5 per cent. in 1970, international trade in terms of value continued to expand at about the same high rate as in 1969. World exports rose by $35 to 279 milliard, or by about 14.5 per cent. The apparent paradox of rapid world trade growth in a year with recessionary tendencies is to a large extent explained by the behaviour of export prices, whose upward movement accelerated from about 3.5 per cent. in 1969 to 5.5 per cent. In volume terms export growth slowed down from 10.5 per cent. in 1969 to 8.5 per cent., which roughly corresponds to the average rate of increase in the past ten years.

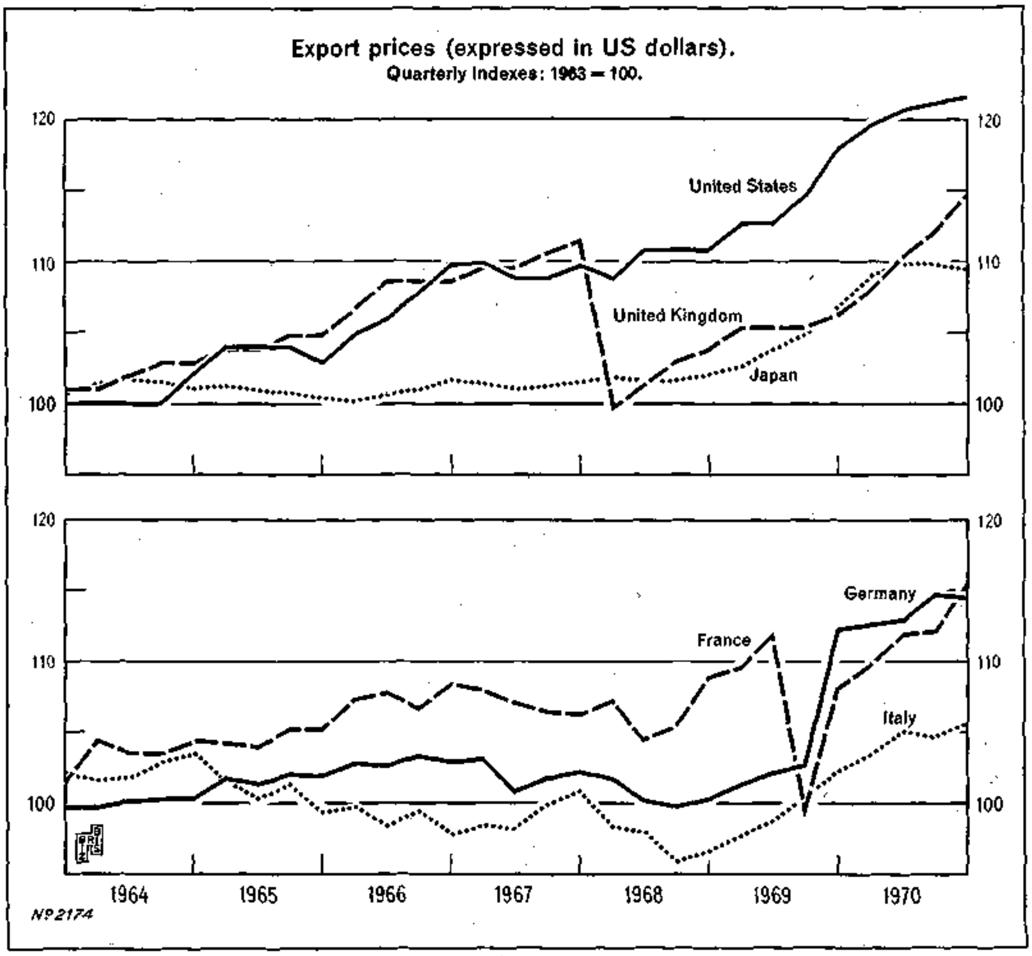
International trade.

Areas	Exports		Imports		Rates of increase in exports		Rates of increase in imports	
	1969	1970	1969	1970	1969	1970	1969	1970
	In milliards of US dollars				In percentages			
Developed areas								
Western Europe								
EEC	75.8	88.7	75.7	88.6	*18.0*	*17.0*	*22.0*	*17.0*
EFTA[1]	38.4	43.3	44.2	51.3	*15.5*	*13.0*	*10.5*	*16.0*
Other countries	5.4	6.4	10.2	11.9	*16.0*	*18.5*	*17.0*	*16.0*
Total	119.6	138.4	130.1	151.8	*17.0*	*15.5*	*17.5*	*16.5*
United States	38.0	43.2	38.3	42.5	*9.5*	*13.5*	*8.5*	*11.0*
Canada	14.4	16.9	14.3	14.5	*9.5*	*17.0*	*14.0*	*2.0*
Japan	16.0	19.3	15.0	18.9	*23.5*	*21.0*	*15.5*	*25.5*
Other areas[2]	7.6	8.5	8.8	10.3	*14.0*	*11.0*	*7.5*	*17.0*
Total	195.6	226.3	206.5	238.0	*15.5*	*15.5*	*15.0*	*15.0*
Developing areas								
Latin America	12.4	.	12.3	.	*10.0*	.	*10.0*	.
Other areas	36.0	.	37.1	.	*13.0*	.	*7.5*	.
Total	48.4	53.0	49.4	54.0	*12.0*	*9.5*	*9.0*	*9.5*
Grand total[3]	244.0	279.3	255.9	292.0	*14.5*	*14.5*	*13.5*	*14.0*

[1] Including Finland and Iceland. [2] Australia, New Zealand and South Africa. [3] 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.

The strong advance of export prices mainly reflected inflationary pressures in the industrialised countries. Whereas in the ten years up to 1968 export prices of the western industrial countries had shown an average yearly rate of increase of less than 0.5 per cent. and were thus much more stable than domestic prices, their 10.5 per cent. gain over the past two years was of about the same order of magnitude as the rise in domestic price levels. One explanation of this seems to be that in the period 1958–68 domestic price increases were to a large extent concentrated in the service sectors and thus had little effect on export prices; the wage explosions which occurred in several of the leading industrial countries during the past two years, however, had a strong and immediate impact on the prices of industrial exports. A second factor was the revaluation of the Deutsche Mark in the autumn of 1969. In view of Germany's domestic demand and cost pressures, it was not only translated into a corresponding advance in the dollar prices of German exports, but probably also lessened the resistance of other countries to increases in their export prices.

From the fourth quarter of 1968 to the fourth quarter of 1970 the advance in the dollar export-price index of the industrialised countries amounted to 11 per cent. Considering the largest countries only, the league was headed by Germany, with an increase of 15 per cent., followed by Italy, with one of 12 per cent. Both countries, however, had started out with a very strong international competitive position, since in the five years up to the end of 1968 their export prices had shown virtually no increase. The advance in the United Kingdom's export prices was close to the 11 per cent. average, whereas that of the United States, at 10 per cent., was slightly below. However, the respective situations of the two countries at the beginning of this period had been quite different, UK export prices, expressed in dollars, having declined substantially



in 1968 as a result of the devaluation of sterling, whereas US export prices had already shown a marked upward movement from 1965 to 1968. In Japan the rise in export prices, at 8 per cent., was well below the average, while in France, with the help of the 1969 devaluation, it was only 6 per cent.

Another factor behind the sharp acceleration during the past two years in the rise in prices in international trade was the behaviour of raw-material prices, which, after a prolonged period of stability, went up by 7 per cent. Nevertheless, at 3 per cent., their increase in 1970 was less than half that of manufactured products and this entailed a substantial deterioration in the terms of trade of the developing countries. In fact, on a quarterly basis, the upward movement in the price index for primary commodities exported by the developing countries came to a halt in the final quarter of 1969. As regards individual groups of primary commodities, the steep climb in the prices of metal ores and of coffee, tea and cocoa, which had been responsible for much of the rise in the average yearly price index from 1968 to 1970, was partly reversed in the course of the latter year. On the other hand, prices of fuels, which had shown no increase in the preceding years, advanced by 7 per cent. between the last quarters of 1969 and 1970, and those of cereals, after falling by 7 per cent. between the second quarters of 1969 and 1970, went up by the same percentage in the second half of 1970.

In addition to the effects of rising prices, an important factor behind the expansion in the dollar value of international trade in 1970 was the somewhat surprising strength of import demand in the United States, where recessionary tendencies were most marked last year. Whereas in 1958 the decline in US real gross national product had led to a contraction in the value of imports, in 1970 their growth accelerated from 8.5 per cent. in 1969 to about 11 per cent. In Canada, on the other hand, a similar cyclical situation produced a sharp decline in the import growth rate from 14 to 2 per cent. Western European imports continued to expand at about the same rate as in 1969, though within Europe the import growth rate of the EFTA countries accelerated from 10.5 to 16 per cent., while that of the EEC countries slowed down from 22 to

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

Areas	Years	Exports to						
		Western Europe		North America	Japan	Other developed countries[2]	Developing countries	Total
		EEC	EFTA[1]					
		in percentages over previous year						
EEC	1968	18.0	7.0	28.5	9.0	5.5	12.0	14.5
	1969	26.0	14.5	4.5	16.0	12.5	11.5	18.0
	1970	18.5	17.0	10.5	33.0	15.0	15.5	17.0
EFTA[1]	1968	10.0	6.0	17.5	1.5	2.0	10.0	8.5
	1969	18.5	17.0	4.5	30.0	13.5	16.5	15.5
	1970	15.0	19.0	3.0	14.5	10.5	9.0	13.0
North America .	1968	8.0	10.5	19.0	9.0	3.0	8.5	11.5
	1969	14.5	4.5	14.0	16.0	5.0	4.0	10.0
	1970	23.5	18.5	3.5	33.0	19.0	17.5	14.5
Japan	1968	25.5	4.0	35.0	— —	15.5	22.0	24.0
	1969	41.0	3.0	23.0	— —	36.5	22.0	23.5
	1970	34.5	46.5	19.5	— —	33.0	13.5	21.0

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

about 17 per cent. The growth rate of Japanese imports accelerated from 15.5 to 25.5 per cent.

As might have been expected in view of the international cyclical situation, North America was the only area in 1970 to show a steeper rise in exports than in 1969. Canada's export growth rate jumped from 9.5 to 17 per cent. and that of the United States from 9.5 to 13.5 per cent. While the expansion of trade between the United States and Canada dropped off sharply, the increase in North America's exports accelerated from 14.5 to 23.5 per cent. vis-à-vis the EEC, from 4.5 to 18.5 per cent. vis-à-vis EFTA countries and from 4 to 17.5 per cent. vis-à-vis the developing countries. In the EEC, too, the expansion of intra-area trade slowed down, while the growth of exports to all other areas, in particular to North America and Japan, was more rapid than before. In the case of the EFTA group of countries, however, the situation was exactly the reverse. Japan's export growth slackened quite appreciably vis-à-vis the developing countries but was fairly well maintained vis-à-vis North America; the rise in its exports to western Europe (EEC and EFTA countries only) quickened from 17.5 to 40 per cent., but as a proportion of Japanese exports this group still accounts for only one-eighth.

Balances of payments.

With the exception of Japan, the balances of payments of the main industrial areas of the world, measured by the changes in their net official external positions, were all very different from what they had been in 1969. The combined balance of the EEC countries shifted from a \$4.4 milliard deficit to a \$9.1 milliard surplus; the \$2.7 milliard official settlements surplus recorded by the United States in 1969 gave way to a \$10.7 milliard deficit; Canada's balance of payments, which had been approximately in equilibrium in 1969, showed a \$1.6 milliard surplus; and the surplus of the EFTA countries rose by \$1.6 to 2.9 milliard. All in all, the combined surplus of the main industrial areas increased from \$0.5 to 3.9 milliard, excluding the counterpart of the first allocation of SDRs. This movement was not accompanied by a corresponding deterioration in the rest of the world's balance of payments — which, on the contrary, showed an improvement of roughly \$1 milliard — but reflected official placements in the Euro-dollar market. The way in which this came about is explained in Chapter I, on page 16.

The increase in official reserves held in the Euro-dollar market was also a major factor in the turn-around in the industrial countries' combined balance of capital movements from an outflow of \$13 milliard in 1969 to an inflow of \$0.3 milliard. A second, and even more important, influence behind this shift was the reduction by US banks of their Euro-dollar indebtedness and the re-lending by the Euro-dollar banks of a large part of the funds released in this way to non-bank firms in Europe and to some extent even in the United States. On the sources side this movement of funds was, of course, reflected only in the banks' foreign positions, whereas on the uses side it led to corresponding changes in the balances on capital account. Thus the EEC and EFTA groups of countries showed a combined change from net capital exports of \$8.6 milliard in 1969 to net capital imports of \$6.1 milliard

Balances of payments of the main industrial areas.

Items	Years	United States	Canada	Japan	EEC	EFTA[1]	Total
		In milliards of US dollars					
Trade balance	1968	+ 0.6	+ 1.4	+ 2.5	+ 5.3	− 4.4	+ 5.4
	1969	+ 0.7	+ 0.9	+ 3.7	+ 3.7	− 3.4	+ 5.6
	1970	+ 2.2	+ 3.0	+ 4.0	+ 5.8	− 5.1	+ 9.9
Services and transfers .	1968	+ 0.8	− 1.5	− 1.5	− 1.2	+ 3.9	+ 0.5
	1969	+ 0.1	− 1.6	− 1.6	− 1.5	+ 4.7	+ 0.1
	1970	+ 0.1	− 1.7	− 2.0	− 3.4	+ 5.4	− 1.6
Current balance . . .	1968	+ 1.4	− 0.1	+ 1.0	+ 4.1	− 0.5	+ 5.9
	1969	+ 0.8	− 0.7	+ 2.1	+ 2.2	+ 1.3	+ 5.7
	1970	+ 2.3	+ 1.3	+ 2.0	+ 2.4	+ 0.3	+ 8.3
Net capital movements (excluding bank capital, but including errors and omissions) .	1968	− 3.4	+ 0.5	+ 0.1	− 6.0	+ 0.1	− 8.7
	1969	− 5.9	+ 1.3	+ 0.2	− 8.8	+ 0.2	−13.0
	1970	− 5.6	+ 0.4	− 0.6	+ 3.8	+ 2.3	+ 0.3
Changes in net external position of banks[2] . .	1968	+ 3.7	− 0.3	− 0.2	− 0.8	− 1.6	+ 0.8
	1969	+ 7.8	− 0.5	− 1.5	+ 2.2	− 0.2	+ 7.8
	1970	− 7.4	− 0.1	− 0.4	+ 2.9	+ 0.3	− 4.7
Changes in net official external position (excluding counterpart of SDR allocations)	1968	+ 1.7	+ 0.1	+ 0.9	− 2.7	− 2.0	− 2.0
	1969	+ 2.7	+ 0.1	+ 0.8	− 4.4	+ 1.3	+ 0.5
	1970	−10.7	+ 1.6	+ 1.0	+ 9.1	+ 2.9	+ 3.9

[1] Including Finland and Iceland. [2] In the country tables which follow, with the exception of that for the United States, this item is considered as a monetary item.

in 1970. And despite an appreciable increase in US direct investment abroad and reduced foreign purchases of US stocks, the US capital balance showed a $0.3 milliard improvement; this was due mainly to a considerable reduction in short-term capital outflows (including errors and omissions) from the US non-bank sector, principally to the Euro-dollar market.

The main counterpart of the changes on capital account was the $15.2 milliard shift in the US banks' foreign positions from $7.8 milliard of net borrowing in 1969 to $7.4 milliard of repayments. On the other hand, net new foreign borrowing by the banks of EFTA and EEC countries accelerated from $2 milliard in 1969 to $3.2 milliard last year. Japanese banks' net new foreign lending amounted to only $0.4 milliard, against $1.5 milliard in 1969, but this decline was largely offset by a shift in the movement of non-bank funds from $0.2 milliard of net inflows in 1969 to a $0.6 milliard outflow.

A positive note in the main industrial areas' combined balance of payments was the strengthening of their global current-account surplus by $2.6 to 8.3 milliard. Except for some deterioration in the current balance of other developed countries, this indicates an increased transfer of real resources to developing countries. North America's combined current balance moved from equilibrium to a $3.6 milliard surplus, the whole of the improvement occurring on trade account. More surprisingly, in view of their cyclical situation, the EEC countries' trade surplus also increased, by \$2.1 milliard. This was, however, largely offset by a \$1.9 milliard rise in their net invisible expenditure. The current surplus of EFTA countries, on the other hand, dropped from \$1.3 to 0.3 milliard, well over half the decline being accounted for by Switzerland.

* * *

United States. As in 1969, the two conventional measures of the US balance of payments produced widely divergent results last year. Excluding the counterpart of the first SDR allocation, the liquidity balance showed a deficit of \$4.7 milliard, considerably less than the \$7 milliard 1969 figure; on the official settlements account, however, the deficit was \$10.7 milliard, as against a surplus of \$2.7 milliard the year before.

Neither measure provides a good indication of underlying developments in the US balance of payments last year. On the official settlements account, most of the deterioration was due to the US banking system having repaid to its overseas branches \$5.1 milliard, whereas in 1969 it had borrowed \$6.8 milliard through them. And, on the other hand, the \$2.3 milliard decline in the liquidity deficit cannot be taken as a sign of real improvement, since it is more than accounted for by two "non-basic" factors: a \$1.6 milliard reduction in the negative errors and omissions item, reflecting a sharp fall in outflows of non-bank funds to the Euro-dollar market; and a \$1 milliard favourable movement in special financial transactions, which was mainly the result of debt prepayments to the US Government and of a much smaller decline than the year before in foreign countries' dollar reserves held in non-liquid form. Excluding these two factors, the liquidity deficit was, in fact, slightly larger than in 1969.

The current-account surplus went up from its 1969 low point of only \$0.8 to 2.3 milliard. This improvement, which occurred entirely on trade account, largely reflected the combination of the economic slow-down in the United States and the continuing high level of demand in some other leading industrial countries. Thus, the trade surplus vis-à-vis western Europe improved by \$1.5 milliard; vis-à-vis Canada, however, where the cyclical situation was much the same as in the United States, the trade deficit doubled to \$1.6 milliard. In regard to developing countries the export surplus increased by \$0.6 milliard.

Given last year's economic constellation, the increase in the trade surplus from \$0.6 to 2.2 milliard was not very spectacular. In 1964, with a somewhat less favourable cyclical situation, the trade surplus had amounted to \$6.8 milliard. Moreover, the improvement, which had begun in mid-1969, came to a halt in mid-1970 and was quite abruptly reversed in the last quarter of the year.

The relatively modest performance on foreign trade account was the consequence of the continuing strength of imports. Their growth rate actually accelerated from 9 to 11 per cent., despite the recession. In part, the high 1970 level of imports was the result of the 1969 dock strike. If allowance is made for the effect of strikes in general, United States: Balance of payments.[1]

Items	1969	1970[2] Year	1970[2] 1st quarter	1970[2] 2nd quarter	1970[2] 3rd quarter	1970[2] 4th quarter	1971[2] 1st quarter
	in millions of dollars						
Merchandise trade[3] (f.o.b.)							
Exports	36,475	42,040	10,250	10,585	10,700	10,505	11,040
Imports	35,835	39,855	9,725	9,830	9,990	10,310	10,750
Trade balance	+ 640	+ 2,185	+ 525	+ 755	+ 710	+ 195	+ 290
Services and transfers							
Investment income	+ 5,745	+ 6,045	+ 1,520	+ 1,395	+ 1,505	+ 1,625	.
Military expenditure	− 3,335	− 3,360	− 925	− 825	− 870	− 740	.
Travel	− 1,330	− 1,595	− 365	− 410	− 435	− 385	.
Other	− 960	− 990	− 235	− 235	− 275	− 245	.
Total	+ 120	+ 100	− 5	− 75	− 75	+ 255	.
Current balance	+ 760	+ 2,285	+ 520	+ 680	+ 635	+ 450	.
US Government grants and capital	− 3,830	− 3,235	− 855	− 725	− 805	− 850	.
US private capital							
Direct investment	− 3,070	− 3,965	− 1,410	− 1,435	− 710	− 410	.
Other long-term capital	− 1,590	− 1,265	− 490	+ 115	− 660	− 230	.
Short-term capital	− 575	− 1,120	+ 190	− 620	+ 190	− 880	.
Foreign capital							
Private	+ 4,870	+ 4,460	+ 1,035	+ 955	+ 1,310	+ 1,160	.
Official	− 735	− 600	− 450	+ 360	− 245	− 265	.
Total	− 1,100	− 2,490	− 1,125	− 625	− 115	− 625	.
Errors and omissions	− 2,840	− 1,275	− 205	− 780	− 535	+ 245	.
Balance on liquidity basis	− 7,010	− 4,715	− 1,665	− 1,450	− 820	− 780	− 3,260
Balance on liquidity basis unadjusted	− 7,010	− 4,715	− 1,555	− 1,430	− 1,640	− 90	− 3,150
Increase in US liquid liabilities other than to foreign monetary authorities, less increase in official non-liquid liabilities	+ 9,710	− 5,970	− 1,280	− 640	− 970	− 3,080	− 2,255
Balance on official reserve transactions basis	+ 2,700	−10,685	− 2,835	− 2,070	− 2,610	− 3,170	− 5,405
Counterpart of SDR allocations	—	+ 865	+ 865	—	—	—	+ 720
Balance on official reserve transactions basis including counterpart of SDR allocations	+ 2,700	− 9,820	− 1,970	− 2,070	− 2,610	− 3,170	− 4,685

[1] On a transactions basis. [2] Quarterly data for the liquidity balance are seasonally adjusted. [3] Excluding military grant shipments and military import purchases.

the growth rate of imports is estimated to have declined between 1969 and 1970 from 13 to 10 per cent. Another factor behind the continuing high level of imports was the 8 per cent. rise in their unit-value index, the largest in any year since the Korea boom. In addition, however, there were the effects of last year's 7 per cent. increase in personal consumption in the United States. On a Bureau of Census basis, imports of non-food consumer goods rose by 14 per cent., accounting for two-fifths of the total rise in imports, and food imports by 18 per cent. Moreover, imports of capital goods, despite the slackening of domestic investment expenditure, were 15 per cent. above the 1969 level.

The 15 per cent. growth of US exports in 1970 compares with a figure of 9 per cent. the year before. In volume terms the figures are 8 and 6 per cent. respectively. As with imports, the figures are affected by strikes, without which it is estimated that the total value of exports would have risen by 12 per cent. in 1970 and 13 per cent. the year before. By commodities, the whole of last year's more rapid increase in exports (on a Bureau of Census basis) can be attributed to agricultural products, sales of which went up by $1.2 milliard, after having declined in each of the three preceding years, and accounted for about one-quarter of the total rise of exports in 1970. Non-agricultural exports rose at about the same rate as in 1969, by 12.5 per cent. Sales of civil aircraft, which included the first jumbo jets, were up by 21 per cent. and there were also large increases in exports of industrial supplies and materials and of capital goods, which went up by 17 and 16 per cent. respectively. The picture was very different, however, as regards consumer goods. Sales of motor-cars, engines and spare parts were 8 per cent. down on 1969, mainly owing to the General Motors strike, and those of all other durable consumer goods showed an increase of only 6 per cent.

At $0.1 milliard, the surplus on invisibles was the same as in 1969. Net investment income, which, as a result of the steep rise in Euro-dollar rates and in the US banks' Euro-dollar indebtedness, had declined by $0.3 milliard in 1969, regained its 1968 level. This improvement, however, was offset by a $0.3 milliard increase in net foreign travel expenditure. Owing mainly to larger foreign debt repayments, the net outflow in the form of government grants and loans declined by $0.6 to 3.2 milliard and was covered by the surplus on current account to the extent of 70 per cent.

The balance of identified private capital movements showed a net outflow of $1.9 milliard, which was $1.5 milliard more than in 1969. Net outflows of US capital went up from $5.2 to 6.4 milliard, while the net inflow of foreign private capital declined from $4.9 to 4.5 milliard.

So far as movements of US capital are concerned, the main feature of 1970 was the $0.9 milliard rise in direct investment abroad to $4 milliard. Expenditure on plant and equipment by foreign affiliates of US corporations is estimated to have been 22 per cent. above the 1969 level and a larger proportion of it was financed from domestic sources. Direct investment outflows to Europe expanded by $0.6 milliard, while most of the rest of the increase went to Canada and Australia. Foreign claims of US banks also rose considerably more than in 1969, by $0.9 milliard as against $0.5 milliard. While their long-term assets declined by $0.2 milliard, their short-term claims went up by $1.1 milliard, of which those vis-à-vis Japan accounted for almost one-half and those vis-à-vis Canada for about one-quarter. Most of this rise was in the fourth quarter of the year, when US money-market rates dropped sharply. In contrast to direct investment and bank lending, net US purchases of foreign securities decreased between 1969 and 1970 from $1.5 to 0.9 milliard — including a $0.5 milliard drop in net issues of Canadian bonds in the United States.

As regards foreign capital, direct investment in the United States, which had nearly trebled in 1969, edged up only marginally to $0.9 milliard. Foreign purchases of US securities (other than Treasury issues), after declining from $4.4 to 3.1 milliard in 1969, showed a further substantial decrease, to $2.2 milliard. Purchases of US shares dropped from $1.6 to 0.7 milliard; reflecting the gradual improvement in the climate of the US stock market after mid-year, however, there was a sharp turn-round from $0.2 milliard of net sales in the first half of 1970 to $0.9 milliard of net purchases in the second half. The decline in foreign purchases of US securities was to a large extent offset by a $0.7 milliard rise to $1.5 milliard in other foreign lending to US non-bank residents. Most of this was at short term, and the fact that US non-bank liabilities to the United Kingdom alone grew from $0.1 to 1.1 milliard suggests that there was a sharp increase in Euro-dollar lending to US corporations. At the same time, the reduced outflow of US non-bank funds to the Euro-dollar market was the main factor behind the $1.6 milliard contraction of the negative errors and omissions item. The total net outflow of private capital, including errors and omissions, came to $3.2 milliard, almost exactly the same figure as in 1969.

So far as the movements of foreign official capital are concerned, there was a net outflow of $0.6 milliard in 1970, some $0.1 milliard less than the year before. It included a $0.6 milliard reduction in US Government liabilities associated with military sales contracts.

Moving for once in the same direction, both the liquidity and the official settlements balances registered a sharp deterioration in the first quarter of 1971. The liquidity deficit jumped from $0.8 milliard in the last quarter of 1970 to $3.3 milliard, and was thus nearly three times as large as its quarterly average in 1970. The official settlements deficit (not seasonally adjusted) rose by $2.2 to 5.4 milliard. Apart from the reversal of end-year operations not fully taken into account by the seasonal adjustment factor, the steep rise in the liquidity deficit seems to have reflected above all the widening discrepancy between interest rates in the United States and those in the rest of the world. There was a sharp drop in comparison with the last quarter of 1970 in foreign purchases of US securities and an increase in US purchases of foreign securities. At $0.3 milliard, the trade surplus was $0.1 milliard larger than in the fourth quarter of 1970, when it had been depressed by the General Motors strike, but $0.4 milliard smaller than its average level in the first three quarters of that year.

Canada. The most impressive development in the Canadian balance of payments last year was a $1.9 milliard swing on current account to a surplus — the first since 1952 — of $1.2 milliard. As regards the overall surplus, its previously moderate upward trend, which started in 1966, steepened considerably in 1970: excluding the counterpart of the initial SDR allocation, it increased by $1.1 to 1.7 milliard.

The striking improvement on current account was brought about solely by merchandise trade. At $3 milliard, the trade surplus was the biggest recorded since the war and more than three times as large as the previous year's. In both 1969 and 1970, however, trade was greatly influenced by special factors, particularly the strikes in 1969 and their after-effects. In 1970 the growth rate of exports accelerated from 10 to 17 per cent., while that of imports slowed down from 15 to 2 per cent. In addition, there was a slight improvement in the terms of trade.

Most types of goods contributed to the strong expansion of exports. In terms of Canadian dollars, the only laggards were motor vehicles, aluminium and forestry products, sales of which were affected by a weakening of foreign demand and major production stoppages. Exports of motor vehicles, in particular, rose very little because of the slackness of the car market in the United States early in 1970 and the strike in General Motors (Canadian) in the autumn. Mainly because of delivery backlogs resulting from the large-scale Canadian strikes in 1969, exports of iron ore, steel, copper and nickel were very buoyant in 1970. Sales of oil and gas also rose sharply, as the United States eased its restrictive import quotas for such items. As regards the geographical distribution, the growth of Canadian exports to the United States, which took 65 per cent. of the total compared with 71 per cent. in the previous year, fell from 15 to 4 per cent., or 6 per cent. excluding the motor-car sector. Demand from overseas markets, on the other hand, was extraordinarily strong. Deliveries to the United Kingdom — Canada's second most important trading partner — shot up

Canada: Balance of payments.[1]

Items	1969	1970[2] Year	1970[2] 1st quarter	1970[2] 2nd quarter	1970[2] 3rd quarter	1970[2] 4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	13,860	16,200	3,965	4,015	4,090	4,130
Imports	12,965	13,230	3,290	3,370	3,435	3,135
Trade balance	+ 895	+ 2,970	+ 675	+ 645	+ 655	+ 995
Services and transfers	— 1,590	— 1,725	— 420	— 390	— 480	— 435
Current balance	— 695	+ 1,245	+ 255	+ 255	+ 175	+ 560
Current balance unadjusted	— 695	+ 1,260	+ 50	+ 235	+ 470	+ 505
Long-term capital						
Transactions in Canadian securities	+ 1,600	+ 570	+ 415	— 130	+ 195	+ 90
Direct investment	+ 370	+ 530	+ 45	+ 130	+ 130	+ 225
Other	+ 120	— 335	+ 135	— 40	— 180	— 250
Total	+ 2,090	+ 765	+ 595	— 40	+ 145	+ 65
Basic balance	+ 1,395	+ 2,025	+ 645	+ 195	+ 615	+ 570
Short-term capital[3]	— 845	— 330	— 560	+ 435	— 195	— 10
Overall balance	+ 550	+ 1,695	+ 85	+ 630	+ 420	+ 560
Counterpart of SDR allocation	—	+ 125	+ 125	—	—	—
Overall balance including counterpart of SDR allocation	+ 550	+ 1,820	+ 210	+ 630	+ 420	+ 560

[1] On a transactions basis. [2] Quarterly data for the current balance are seasonally adjusted. [3] Including adjustment factors.

Note: Balance-of-payments figures for the second, third and fourth quarters of 1970 have been converted from Canadian dollars into US dollars at the quarterly average spot closing rates of Can. $1.06551, 1.02073 and 1.01677 per US $1 respectively.

by 34 per cent., after actually declining in 1969; about a quarter of the increase was accounted for by nickel.

The tendency for the deficit on invisible account to grow continued. Its $135 million rise was mainly due to increased net payments of interest and dividends. These accounted for more than half of the $1.7 milliard invisibles deficit.

The very substantial improvement on current account was to a large extent offset by a marked reduction in the net inflow of long-term capital from $2.1 to 0.8 milliard. Sales of new Canadian securities abroad declined by $790 to 755 million last year, owing in large part to the high level of long-term interest rates in both the United States and Europe. Furthermore, in October Canadian borrowers were officially requested to cover their financial requirements as far as possible on the domestic capital market. Transactions in outstanding Canadian securities registered an unfavourable net swing of $235 million. The net capital outflow in connection with long-term export credits rose from $10 million in 1969 to $135 million last year. On the other hand, the net inflow in respect of direct investment grew by $160 to 530 million because of increased foreign investment in Canada and a moderate decline in Canadian investment abroad.

Compared with 1969, when the high level of short-term interest rates abroad had attracted a large volume of Canadian funds, the net outflow of short-term capital was reduced from $845 to 330 million. In the course of the year short-term capital movements showed pronounced fluctuations: a $560 million net outflow in the first quarter was followed by a $435 million inflow in the second quarter, when speculation in favour of the Canadian dollar led to the adoption of a floating exchange rate. The outflow was resumed in the third quarter and became only marginal in the last quarter.

In the first quarter of 1971 Canada's overall balance of payments, excluding the counterpart of the second SDR allocation, showed a deficit of $0.4 milliard, compared with a $0.1 milliard surplus in the corresponding period of 1970. However, the seasonally adjusted trade balance, on a customs basis and with imports f.o.b., remained highly favourable: in the first three months the surplus was running at an annual rate of $2.6 milliard, compared with $2.8 milliard for the whole of last year.

Japan. In 1970, for the third consecutive year, Japan had a large overall surplus. At $1.4 milliard, however, excluding the counterpart of the first SDR allocation, it was $0.9 milliard less than in 1969. The decline in the overall surplus was more than accounted for by a $1.4 milliard increase in net long-term capital outflows. The current-account surplus was only slightly lower than the year before, but net short-term capital inflows expanded by $0.6 milliard.

Gross long-term capital outflows continued their upward trend, increasing from $1.5 to 2 milliard, whereas capital imports fell sharply, from $1.4 to 0.4 milliard. So far as the latter are concerned, net foreign purchases of Japanese securities fell by $540 to 190 million. Loans from abroad declined by $305 to 80 million and proceeds from foreign currency bond issues by $155 to 45 million. With regard to long-term capital outflows, loans to foreigners went up by $290 to 625 million, including $200 million of special yen loans made by the Bank of Japan to the IBRD

Japan: Balance of payments.[1]

Items	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 3rd quarter	1970 4th quarter	1971 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	15,680	19,020	4,050	4,600	4,950	5,420	4,945
Imports	11,980	15,000	3,460	3,740	3,830	3,970	3,860
Trade balance	+ 3,700	+ 4,020	+ 590	+ 860	+ 1,120	+ 1,450	+ 1,085
Services and transfers	— 1,580	— 2,005	— 525	— 475	— 505	— 500	— 595
Current balance	+ 2,120	+ 2,015	+ 65	+ 385	+ 615	+ 950	+ 490
Long-term capital	— 155	— 1,595	— 435	— 465	— 315	— 380	— 190
Basic balance	+ 1,965	+ 420	— 370	— 80	+ 300	+ 570	+ 300
Short-term capital[2]	+ 320	+ 955	+ 355	+ 100	+ 350	+ 150	+ 310
Overall balance	+ 2,285	+ 1,375	— 15	+ 20	+ 650	+ 720	+ 610
Counterpart of SDR allocations	—	+ 120	+ 120	—	—	—	+ 130
Overall balance including counterpart of SDR allocations	+ 2,285	+ 1,495	+ 105	+ 20	+ 650	+ 720	+ 740

[1] On a transactions basis. [2] Including errors and omissions.

in the first quarter. The object of these transactions, as also of a $80 million purchase of special US Export-Import Bank certificates in January 1970, was to prevent the official reserves from increasing too sharply. There were also higher net outflows in connection with direct investment abroad and long-term trade credits, in the latter case as a side-effect of increased exports of ships.

Although the growth rate of imports accelerated from 17 per cent. in 1969 to 25 per cent. last year and that of exports declined from 23 to 21 per cent., the trade surplus rose by $0.3 to 4 milliard. The terms of trade improved last year, as export prices went up by 5 per cent. and import prices by 3.5 per cent.

Exports of machinery and equipment, which accounted for nearly half of the total, rose by 26 per cent. and those of metals and chemicals by 30 and 22 per cent. respectively. Textile exports, on the other hand, grew by only 6 per cent. Of total exports, over 30 per cent. went to the United States, 25 per cent. to south-east Asia and 15 per cent. to western Europe. On the import side, purchases of machinery and equipment increased by over 40 per cent. and those of metals, ores and scrap by 37 per cent. 40 per cent. of Japanese imports came from developing countries, almost 30 per cent. from the United States and 10 per cent. from western Europe. The large rise in imports pushed up transportation expenditure; this was the main reason for the $0.4 milliard widening of the deficit on services and transfers to $2 milliard in 1970.

The basic balance showed a surplus of only $0.4 milliard, against one of $2 milliard the year before. In contrast, the surplus on short-term capital movements increased by $0.6 to almost 1 milliard; most of this increase took the form of short-term trade credits, which rose by $0.5 to 0.7 milliard.

During 1970 the policy of giving preferential interest rate treatment to export credits began to be progressively abandoned. In May the Bank of Japan's export-related interest rates, which had previously been kept well below other domestic rates, were raised. Subsequently, when the Bank lowered its official discount rate in October 1970 and again in January 1971, these rates were left unchanged.

In the first quarter of 1971 the overall balance of payments, excluding the counterpart of the second SDR allocation, showed a further substantial surplus of $0.6 milliard. The current surplus was $0.5 milliard, and in addition there was a small net capital inflow: on long-term capital account the net outflow was only $0.2 milliard, owing to a very high level of non-resident purchases of Japanese securities, while short-term capital movements, reflecting the difference between Japanese and US interest rates, produced a $0.3 milliard net inflow.

United Kingdom. With the benefits of the 1967 devaluation continuing to be felt, although probably on a diminishing scale as the year went on, the United Kingdom's current external surplus increased by nearly 50 per cent. in 1970 to a record figure of $1.5 milliard. Most of this further improvement was in the foreign trade account, which, for the first time since 1958, showed a small surplus for the year as a whole. However, the identified net outflow of capital (excluding changes in sterling balances and in the banks' short-term foreign currency positions, which are treated under monetary movements in Chapter IV) increased by virtually the same amount as the current surplus; and in addition the errors and omissions item, though still substantially positive, was only about half the 1969 figure. Consequently the overall surplus came down from $1.5 to 1.1 milliard.

The trade balance improved between 1969 and 1970 by $345 million to a surplus of $5 million. The total value of exports rose by 12 per cent. and that of imports, excluding payments for US military aircraft, by 10 per cent. In volume terms, however, it was the other way around, imports rising by 7 per cent. and exports by 3 per cent. In other words, last year's improvement in the foreign trade balance was the result of a considerable rise in export prices, which, if it continued, might undermine the United Kingdom's international competitive position.

The main element in the very small volume increase in exports last year was the growth of only 1 per cent. in exports of manufactured goods. In the two preceding years, immediately following devaluation, the rise had averaged 13 per cent. As well as the diminishing influence of devaluation, disruption of production probably played a part in this abrupt change, which caused the UK share of world trade in manufactured goods to resume its downward trend after a pause of only one year. Exports of non-manufactured goods, however, rose by 9 per cent. during 1970.

Last year's increase in the volume of imports was rather large, given the state of the economy. It, too, was probably affected both by the waning influence of devaluation and by strikes. And, in addition, the gradual elimination of the import deposit scheme during the course of the year will have had some effect. By commodities, the rise of 7 per cent. in imports was due chiefly to increases of 12 per cent. in finished manufactures, double the rate of the previous year, and of 8 per cent. in fuels. Imports

United Kingdom: Balance of payments.[1]

Items	1969	1970[2] Year	1st quarter	2nd quarter	3rd quarter	4th quarter
	in millions of US dollars					
Merchandise trade (f.o.b.)						
Exports	16,945	18,925	4,620	4,710	4,490	5,105
Imports	17,140	18,895	4,480	4,800	4,645	4,970
Trade balance	− 195	+ 30	+ 140	− 90	− 155	+ 135
Payments for US military aircraft	− 145	− 25	− 5	—	− 15	− 5
Trade balance including above item	− 340	+ 5	+ 135	− 90	− 170	+ 130
Services and transfers						
Official	− 1,905	− 1,785	− 480	− 420	− 430	− 455
Private	+ 3,295	+ 3,295	+ 860	+ 855	+ 785	+ 795
Total	+ 1,390	+ 1,510	+ 380	+ 435	+ 355	+ 340
Current balance	+ 1,050	+ 1,515	+ 515	+ 345	+ 185	+ 470
Current balance unadjusted	+ 1,050	+ 1,515	+ 515	+ 380	+ 100	+ 520
Capital movements						
Official long-term capital	− 235	− 490	− 115	− 90	− 50	− 235
Foreign investment in the United Kingdom	+ 1,775	+ 1,550	+ 545	+ 385	+ 240	+ 380
UK private investment abroad	− 1,565	− 1,765	− 455	− 285	− 500	− 525
UK residents' Euro-dollar borrowing in London for investment abroad	+ 175	+ 400	+ 45	+ 75	+ 135	+ 145
Trade credit	− 385	− 700	− 135	− 130	− 85	− 350
Other non-bank short-term capital	− 70	+ 225	+ 125	+ 40	+ 25	+ 35
Total	− 305	− 780	+ 10	− 5	− 235	− 550
Errors and omissions	+ 770	+ 375	+ 590	− 320	− 200	+ 305
Overall balance	+ 1,515	+ 1,110	+ 1,115	+ 55	− 335	+ 275
Counterpart of SDR allocation	—	+ 410	+ 410	—	—	—
Overall balance including counterpart of SDR allocation	+ 1,515	+ 1,520	+ 1,525	+ 55	− 335	+ 275

[1] On a transactions basis. [2] Quarterly data for the current balance are seasonally adjusted.

in the two categories of basic materials and food, beverages and tobacco, both of which fell in 1969, showed only small rises of 2 and 1 per cent. respectively in 1970.

While the quarterly pattern of visible trade in 1970 was distorted by the effects of the July dock strike, the general evolution during the course of 1970 can be seen from a comparison of each half-year with the previous one. Thus, exports rose in value by 6 per cent. in the first half of 1970 and by 3 per cent. in the second; in volume terms, they fell by about 1 per cent. in both periods. The value of imports, on the other hand, after allowing for special factors, rose by about 4.5 per cent. in each half-year, with the greater part of the rises reflected in increased volume. The net result was a small deterioration in the visible trade balance between the two halves of the year. The terms of trade, after changing little in the first half-year, improved quite sharply in the second, to show a favourable movement of some 7 per cent. between end-1969 and end-1970.

The surplus on invisibles increased by $120 million to $1,510 million last year. The whole of this improvement was in the official sector, where net interest payments fell by $160 million, reflecting mainly the lower level of short and medium-term external debt outstanding during the year. The unchanged surplus in the private sector included a deterioration of $140 million on shipping account as a result of increased tanker charges, offset by an increase of $115 million in net receipts from financial and allied services and of $25 million in net travel receipts. The deterioration of $120 million in the invisible surplus between the two half-years was caused largely by a swing-round of the shipping account into deficit in the second half.

On capital account the increase from $305 to 780 million in total net identified outflows in 1970, which was spread over a number of different items, was partly fortuitous in that some inflows which had occurred for special reasons in 1969 were not repeated last year. The outward movement of official long-term capital increased by $255 to 490 million. This increase included a shift of $105 million in transactions with the US Export-Import Bank, from net borrowing of $25 million to net repayments of $80 million, and a $60 million increase in net aid-granting to $205 million. In addition, the net balance of official long-term capital movements was unfavourably affected by the absence of defence offset loans from the German Government, which in 1969 had amounted to $125 million.

The net outflow from trade credit also increased substantially in 1970, from $385 to 700 million. Import credit received went up by only $25 million, against $390 million in 1969, owing to the repayment of credit taken previously in connection with the import deposit scheme.

UK private investment abroad went up by $200 million, including substantial increases in portfolio and in oil companies' investment. This rise was, however, more than covered by an increase in UK residents' Euro-dollar borrowing from UK banks for financing such investment, so that the amount of UK private investment abroad that was financed from domestic sources was a little smaller than in 1969. There was, in addition, a decline of $225 million in foreign investment in the United Kingdom, owing mainly to the fact that foreign borrowing by public corporations and local authorities, which had amounted to $180 million in 1969, fell away to virtually nothing. Finally, the total net outflow arising from the above-mentioned changes was reduced by a favourable turn-round, from an outflow of $70 million to an inflow of $225 million, in other non-bank short-term capital movements.

The errors and omissions item showed very marked quarterly fluctuations during the year. The large positive figure of $590 million recorded for the first quarter of 1970 resulted partly from the continued unwinding of positions taken up before the revaluation of the Deutsche Mark, but principally from the seasonal shortage of liquidity in the main tax-payment months. Subsequent fluctuations reflected the varying fortunes of sterling as well as, in the fourth quarter, the renewed attraction of high domestic interest rates.

The official financing surplus of $2.6 milliard points to a very large overall surplus in the first quarter of 1971. Very little of this can have come from the current account, where the trade balance deteriorated quite markedly to a deficit of $185 million. All of this deterioration shows up as a fall in exports. However, comparing the average trade figures for the first four months of 1971 with those for the last six of 1970 in order to avoid distortions caused by the dockers' and postal workers' strikes, the trend of 1970 was continuing in the early months of 1971; that is, the rise in the value of exports was more than accounted for by higher prices, while that in the value of imports mainly reflected increased volume. The surplus on services and transfers was estimated to be running at about $115 million a month in the first quarter, so that the current-account surplus may have amounted to about $160 million, greatly reduced from the $470 million surplus of the preceding three months. It is likely, therefore, that, as in the first quarter of 1970, a large part of the overall payments surplus took the form of a substantial positive errors and omissions item, reflecting an inflow of short-term capital in response to high UK interest rates and tight corporate liquidity positions.

France. After two years of substantial deficits France's overall balance of payments vis-à-vis non-franc-area countries showed a surplus (excluding the counterpart of the first SDR allocation) of $1.4 milliard in 1970. The new trend, which was observable in all sectors of the balance of payments, had already begun in the last quarter of 1969, following the devaluation of the franc and the revaluation of the Deutsche Mark; the quarterly surpluses continued to grow until mid-year, reaching $0.9 milliard in the second quarter. In the second half of the year, however, the surplus dwindled to $0.1 milliard and fell to only $30 million in the first quarter of 1971.

Measured on a cash basis, two-thirds of last year's improvement in the balance of payments was on foreign trade account, where the balance shifted from a deficit of $1.6 milliard in 1969 to a surplus of $0.5 milliard. And two-thirds of this surplus, in its turn, was the result of more favourable terms of payment. For the rest, f.o.b./c.i.f. customs data expressed in French francs show that exports rose by 28 per cent. in value and imports by 18 per cent. In the first three quarters of 1970 the value of exports on a seasonally adjusted basis was running 32 per cent. above the level of a year earlier, but this figure dropped to 19 per cent. in the fourth quarter since there had already been a steep rise in the French franc value of exports in the fourth quarter of 1969, following devaluation. In the first quarter of 1971 the growth of exports decelerated further to 15 per cent. over a year earlier and that of imports fell from 21 to 14 per cent. For the year 1970 as a whole the f.o.b./c.i.f. export/import cover ratio averaged 91 per cent., a figure which is close to what is considered to be a position of equilibrium. As unit values for exports and imports were respectively 12 and 11 per cent. higher than in 1969, the volume increase in exports was 15 per cent., as against only 7 per cent. for imports.

As regards the different categories of exports to non-franc-area countries, consumer goods showed the fastest advance, having expanded by 38 per cent. in value, while semi-manufactured and capital goods recorded increases of 30 per cent. each. Exports of agricultural products rose by 13 per cent., but wheat sales, owing to poor crops, fell below their 1969 level. On the import side capital goods expanded by 27 per cent., semi-manufactured goods and raw materials and fuels by some 20 per cent. and agricultural products by 14 per cent. Imports of consumer goods, on the other hand, showed practically no rise. The chronic deficit vis-à-vis EEC countries was

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

Items	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 2nd half
	in millions of US dollars				
Merchandise trade (f.o.b.)					
Exports	13,285	16,400	3,920	4,185	8,395
Imports	14,845	15,940	3,715	4,000	8,225
Trade balance	− 1,560	+ 460	+ 105	+ 185	+ 170
Services and transfers[2]	− 445	− 180	+ 30	+ 105	− 315
Current balance	− 2,005	+ 280	+ 135	+ 290	− 145
Long-term capital					
Private					
French investment abroad	− 260	− 440	− 130	− 5	− 305
Foreign investment in France	+ 660	+ 1,410	+ 305	+ 245	+ 860
Banking sector	− 5	− 280	− 5	− 30	− 245
Total	+ 395	+ 690	+ 170	+ 210	+ 310
Official	− 70	− 140	− 55	− 20	− 65
Total	+ 325	+ 550	+ 115	+ 190	+ 245
Basic balance	− 1,680	+ 830	+ 250	+ 480	+ 100
Short-term capital, multilateral settlements and adjustments	+ 15	+ 540	+ 185	+ 390	− 35
Overall balance	− 1,665	+ 1,370	+ 435	+ 870	+ 65
Counterpart of SDR allocation	—	+ 165	+ 165	—	—
Overall balance including counterpart of SDR allocation	− 1,665	+ 1,535	+ 600	+ 870	+ 65

[1] On a cash basis. [2] Including merchanting.

reduced from $1.6 to 0.6 milliard in 1970. Not quite half of this change was due to a reversal in the trade balance with Italy, which shifted from a deficit of $0.2 milliard to a surplus of similar magnitude. There was also an improvement in balances vis-à-vis all other areas, with the exception of North America, where the deficit increased by nearly $0.3 milliard vis-à-vis the United States.

The structural deficit on services and transfers was further reduced from $445 million in 1969 to $180 million last year. Three main factors contributed to this improvement: the travel account, after having been in equilibrium, showed a surplus of $120 million, despite a rise in the French travel allowance; the deficit on government transactions contracted from $270 to 140 million, owing mainly to a smaller interest burden, as all of the financial assistance obtained previously from central banks had been repaid by April 1970; and, finally, there was a substantial increase in receipts from the EEC's agricultural fund.

The net inflow of private long-term capital into France rose from $0.4 milliard in 1969 to $0.7 milliard last year. Encouraged by the better economic climate, net foreign non-bank investment in France more than doubled to a record level of

\$1.4 milliard. Direct investment and loans each went up by some \$300 million and portfolio investment, mostly through subscriptions to French bond issues abroad, by \$230 million. Net long-term foreign investment by French residents also increased substantially in 1970. In the non-bank sector, it rose from \$260 million to \$440 million, with direct investments, which were facilitated by a relaxation of exchange controls, accounting for \$100 million of the increase. A large part of non-bank foreign investment was financed with the proceeds of loans from non-residents. Even more striking was the rise in banks' long-term investment abroad, from virtually zero in 1969 to \$280 million last year. Most of this occurred in the second half of the year as a result of the increase in the cost of borrowing on the Euro-bond market; and it was financed by the banks' taking short-term funds from the Euro-dollar market.

On short-term capital account, including multilateral settlements and adjustments, the increase in net inflows was even more marked, from \$15 to 540 million. These inflows were concentrated in the first half of the year, when French enterprises took up a substantial volume of short-term loans abroad in order to circumvent domestic credit restrictions. In the second half, following the prohibition in July 1970 on borrowing abroad for periods of less than one year — except to finance foreign trade — there was a small net outflow.

Germany. Both the main elements of Germany's basic balance of payments moved nearer to equilibrium in 1970. The tightening of domestic liquidity and the substantial increase in domestic interest rates brought the net outflow on long-term capital account down from the abnormally high 1969 figure of \$6 milliard to \$1.2 milliard. In addition, the current-account surplus, despite a further increase in the foreign trade surplus, came down from \$1.6 to 0.7 milliard under the combined influence of the revaluation, on the one hand, and the large increase in domestic incomes and demand, on the other. Thus the basic payments deficit declined quite sharply from \$4.4 to 0.6 milliard. At the same time the domestic factors that reduced the net outflow of long-term capital produced, in combination with the decline in dollar interest rates, a \$4.4 milliard net inflow on short-term capital account, including errors and omissions. The overall balance of payments (excluding the counterpart of the first SDR allocation) thus shifted by \$8 milliard to a surplus of \$3.8 milliard.

The enormous change on long-term capital account was concentrated in the private sector, where net outflows fell away from \$5.5 to 0.5 milliard. Two types of capital transactions were affected in particular by the tightening of domestic liquidity. Firstly, the balance of the banks' long-term capital transactions turned round from net lending of \$3 milliard during 1969 to net borrowing of \$0.3 milliard. In the first quarter of 1970 the banks were still net long-term lenders to non-residents to the extent of \$0.4 milliard, but during the rest of the year they were net borrowers to the extent of \$0.7 milliard, mainly for the purpose of circumventing the special reserve requirements imposed on increases in their short-term foreign liabilities. Secondly, the net outflow on account of portfolio investment declined between 1969 and 1970 from \$2.7 to 0.2 milliard. German purchases of foreign securities fell from \$2.4 to 0.6 milliard, subscriptions to foreign bond issues in Deutsche Mark and other denominations by German syndicate banks declining from \$1.4 to 0.3 milliard and net purchases of foreign investment certificates from \$0.5 milliard virtually to zero. In addition, non-residents' transactions in German securities produced a $0.4 milliard inflow last year, after a $0.3 milliard outflow in 1969. Direct investment, being much less influenced by capital and money-market conditions, moved in the opposite direction to the rest of the long-term private capital account in 1970, net outflows increasing from $0.2 to 0.4 milliard.

The net long-term capital outflow of the public sector increased from $0.5 to 0.7 milliard in 1970. Most of the change was due to larger purchases of US Government paper under the terms of the foreign exchange offset agreement with the United States.

Exports and imports on an f.o.b. dollar basis both expanded by approximately 18 per cent. last year, compared with rises of 17 and 25 per cent. respectively in 1969. Since exports are substantially larger than imports, the trade surplus went up from $5.1 to 5.8 milliard. On a customs basis most categories of imports recorded a lower rate of growth. The slow-down was especially pronounced in the cases of semi-manufactured goods and products for further processing, where the growth rates were reduced from 26 to 13 per cent. and from 28 to 15 per cent. respectively. In

Germany: Balance of payments.*

Items	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 3rd quarter	1970 4th quarter	1971 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	29,095	34,105	7,820	9,490	8,390	9,405	9,020
Imports	23,960	28,285	6,670	7,195	6,815	7,605	7,560
Trade balance	+ 5,135	+ 5,820	+ 1,150	+ 1,295	+ 1,575	+ 1,800	+ 1,460
Services and transfers	− 3,525	− 5,155	− 1,140	− 1,115	− 1,665	− 1,235	− 1,360
Current balance	+ 1,610	+ 665	+ 10	+ 180	− 90	+ 565	+ 100
Long-term capital							
Private	− 5,475	− 545	− 1,000	− 65	+ 285	+ 235	+ 95
Official	− 530	− 690	− 95	− 235	− 190	− 170	− 155
Total	− 6,005	− 1,235	− 1,095	− 300	+ 95	+ 65	− 60
Basic balance	− 4,395	− 570	− 1,085	− 120	+ 5	+ 630	+ 40
Short-term capital							
Private	− 190	+ 1,760	+ 210	+ 540	+ 790	+ 220	+ 830
Official	− 10	− 110	+ 25	− 130	+ 50	− 55	+ 175
Total	− 200	+ 1,650	+ 235	+ 410	+ 840	+ 165	+ 1,005
Errors and omissions	+ 370	+ 2,720	+ 600	+ 875	+ 1,040	+ 205	+ 2,275
Overall balance	− 4,225	+ 3,800	− 250	+ 1,165	+ 1,885	+ 1,000	+ 3,320
Counterpart of SDR allocations	—	+ 200	+ 200	—	—	—	+ 170
Overall balance including counterpart of SDR allocations	− 4,225	+ 4,000	− 50	+ 1,165	+ 1,885	+ 1,000	+ 3,490

* On a transactions basis.

terms of volume the growth rate of exports moderated from 12 to 8 per cent. last year and that of imports from 18 to 14 per cent.

On a customs basis, the trade surplus increased from $4 to 4.3 milliard. It was $0.6 milliard larger with EFTA countries — bigger surpluses with Austria and Switzerland having largely compensated a narrowing of the surplus with the United Kingdom — and $0.3 milliard larger with industrialised countries other than the EEC, the EFTA and North America. Among those other countries, the surplus in relation to Yugoslavia went up by nearly $0.2 milliard. On the other hand, Germany's export surplus was smaller with EEC countries, declining from $0.7 to 0.5 milliard. Finally, fast-growing imports from North America caused a $0.5 milliard turn-round from surplus to deficit in Germany's trade with that area.

The effects of revaluation, combined with the large increase in domestic incomes and demand, showed up most clearly in services and transfers, where the deficit jumped from $3.5 to 5.2 milliard in 1970. With the exception of military receipts, which went up by $0.2 milliard, the deficits on all items were larger, in particular on those relating to travel, unilateral transfers and transportation. The deficit on travel increased from $1 to 1.5 milliard, as expenditure by German tourists abroad rose by one-third, whereas receipts from foreign tourists in Germany went up by only 12 per cent. The transportation deficit widened from $0.2 to 0.5 milliard, partly owing to a 15 per cent. rise in imports from overseas (maritime freight charges represent about half of all transport costs) and partly for statistical reasons. Finally, the deficit on unilateral transfers went up from $2.2 to 2.5 milliard. Although government transfers declined by about $0.1 milliard because of a drop in payments to the EEC's agricultural fund, workers' remittances abroad rose by $0.5 to 1.2 milliard. This was the result both of an increase of 400,000 in the number of foreign workers employed, who totalled nearly two million at the end of last year, and of the upsurge in wages.

The net inflow of short-term capital, including errors and omissions, soared from $0.2 to 4.4 milliard in 1970. Private enterprises, faced with a tightening of domestic credit and higher interest rates, turned to the Euro-currency market and took up financial credits amounting to $1.8 milliard. The remaining short-term inflow of $2.6 milliard is attributable to unidentified financial credits and to trade credits.

In the first quarter of 1971 the overall balance (excluding the counterpart of the second allocation of SDRs) showed a surplus of $3.3 milliard, including a net inflow of short-term capital of the same size. Identified capital movements made up less than a third of this inflow, the bulk of it being accounted for by net unidentified receipts of $2.3 milliard. The current account, the long-term capital account and, thus, the basic balance were all about in equilibrium. Within the current account, however, in comparison with the first quarter of 1970 the export surplus rose from $1.2 to 1.5 milliard, while the deficit on services and transfers increased from $1.1 to 1.4 milliard.

Italy. Owing to a drastic reduction of the net capital outflow from $3.5 to 0.4 milliard, Italy's overall balance of payments, which had shifted from surplus to

Italy: Balance of payments.[1]

Items	1969	1970[2] Year	1970[2] 1st quarter	1970[2] 2nd quarter	1970[2] 3rd quarter	1970[2] 4th quarter	1971[2] 1st quarter
	in millions of US dollars						
Merchandise trade (f.o.b.)							
Exports	11,640	13,105	2,985	3,305	3,410	3,405	3,415
Imports	11,100	13,445	3,210	3,480	3,480	3,275	3,615
Trade balance	+ 540	− 340	− 225	− 175	− 70	+ 130	− 200
Services and transfers							
Travel	+ 1,140	+ 910	+ 215	+ 215	+ 245	+ 235	.
Workers' remittances	+ 945	+ 955	+ 240	+ 250	+ 240	+ 225	.
Other	− 285	− 710	− 190	− 160	− 165	− 195	.
Total	+ 1,800	+ 1,155	+ 265	+ 305	+ 320	+ 265	+ 250
Current balance	+ 2,340	+ 815	+ 40	+ 130	+ 250	+ 395	+ 50
Current balance unadjusted	+ 2,340	+ 815	− 95	+ 160	+ 590	+ 160	− 125
Capital movements							
Residents	− 3,855	− 2,410	− 985	− 720	− 395	− 310	.
Non-residents	+ 230	+ 2,185	+ 450	+ 695	+ 435	+ 605	.
Errors and omissions	+ 110	− 185	− 80	+ 45	− 260	+ 110	.
Total	− 3,515	− 410	− 615	+ 20	− 220	+ 405	+ 425
Overall balance	− 1,175	+ 405	− 710	+ 180	+ 370	+ 565	+ 300
Counterpart of SDR allocations	—	+ 105	+ 105	—	—	—	+ 110
Overall balance including counterpart of SDR allocations	− 1,175	+ 510	− 605	+ 180	+ 370	+ 565	+ 410

[1] On a transactions basis. [2] Quarterly data for the current balance are seasonally adjusted.

deficit between 1968 and 1969, reverted to a $0.4 milliard surplus last year (excluding the counterpart of the initial allocation of SDRs). The current-account surplus, however, continued to deteriorate, falling sharply from $2.3 to 0.8 milliard. Over half of this decline was attributable to a worsening of the trade balance and the remainder to a smaller surplus on services and transfers.

The trade balance shifted from a surplus of $0.5 milliard in 1969 to a deficit of $0.3 milliard last year. The deterioration had already begun in the last quarter of 1969, when economic activity was severely affected by strikes, and from then until the third quarter of 1970 the trade balance was in deficit. The trend began to improve, however, after the first quarter of 1970, as imports levelled off and then turned down, and in the last quarter of the year a trade surplus, amounting to $0.1 milliard on a seasonally adjusted basis, reappeared. But in the first quarter of 1971 imports rose again and the balance reverted to a deficit of $0.2 milliard.

Taking the year as a whole, the deterioration in the trade balance on a c.i.f./f.o.b. customs basis was due both to the continued high growth rate of imports (20 against 21 per cent.) and to the decline in the growth of exports (from 15 to 12.5 per cent.). As in many other countries, price rises accounted for a significant part of last year's expansion of foreign trade, import prices going up by 4 per cent. and export prices by 5 per cent.

A particularly adverse trend developed in trade in semi-manufactured goods: imports in this category expanded by 30 per cent. in 1970, with those of iron and steel going up by as much as 55 per cent., while exports rose by only 12 per cent. In absolute values the deterioration amounted to over \$0.6 milliard and accounted for roughly two-thirds of the increase in the total trade deficit (from \$0.7 to 1.7 milliard). Another \$0.2 milliard of the deterioration was attributable to the growing deficit on fuel and power.

On a regional basis, the balance of trade vis-à-vis other EEC countries, after two years of surpluses, shifted last year by \$0.6 milliard to a deficit of \$0.5 milliard. Two-thirds of this deterioration took place in trade with France, with a surplus of \$0.1 milliard giving way to a deficit of \$0.3 milliard as a result of a 27 per cent. rise in imports. The balances vis-à-vis the other EEC partner countries also worsened. By contrast — and this was the only regional improvement — the trade surplus in relation to the EFTA and other western European countries increased by \$0.1 milliard.

As well as the deterioration on foreign trade account there was a sharp decline from \$1.8 to 1.2 milliard in the surplus on services and transfers. Net receipts from travel fell from \$1.1 to 0.9 milliard, owing entirely to increased expenditure on the part of Italian tourists; the investment-income account deteriorated from a surplus of \$0.1 milliard to a small net deficit, owing to Italy's greater foreign indebtedness and to the rise in domestic interest rates; and large payments to the EEC's agricultural fund were mainly responsible for the widening of the deficit on net government transfers to \$0.3 milliard.

On capital account the total net identified outflow declined from \$3.6 to 0.2 milliard. Inflows of foreign capital to Italy rose from \$0.2 to 2.2 milliard, while net outflows of Italian capital fell from \$3.9 to 2.4 milliard. These dramatic changes were mainly the result of policy measures taken by the Italian authorities — including the deliberate encouragement of foreign borrowing by the public sector, the raising of domestic interest rate levels and stricter regulations governing the remittance of Italian bank-notes from abroad — though in addition the decline in interest rates on the international markets and the improvement in the domestic political situation in mid-August 1970 were also significant factors. As regards the lower level of resident capital outflows, easily the biggest element was a reduction of the outflow in the form of bank-note remittances from \$2.2 to 1 milliard. In addition, private loans to non-residents declined from \$0.5 to 0.2 milliard and direct investment abroad from \$0.3 to 0.1 milliard. The main factor behind the increase in the net inflow of foreign capital was the large volume of borrowing from abroad, especially by Italian public-sector enterprises, which amounted altogether to \$2 milliard on a gross basis.

In the course of 1970 the net outflow of Italian capital declined from \$1.7 milliard in the first half to \$0.7 milliard in the second, while the net inflow of foreign capital amounted to over \$1 milliard in each period. Taking into account the errors and omissions item, a net outflow of \$0.6 milliard in the first half was followed by a net inflow of \$0.2 milliard. In the last quarter of 1970 and in the first quarter of 1971 the total net capital inflow exceeded \$0.4 milliard.

Belgium-Luxemburg Economic Union. Favourable trade results pushed up the surplus on current account from $0.1 milliard in 1969 to $0.7 milliard last year. On capital account, however, including errors and omissions, the 1969 inflow gave way to an outflow which more than offset the improvement in the current balance. Consequently the overall balance-of-payments surplus (excluding the counterpart of the initial allocation of SDRs) was reduced from $0.3 to 0.1 milliard. But in the first quarter of 1971 the overall surplus came to $125 million, compared with $95 million in the corresponding quarter of 1970.

Most of the improvement on foreign trade account was the result of a favourable movement in Belgium's terms of payment which began in the last quarter of 1969. This is shown by the fact that on a payments basis the trade balance shifted from a deficit of $100 million to a surplus of $470 million, whereas on the basis of customs figures the improvement was only $190 million, from a surplus of $70 million to one of $260 million.

The slower growth of foreign trade in 1970 was due entirely to a smaller rise in the volume of transactions: in the first eleven months the volume of imports increased by 8 per cent. and that of exports by 11 per cent., compared with rates of 17 and 18 per cent. respectively in 1969. Unit values of exports rose by 5 per cent. in both 1969 and 1970, and those of imports by 3 and 4 per cent. respectively. The rise in unit values thus accounted for nearly a third of the increase in the value of exports and was largely attributable to a substantial rise in steel prices. Imports of capital goods showed a much greater expansion than those of other product-groups, rising by 22 per cent. in volume in the first three quarters and by 24 per cent. in value. In the first quarter of 1971 total imports on a seasonally adjusted basis went up by 10 per cent. over the corresponding period of 1970, while exports increased by only 4 per cent.

Both imports from and exports to other EEC countries rose by 17 per cent. last year, and the export surplus vis-à-vis the Community went up by $200 million to $1,265 million. A deterioration of $170 million in the balance with France was more than compensated by improvements in those with the three other partner countries; in particular, the balance with Germany shifted from a small deficit to a surplus of $205 million. The balance of trade with EFTA countries improved from a deficit of $110 million to a surplus of $30 million and there were improvements also in the balances with all other areas except Japan and North America. With the latter area the deficit widened by $300 million, as imports rose sharply — those from the United States by 30 per cent. and those from Canada by 45 per cent.

At $275 million, net receipts from services and transfers were $90 million more than in 1969, half of the improvement being due to larger net investment income. Freight receipts also rose, and net expenditure on foreign travel was somewhat smaller.

In contrast with most European countries, the BLEU's balance on capital account, including errors and omissions, deteriorated, shifting from a net inflow of $205 million to a net outflow of $635 million. About half of this change was the result of statistical adjustments, as shown by the increase from $40 to 405 million in the unfavourable errors and omissions item. The net outflow of identified BLEU private capital increased from $265 to 515 million. Direct investment abroad, which

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

Items	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 3rd quarter	1970 4th quarter
	in millions of US dollars					
Merchandise trade						
Exports	7,780	9,335	2,150	2,360	2,310	2,515
Imports	7,880	8,865	2,000	2,305	2,155	2,405
Trade balance	− 100	+ 470	+ 150	+ 55	+ 155	+ 110
Services and transfers	+ 185	+ 275	+ 95	+ 45	+ 80	+ 55
Current balance	+ 85	+ 745	+ 245	+ 100	+ 235	+ 165
Capital movements						
Public authorities	− 40	−	− 5	−	−	+ 5
Semi-official[2]	+ 190	− 40	− 5	− 20	+ 5	− 20
Private						
Foreign investment in the BLEU	+ 360	+ 325	+ 45	+ 125	+ 45	+ 110
BLEU investment abroad	− 265	− 515	− 100	− 125	− 160	− 130
Total	+ 245	− 230	− 65	− 20	− 110	− 35
Errors and omissions	− 40	− 405	− 85	− 40	− 30	− 250
Overall balance	+ 290	+ 110	+ 95	+ 40	+ 95	− 120
Counterpart of SDR allocation	−	+ 70	+ 70	−	−	−
Overall balance including counterpart of SDR allocation	+ 290	+ 180	+ 165	+ 40	+ 95	− 120

[1] On a cash basis. [2] Public enterprises and non-monetary financial institutions of the public sector.

had been negligible in 1969, rose to $130 million last year. In particular, net loans by Belgian and Luxemburg enterprises (especially oil companies) to their foreign branches, which had declined the year before, showed a rise in 1970. There was also an increase in residents' deposits abroad, following repatriations in 1969. Although foreign direct investment increased by $70 to 335 million, total private foreign investment in Belgium fell from $360 to 325 million. The inflow of flight capital from France, which had been substantial in 1969, came to a halt last year.

Public enterprises and non-monetary financial institutions in the public sector, which had borrowed heavily in 1969, repaid their loans last year. As these payments exceeded new borrowing, there was a net outflow of $40 million, compared with a net inflow of $190 million in 1969.

Netherlands. Domestic inflationary developments caused a substantial deterioration in the current account of the balance of payments last year. On a cash basis the balance shifted from a surplus of $0.2 milliard in 1969 to a deficit of $0.1 milliard. At the same time, however, the anti-inflationary monetary policy of the Dutch authorities, in combination with the decline in dollar interest rates, brought about an even larger opposite shift in net capital movements (including errors and omissions) from a small outflow in 1969 to a net inflow of $0.6 milliard. The overall balance-of-payments surplus (excluding the counterpart of the first SDR allocation) therefore actually increased from $0.2 to 0.5 milliard.

Netherlands: Balance of payments.[1]

Items	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 3rd quarter	1970 4th quarter	1971 1st quarter
	in millions of US dollars						
Merchandise trade							
Exports	9,300	11,115	2,450	2,830	2,785	3,050	2,920
Imports	9,655	11,760	2,545	3,035	2,900	3,280	3,135
Trade balance	− 355	− 645	− 95	− 205	− 115	− 230	− 215
Services and transfers							
Investment income	+ 215	+ 125	+ 10	− 15	+ 130	—	− 45
Other	+ 315	+ 375	+ 90	+ 130	+ 80	+ 75	+ 125
Total	+ 530	+ 500	+ 100	+ 115	+ 210	+ 75	+ 80
Current balance	+ 175	− 145	+ 5	− 90	+ 95	− 155	− 135
Long-term capital							
Dutch securities	+ 375	+ 665	+ 70	+ 115	+ 200	+ 280	+ 95
Foreign securities	− 240	− 250	− 55	− 35	− 85	− 75	
Direct investment[2]	− 145	+ 35	+ 60	+ 170	− 235	+ 40	+ 165
Banks and other private capital[3]	+ 15	+ 105	+ 5	− 30	+ 205	− 75	—
Official	− 30	− 30	− 10	− 15	− 5	—	− 5
Total	− 25	+ 525	+ 70	+ 205	+ 80	+ 170	+ 255
Basic balance	+ 150	+ 380	+ 75	+ 115	+ 175	+ 15	+ 120
Short-term capital							
Non-banks	− 60	—	− 30	− 75	+ 150	− 45	+ 35
Banks	+ 20	+ 25	− 85	+ 120	− 20	+ 10	− 85
Errors and omissions	+ 40	+ 50	+ 45	− 5	− 15	+ 25	+ 10
Total	—	+ 75	− 70	+ 40	+ 115	− 10	− 40
Overall balance	+ 150	+ 455	+ 5	+ 155	+ 290	+ 5	+ 80
Counterpart of SDR allocations	—	+ 90	+ 90	—	—	—	+ 75
Overall balance including counterpart of SDR allocations	+ 150	+ 545	+ 95	+ 155	+ 290	+ 5	+ 155

[1] On a cash basis. [2] Including inter-company credits at long and short term. [3] Mostly credits.

The large change on capital account between 1969 and 1970 was mainly in the long-term sector, where it amounted to $550 million. More than half of this took the form of a rise from $375 to 665 million in net sales of Dutch securities to non-residents, which increased steadily throughout 1970 from $70 million in the first quarter to $280 million in the fourth. Non-resident net purchases of Dutch bonds increased from $255 to 605 million, by far the largest demand coming from Switzerland. Net sales of Dutch shares, on the other hand, declined from $120 to 60 million. In the first quarter of 1971 the net long-term capital inflow came to $255 million, almost half as much as in the whole of 1970. Of this inflow $165 million was in the form of direct investment and $95 million in that of security transactions.

Nine-tenths of the current-account deterioration on a cash basis last year was due to the increase in the trade deficit from $355 to 645 million. Imports were 22 per cent. higher than in 1969, and exports 20 per cent. The underlying deterioration in the trade balance between the two years was even greater when measured on a transactions basis, the deficit rising from $1,015 to 1,600 million. Part of this increase was, however, attributable to net short-term trade credits received by the Netherlands, which rose from $190 to 330 million as a result of the tight domestic monetary policy. At $135 million, the current deficit on a cash basis in the first quarter of 1971 was nearly as large as that for the whole of the previous year.

On a regional basis, the trade deficits vis-à-vis North America and the developing countries both worsened by roughly $300 million to $910 and 1,030 million respectively. In Europe, the surplus in relation to EFTA countries diminished but the deficit vis-à-vis EEC countries was smaller, a substantial deterioration in the balance with France being more than compensated by an improvement in that with Germany.

In volume, imports and exports both expanded at a rate of 15 per cent. in 1970. Average prices of imports, however, rose much faster than those of exports, by 7 as against 4 per cent. On the import side the main feature of 1970 was a rise of 21 per cent. in the volume of purchases of capital goods following one of only 6 per cent. the year before. On the export side, sales of food, drink and tobacco rose by 15 per cent., twice as fast as in 1969.

The surplus on services and transfers was $30 million less than in 1969. Net investment income declined by $90 to 125 million, but this was partly offset by larger receipts from the EEC's agricultural fund. The transportation and travel items showed an improvement compared with 1969, owing in the latter case to bigger receipts from Germany.

Austria. In 1970 the overall balance-of-payments surplus, excluding the counterpart of the first SDR allocation, came to $70 million, somewhat less than the year before. Moreover, whereas the 1969 surplus had been almost entirely on current account, in 1970 it was essentially the result of unidentified inflows.

The trade deficit shot up by $290 to 725 million, widening steadily during the course of the year. The growth of exports slowed down from 21 per cent. in 1969 to 18 per cent., while that of imports accelerated from 13 to 26 per cent.

Imports of machinery and means of transport moved up by 33 per cent. and those of mineral fuels and energy by as much as 44 per cent. With regard to geographical distribution, exports to the EFTA rose much faster than, and those to the EEC more slowly than, total exports. Deliveries to Yugoslavia went up by almost 50 per cent., accounting for one-tenth of the increase in Austrian exports.

The deterioration on trade account was partly offset by a further rise of $180 million in the invisible surplus, entirely owing to larger net receipts from tourism. The current account worsened from a surplus of $100 million to a position of approximate balance.

The long-term capital account shifted from a net outflow of $25 million in 1969 to a net inflow of $15 million last year. On short-term capital account, which includes errors and omissions, the increase in the net inflow from $30 to 65 million was more than accounted for by a $50 million rise in unidentified receipts.

Western European countries: Balances of payments.

Countries	Years	Trade balance (f.o.b.)	Services and transfers	Current balance	Net capital movements (inflow +)[1] Long-term	Net capital movements (inflow +)[1] Short-term	Overall balance[2]
		in millions of US dollars					
Belgium-Luxemburg*	1969	– 100	+ 185	+ 85	+ 205		+ 290
	1970	+ 470	+ 275	+ 745	– 635		+ 110
France*	1969	– 1,560	– 445	– 2,005	+ 325	+ 15[3]	– 1,665
	1970	+ 460	– 180	+ 280	+ 550	+ 540[3]	+ 1,370
Germany	1969	+ 5,135	– 3,525	+ 1,610	– 6,005	+ 170	– 4,225
	1970	+ 5,820	– 5,155	+ 665	– 1,235	+ 4,370	+ 3,800
Italy	1969	+ 540	+ 1,800	+ 2,340	– 3,515		– 1,175
	1970	– 340	+ 1,155	+ 815	– 410		+ 405
Netherlands*	1969	– 355	+ 530	+ 175	– 25	–	+ 150
	1970	– 645	+ 500	– 145	+ 525	+ 75	+ 455
Total EEC	1969	+ 3,660	– 1,455	+ 2,205	– 8,830		– 6,625
	1970	+ 5,765	– 3,405	+ 2,360	+ 3,780		+ 6,140
Austria	1969	– 435[4]	+ 535	+ 100	– 25	+ 30	+ 105
	1970	– 725[4]	+ 715	– 10	+ 15	+ 65	+ 70
Denmark	1969	– 630	+ 220	– 410	+ 330		– 80
	1970	– 785	+ 245	– 540	+ 545		+ 5
Finland	1969	– 55[4]	+ 75	+ 20	+ 25	+ 10	+ 55
	1970	– 350[4]	+ 125	– 225	+ 80	+ 205	+ 60
Iceland	1969	–	+ 5	+ 5	+ 20	– 10	+ 15
	1970	+ 10	+ 5	+ 15	– 5	–	+ 10
Norway	1969	– 780[4]	+ 915	+ 135	– 160	– 30	– 55
	1970	– 1,285[4]	+ 1,100	– 185	+ 90	+ 220	+ 125
Portugal	1969	– 390	+ 435	+ 45	– 40	+ 80[5]	+ 85
	1970	– 500	+ 540	+ 40	+ 15	+ 25[5]	+ 80
Sweden	1969	– 175[4]	– 20	– 195	– 135		– 330
	1970	– 195[4]	– 125	– 320	+ 400		+ 80
Switzerland	1969	– 630[4]	+ 1,155	+ 525	– 365		+ 160
	1970	– 1,330[4]	+ 1,330	–	+ 1,080[6]		+ 1,080[6]
United Kingdom	1969	– 340	+ 1,390	+ 1,050	+ 465		+ 1,515
	1970	+ 5	+ 1,510	+ 1,515	– 405		+ 1,110
Total EFTA	1969	– 3,435	+ 4,710	+ 1,275	+ 195		+ 1,470
	1970	– 5,155	+ 5,445	+ 290	+ 2,330		+ 2,620
Greece	1969	– 900[4]	+ 550	– 350	+ 210	+ 135	– 5
	1970	– 1,095[4]	+ 680	– 415	+ 275	+ 115	– 25
Ireland	1969	– 385	+ 195	– 190	+ 75	+ 260	+ 145
	1970	– 390	+ 240	– 150	+ 120	+ 20	– 10
Spain*	1969	– 2,105	+ 1,610	– 495	+ 430	– 155	– 220
	1970	– 1,940	+ 2,175	+ 235	+ 565	+ 25	+ 825
Turkey	1969	– 265[4]	+ 45	– 220	+ 160		– 60
	1970	– 350[4]	+ 155[7]	– 195[7]	+ 225[7]		+ 30
Total "Other"	1969	– 3,655	+ 2,400	– 1,255	+ 1,115		– 140
	1970	– 3,775	+ 3,250	– 525	+ 1,345		+ 820
Grand total	1969	– 3,430	+ 5,655	+ 2,225	– 7,520		– 5,295
	1970	– 3,165	+ 5,290	+ 2,125	+ 7,455		+ 9,580

Note: Balances of payments of countries marked with an asterisk are on a cash basis.

[1] Difference between current and overall balances, including errors and omissions. [2] Equal to changes in net official assets (excluding SDR allocation) and the net foreign position of commercial banks, except in the case of the United Kingdom and Turkey. For the United Kingdom, excluding UK residents' Euro-dollar borrowing from banks in London for investment abroad and trade credit provided by UK banks, which are included in net capital movements; for Turkey, equal to changes in net official assets only. [3] Including multilateral settlements and adjustments. [4] Imports c.i.f. [5] Including the balance of Portuguese overseas territories vis-à-vis the non-escudo area. [6] Owing to major changes in coverage for Swiss commercial banks' net foreign position, data for 1970 are not comparable with the corresponding figures for earlier periods. [7] Estimates.

In the first quarter of 1971 the trade deficit was \$245 million, compared with \$150 million in the corresponding period of 1970, and the current-account deficit \$75 million. This was broadly offset by long and short-term capital inflows, so that the overall balance (excluding the counterpart of the second SDR allocation) was virtually in equilibrium.

Switzerland. Reflecting the over-heating of the economy, Switzerland's trade deficit last year, at over \$1.3 milliard, was more than twice as large as it had been in 1969. Consequently, although the invisible surplus went up by a further \$0.2 milliard, the current-account surplus disappeared. However, despite this and despite a further heavy outflow of identified long-term capital, the overall balance of payments showed a surplus of \$1.1 milliard, as against only \$0.2 milliard in 1969. This was because of a \$1.3 milliard rise to \$2.1 milliard in other net capital inflows, including errors and omissions. Owing, however, to changes in the coverage of the Swiss commercial banks' net foreign position, the overall balance for 1970 is not entirely comparable with that for 1969.

Whereas in 1969 merchandise imports and exports had risen by 17 and 15 per cent. respectively, the growth rate of imports accelerated to 23 per cent. last year, while that of exports slowed down to 11 per cent. The terms of trade deteriorated by 4 per cent., import prices going up by 8 per cent. and export prices by 4 per cent., so that, in terms of volume, imports and exports rose by 15 and 7 per cent. respectively. Of the various categories of imports, that of investment goods showed the highest rate of increase, soaring by 35 per cent. in value, compared with 13 per cent. in 1969. Imports of raw materials and semi-finished products went up by 23 per cent. On the other hand, imports of consumer goods rose less than total imports. On the export side, the best performance was again put up by investment goods, which rose by 16 per cent.

The main source of the increase in Switzerland's imports last year was the EEC countries, purchases from which went up by 23 per cent., as against 14 per cent. in 1969. In addition, imports from EFTA countries grew by 23 per cent., but this was slightly less than the 28 per cent. growth rate recorded the year before. On the export side, the slow-down in growth was particularly marked vis-à-vis Germany and France, sales to which countries rose by 8 and 5 per cent. respectively. Exports to the United States grew by 4 per cent., about the same as in 1969. In the first quarter of the current year the seasonally adjusted trade deficit was running at an annual rate of \$1.5 milliard. But the rise in imports slowed down to 9 per cent., compared with 32 per cent. in the corresponding period of 1970.

In 1970 the improvement of \$175 million in net receipts from invisibles stemmed from higher investment income, increased earnings from tourism, and bigger receipts from other services. At \$310 million, the deficit in respect of foreign workers' remittances was only slightly larger than in 1969.

The outflow of identified long-term capital contracted by \$150 to 1,045 million. The net outflow of funds stemming from the operations of investment trusts went down by \$110 million and new foreign bond issues in Switzerland by \$65 million.

As regards the big unidentified inflow, estimated at $2.1 milliard, no doubt part of it can be accounted for by a reflux of funds to Switzerland following the decline in Euro-currency interest rates.

Sweden. Despite a $125 million deterioration on current account, the overall balance of payments improved very substantially between 1969 and 1970, from a $330 million deficit to a surplus, excluding the counterpart of the initial SDR allocation, of $80 million. This was because the balance of capital movements shifted from a $135 million outflow to a $400 million inflow.

The turn-round on capital account was primarily the result of a marked improvement in unidentified capital movements, from a $95 million outflow in 1969 to a $175 million inflow in 1970. The capital inflow occurred in the first half of the year and was no doubt largely due to increasing recourse to trade credit from abroad as a result of the tight domestic monetary policy. In addition there was a favourable shift of $70 million on portfolio investment account, resulting from issues of Swedish bonds abroad to finance foreign investment by Swedish enterprises; net receipts from private long-term loans rose by $65 million and other net private capital inflows by $130 million.

The deterioration in the current-account balance, which showed a deficit of $320 million last year, occurred mainly in invisibles and reflected larger net travel expenditure.

The trade deficit widened slightly to $195 million. The growth of exports and imports was close to 20 per cent., but about half of this increase was due to higher prices. Engineering exports, excluding ships, represented a particularly expansionary element, their value increasing by some 30 per cent. Exports of iron ore, however, declined by 4 per cent., partly owing to a strike in certain Swedish mines early in the year. The rise in imports was boosted by stock-building of raw materials and semi-manufactures.

Excluding the counterpart of the second SDR allocation, Sweden's balance of payments showed an overall surplus of $50 million in the first quarter of 1971. With exports on a customs basis 19 per cent. higher than a year before and imports unchanged, the seasonally adjusted trade balance moved to a surplus of $170 million, compared with a deficit of $125 million in the first quarter of 1970.

Denmark. The overall balance of payments swung from a deficit of $115 million (excluding the counterpart of the initial SDR allocation) in the first half of 1970 to a surplus of $120 million in the second half, thus recording a surplus of $5 million for the year as a whole, compared with a deficit of $80 million in 1969. This improvement was due to the fact that the increase in net capital inflows during the year was more than sufficient to offset a $130 million deterioration on current account.

The increase in the current deficit was all on trade account. Having risen steeply in the first half of the year in response to the persistent strength of domestic demand, the growth of imports slowed down in the second half. Even so, over the year as a whole, they were up by 14 per cent., while exports increased by 11 per cent. As a result the trade deficit widened from $630 to 785 million. There was only a small improvement of $25 million in the surplus on invisible account, so that the current deficit went up from $410 to 540 million.

On capital account the net inflow increased from $330 to 545 million. Public-sector net borrowing abroad fell slightly, but the net inflow of private capital almost doubled to $460 million, principally reflecting tight domestic credit conditions. The larger part of it took the form of short-term trade credits, which increased sharply to about $300 million; but in addition Danish firms had increasing recourse to medium-term financial loans abroad. On direct investment there was a net inflow of $35 million.

In the first quarter of 1971, despite a worsening trade balance, the overall position, excluding the counterpart of the second SDR allocation, showed a surplus of $90 million.

Norway. Norway's balance of payments, which had shown a deficit of $55 million in 1969, moved back into surplus last year. Excluding the counterpart of the first allocation of SDRs, the overall surplus amounted to $125 million. The improvement was due to favourable swings on long and short-term capital account, which, totalling about $250 million in each case, far exceeded a $315 million deterioration on current account. In the first three months of 1971 there was an overall surplus of $35 million.

The turn-round in the current-account balance to a deficit of $185 million in 1970 included a $505 million deterioration in general trade and in trade in ships. Excluding the latter, the trade balance worsened by $305 million to a deficit of $1,170 million. Exports rose by 14 per cent. and imports by 21 per cent. The strong increase in imports reflected the continued sharp rises in domestic investment and consumption and the building-up of stocks. Imports of raw materials and of fuel, which had grown only moderately in 1969, advanced at rates of 36 and 32 per cent. respectively last year. The growth of imports of machinery accelerated from 15 to 27 per cent., while that of manufactured goods remained high. The net balance of trade in ships swung round from a $85 million surplus in 1969 to a deficit of $115 million, imports of ships having increased by $180 million. In the first quarter of 1971 the trade deficit, excluding ships, widened to $280 million from $235 million in the first quarter of 1970.

The $185 million increase to $1,100 million in the invisible surplus was the result of higher net freight earnings; the latter item covered roughly two-thirds of the rise in the trade deficit (excluding ships).

The turn-round on long-term capital account from a net outflow of $160 million to an inflow of $90 million was due, in particular, to substantial net borrowing by the shipping sector. Net public and private borrowing from abroad came to $135 million, whereas in 1969 there had been net repayments of $35 million. Net lending abroad was reduced last year by $35 million. After a $30 million net outflow in 1969, the short-term capital account registered an inflow of $220 million, most of which was concentrated in the last quarter of 1970, when domestic credit policy was further tightened.

Finland. A sharp worsening of the trade deficit from $55 million in 1969 to $350 million in 1970, only partially offset by higher net earnings from invisibles, caused the current balance of payments to shift from a surplus of $20 million to a deficit of $225 million. However, owing to a larger surplus on long-term capital account and, above all, a pronounced inflow of short-term funds, the overall balance remained favourable. At $60 million, excluding the counterpart of Finland's first SDR allocation, the overall payments surplus was even greater than in the previous year. In the first quarter of 1971 it amounted to $70 million.

The marked deterioration on trade account was due to imports expanding almost twice as fast as exports. In value, the year-to-year growth of imports accelerated from 27 to 30 per cent. as a result of booming domestic demand, particularly for investment goods; the growth of exports slowed down from 21 to 16 per cent. owing to insufficient capacity in the export industries. On a seasonally adjusted basis, the level of Finnish exports remained fairly steady during the individual quarters of 1970, while the increase in imports grew from quarter to quarter. Consequently, the trade balance, after being in equilibrium in the first quarter, showed larger deficits as the year went on. There were sharp increases in 1970 in the unit values of both imports and exports. In volume, imports rose by 20 per cent. and exports by 5 per cent. Imports of raw materials, fuels and investment goods all went up by about one-third in value.

Net invisible receipts rose by $50 to 125 million last year. Following the sharp rise in freight rates, there was an increase of $50 million in the net transport surplus. Receipts from travel, too, moved up by $35 million. On the other hand, net interest and dividend payments were $15 million higher than the year before.

In 1970 the net inflow of long-term capital, at $80 million, was $55 million higher than in the preceding year. In particular, foreign loans increased by $100 million, while the net outflow through the granting of long-term export credits and other long-term capital items (including direct investment) doubled to $110 million.

The short-term capital account, including errors and omissions, turned from approximate balance in 1969 to a $205 million inflow. Within this, trade credits produced a net inflow of $230 million last year, as against a very small outflow in 1969. In view of Finland's increasing short-term foreign indebtedness and persisting excess domestic demand, in November 1970 the permitted use of short-term credit from abroad was drastically reduced and a range of goods, which account for about one-quarter of total imports, was made subject to cash payment in advance of customs clearance.

Spain. In response to the various monetary and fiscal measures of restraint taken by the authorities in view of the substantial worsening of the external position in 1969, Spain's balance of payments (on a cash basis) improved markedly last year on both current and capital account. The overall balance swung round from a $220 million deficit to a surplus of $825 million (leaving the counterpart of the initial allocation of SDRs out of account).

For the first time since 1964 net earnings from invisibles, which increased by $565 to 2,175 million, exceeded the deficit in the trade balance. The most important factor in this was a rise of $345 million in net receipts from foreign travel to $1,570 million. Net receipts from transfers, which consist mainly of workers' remittances, went up by $110 to 660 million. As a result, the current account shifted from a deficit of almost $500 million in 1969 to a surplus of $235 million.

The trade deficit declined by $165 to 1,940 million. After 21 per cent. increases in 1969, exports continued to expand at the same rate in the following year, while the growth of imports slowed down to 6 per cent., partly as a result of the import deposit scheme. On a customs basis, the deceleration in import growth over the year was most pronounced in purchases of semi-manufactured goods and raw materials, whereas imports of capital goods grew only a little less than in 1969 and those of fuel rose by 19 per cent. On the export side, agricultural and food products recorded a rise of 32 per cent. after one of only 8 per cent. the year before, while the growth of non-food exports slowed down from 26 to 22 per cent. In the first quarter of 1971 exports were almost 30 per cent. higher than a year before, while imports were up by only 2 per cent. As a result, the seasonally adjusted trade deficit on a customs basis narrowed from $620 million in January–March 1970 to $485 million.

The long-term capital account improved by $135 million to $565 million, owing to a bigger inflow on private account. In particular, net receipts from foreign loans and credits went up by $180 million and those from foreigners' real-estate investment in Spain by $35 million. On the other hand, public-sector capital movements registered a $55 million swing to net repayments of $25 million.

The short-term capital account shifted from a $155 million outflow in 1969 to an inflow of $25 million in 1970, reflecting the domestic liquidity squeeze and the accompanying rise in Spanish interest rates.

Commercial policy.

The most-favoured-nation clause and the principles of reciprocity were the two fundamentals of the General Agreement on Tariffs and Trade (GATT). In recent years, however, they have lost ground to the growing tendency towards regionalisation of trade and the development of a system of preferences for developing countries.

Trade liberalisation within the GATT. The conclusion of the Kennedy Round in May 1967 marked the peak of the post-war efforts to achieve world-wide trade liberalisation. Almost fifty countries took part in the negotiations and thirty-seven of them undertook to grant tariff reductions on manufactured goods. It was agreed that these reductions would be spread over five years in annual tranches of 20 per cent. By 1st January 1971, therefore, four-fifths of the total had been implemented. Meanwhile the conclusion of the separate agreement relating to chemicals, which was to have come into force at the beginning of 1969, has been postponed to 1st January 1972, as the US Congress has so far been unwilling to abolish the American selling price system applying to certain chemicals — chiefly dye-stuffs. Pursuant to a decision reached by the GATT Council in early 1971, a comparative study is to be made of the tariff structure resulting from implementation of the Kennedy Round concessions.

At the beginning of 1971 seventy-eight countries were full contracting parties to the GATT, one country — Tunisia — had acceded provisionally and fourteen countries which had applied the GATT rules when they were still dependent territories continued to do so de facto after achieving independence, pending a decision on their future commercial policy. Poland acceded in 1967 and Rumania and Hungary applied for membership in 1968 and 1969 respectively.

In the last two years the GATT Secretariat has prepared material for an attack on non-tariff barriers. It has analysed some 800 measures of a technical or administrative character which had been notified to it by the contracting parties and which, directly or indirectly, are obstacles to international trade. Following a decision taken by the GATT Council in February 1971, problems concerning customs valuation, quotas and the application of industrial standards to imported goods will be examined at the annual session of the Contracting Parties next November. Meanwhile the problem of non-tariff barriers has also been tackled in the EEC and EFTA, which have set up common standards for certain industrial products.

European Economic Community. On 1st January 1970 the EEC entered its definitive phase. By that date all tariffs and quotas between member countries had been abolished, as had measures having an effect equivalent to quantitative restrictions. Restrictive measures relating to government or public-authority procurement practices had also been brought to an end. The common external tariff had been established and quotas vis-à-vis most market-economy countries almost entirely abolished. The items still subject to quantitative restrictions are chiefly manufactured goods imported from Asia. They include textiles, imports of which are regulated by agreements signed with India and Pakistan in 1968 and with Japan in 1969.

At the Hague Conference in early December 1969 the representatives of the Six had reaffirmed their agreement in principle with regard to an enlargement of the Community in application of Article 237 of the Treaty of Rome. On 30th June 1970 negotiations between the EEC and the four candidates for admission, Denmark, Ireland, Norway and the United Kingdom, were formally opened. It had also been agreed that EFTA countries not applying for membership might, at their request, enter into discussions with the EEC in order to find a modus vivendi with it. Exploratory conversations were started in December 1970 with Sweden and Switzerland and in January 1971 with Austria, Finland, Iceland and Portugal. By the end of May 1971 significant progress had been made in the negotiations with the United Kingdom.

Association between the Community and its member countries' dependent territories had been provided for in the Treaty of Rome. After these territories gained their independence, the form this association should take was agreed in the Yaoundé Convention, signed in 1963 between the EEC and eighteen African states including Madagascar. This Convention was renewed in 1969 and the new agreement came into force on 1st January 1971 for a period of five years. On the same date an agreement of association with three other African states, Kenya, Tanzania and Uganda, which had been concluded in 1969 (the Arusha Convention), also came into force.

The two conventions of Yaoundé and Arusha are similar to each other in the matter of tariffs and quantitative restrictions. They provide for industrial and non-competing agricultural products to be imported into EEC countries duty-free and for agricultural products or processed agricultural goods which are identical with or which compete with goods produced by the EEC to be imported on more favourable terms than the same goods from other countries. As a token of goodwill towards non-associated countries, EEC duties on certain tropical products, in particular cocoa, coffee and palm-oil, have been suspended. All associated countries grant reverse preferences on products originating in the EEC, though not all do so to the same extent. The associated countries are entitled to maintain or to reintroduce tariffs and quantitative restrictions and even to suspend imports if development needs warrant it. Both conventions seek to promote regional co-operation between the associated countries. The Yaoundé Convention increased the amount of financial assistance granted to the EEC's African partner countries, whereas the Arusha Convention made no provision for financial aid.

The EEC has also concluded association agreements and preferential agreements with Mediterranean countries. Its association agreements with Greece and Turkey have been in effect since 1962 and 1964 respectively. While Greece has made little headway in recent years in the process of its gradual association with the EEC, Turkey moved from the preparatory to the transitional phase early in 1971.

At the end of 1969 association agreements with Morocco and Tunisia entered into force and one was concluded with Malta. All three agreements are to run for five years. Reciprocal preferential agreements with Israel and Spain, valid for five and six years respectively, came into force in October 1970 and early in 1971 negotiations were being held with the Lebanon and the United Arab Republic with a view to the conclusion of similar agreements.

Preferences for developing countries. An important departure from the most-favoured-nation clause and the principles of reciprocity was made at the second United Nations Conference on Trade and Development (UNCTAD), held in New Delhi in 1968. In order to help developing countries to increase their export earnings and speed up their economic growth, the Conference adopted a resolution calling for the early establishment of a mutually acceptable system of generalised preferences covering all such countries, without their having to grant reciprocal trade concessions. It also set up a consultative body, the Special Committee on Preferences.

In October 1970 negotiations conducted within the Special Committee on Preferences resulted in the conclusion of arrangements between eighteen industrial countries and ninety-one developing countries. Although the industrial countries agreed in principle that all should grant the same, or equivalent, concessions, it was found impossible to devise a uniform system of preferences, so individual schemes are to be put into operation, though on a common basis. The preferences in question will apply mainly to manufactured and semi-manufactured goods and will be granted on a temporary basis for an initial period of ten years. Developing countries, such as those belonging to the Yaoundé Convention or to the Commonwealth, are to retain their special links, which are not to be prejudiced by the introduction of generalised preferences. The industrial countries' requirements concern measures establishing the country of origin of imported goods and the provision of safeguard mechanisms. The latter vary from country to country. Thus, while the European Economic Community allows duty-free entry of all manufactured and semi-manufactured goods, it applies quantitative limitations in the form of ceilings. The United States also permits duty-free entry of such goods and, in addition, of certain primary and processed agricultural products, subject, however, to important exceptions covering a number of tariff items, namely textiles, shoes, petroleum-based chemicals and petroleum products. Moreover, the United States will not extend the concessions to developing countries which grant reverse preferences to the EEC, unless they undertake to remove these gradually. Finally, escape clauses are provided for cases when imports reach a level at which they are considered to be a threat to domestic industries.

It is intended that the various schemes, incorporating additional measures in favour of the poorest of the developing countries, should come into force in 1971 as soon as the governments of the countries concerned have obtained parliamentary approval for the preferences they are to grant. The only decision taken so far is that of the Council of Ministers of the EEC, which announced in March that its list of preferences would be applied as from 1st July. In early April the Swiss Government submitted its report to Parliament proposing that a first tariff reduction of 30 per cent. on industrial products should come into effect at the end of 1971 and that the remaining duties on such products should be abolished two years later. Also in April, the Swedish Government presented a bill under which most industrial goods and a number of foodstuffs will be imported free of duty.

In May 1971 the GATT Council agreed to grant a waiver for a period of ten years under Article XXV of its Statutes, whereby all industrial countries extending generalised preferences are to be exempted from applying the most-favoured-nation clause. This waiver will come into force when more than half of the contracting parties have approved it.

US policy. The object of the Trade Expansion Act of 1962 having been achieved by the completion of the Kennedy Round in May 1967, a new trade bill was presented to Congress in November 1969. It aimed at continuing the movement towards freer trade, but was less far-reaching than its predecessor. More specifically, it would have given the President power to make tariff reductions, though only on a limited scale. It was to abolish the American selling price system, to broaden the present authority to take action against countries that threaten US products unfairly, and to introduce new authority to take measures against countries which, by way of export subsidies, weaken the position of US exports in third markets. In the course of 1970, when Congress was discussing the new legislation, protectionist pressures, which had been building up for several years, became so strong that restrictive amendments, in particular the introduction of quotas for textile products and footwear, were incorporated into the bill (known as the Mills bill) which was adopted by the House of Representatives. Since, however, there was not sufficient time for the Senate to pass the proposed legislation before the end of the 91st Congress, it has never come into effect, but Representative Mills presented his bill again at the opening of the 92nd Congress in January 1971.

IV. GOLD, RESERVES AND FOREIGN EXCHANGE.

Gold production, markets and reserves.

World gold production (excluding that of the USSR, other eastern European countries, mainland China and North Korea) went up in 1970 from 40.6 to 41.4 million ounces, thus slightly exceeding its previous peak recorded in 1966. As usual, the whole of the increase was accounted for by South Africa, where output rose from 31.3 to 32.1 million ounces, while in the rest of the world it remained practically unchanged at 9.3 million ounces. Canadian output contracted by 0.2 to 2.3 million ounces, only half the record amount mined in 1960.

World gold production.[1]

Countries	1929	1940	1946	1953	1966	1967	1968	1969	1970
	weight, in thousands of fine ounces								
South Africa	10,412	14,046	11,927	11,941	30,869	30,535	31,169	31,276	32,146
Canada	1,928	5,333	2,849	4,056	3,319	2,986	2,688	2,545	2,338
United States	2,057	4,863	1,462	1,971	1,803	1,526	1,539	1,717	1,790
Japan	335	867	40	258	555	678	614	677	709
Ghana	208	886	586	731	684	767	727	707	705
Australia	427	1,644	824	1,075	917	805	786	699	615
Philippines	163	1,121	1	481	454	491	527	539	590
Rhodesia	561	826	545	501	550	515	515	515	500
Colombia	137	632	437	437	281	258	240	219	200
Mexico	655	883	420	483	214	165	177	181	180
Congo, Dem. Rep.	158	562	332	371	160	153	172	177	180
Total listed	17,041	31,663	19,423	22,305	39,806	38,879	39,154	39,252	39,953
Other countries	1,299	5,797	2,007	1,955	1,504	1,281	1,416	1,328	1,457
Estimated world total	18,340	37,460	21,430	24,260	41,310	40,160	40,570	40,580	41,410
	in millions of US dollars								
Value of estimated world total at \$35 per fine ounce	640[2]	1,310	750	850	1,445	1,405	1,420	1,420	1,450

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

The expansion in South Africa's gold production was due to an increase in the amount of ore milled, the average gold content of the ore showing little change. Owing to the relatively weak state of the private gold market until late in the year the average price obtained per ounce of gold dropped from \$37.9 in 1969 to \$36.5. Since average costs went up by nearly 3 per cent., profits per ounce fell from \$14.9 to \$12.9 (excluding profits from uranium). The continuing high level of average profits earned mainly reflected the results of some of the very large newer mines; the majority of the mines in the older goldfields, which now account for less than 10 per cent. of South Africa's output, were operating at a loss.

Calculated at \$35 per fine ounce, the value of western gold production for 1970 was \$1,450 million, \$30 million more than in 1969. As in the four preceding years, no sales of gold by communist countries were reported. Additions to official gold stocks were \$270 million, as against \$105 million in 1969, while the net amount of gold absorbed by the market declined from \$1,315 to 1,180 million.

The larger increase in official gold stocks during 1970 was mainly due to the agreement reached between the IMF and South Africa at the end of 1969. Under this agreement South Africa sold a total of \$640 million's worth of gold to the Fund during 1970. Total official South African sales of gold, at \$685 million, were somewhat higher than this figure, since there were also sales totalling \$23 million to Switzerland and conversions into gold of \$22 million's worth of South African rand drawn on the IMF. As South Africa's gold reserve declined by \$450 million during 1970, it appears that \$235 million of gold from current South African production found its way into official stocks last year.

Estimated uses of gold.

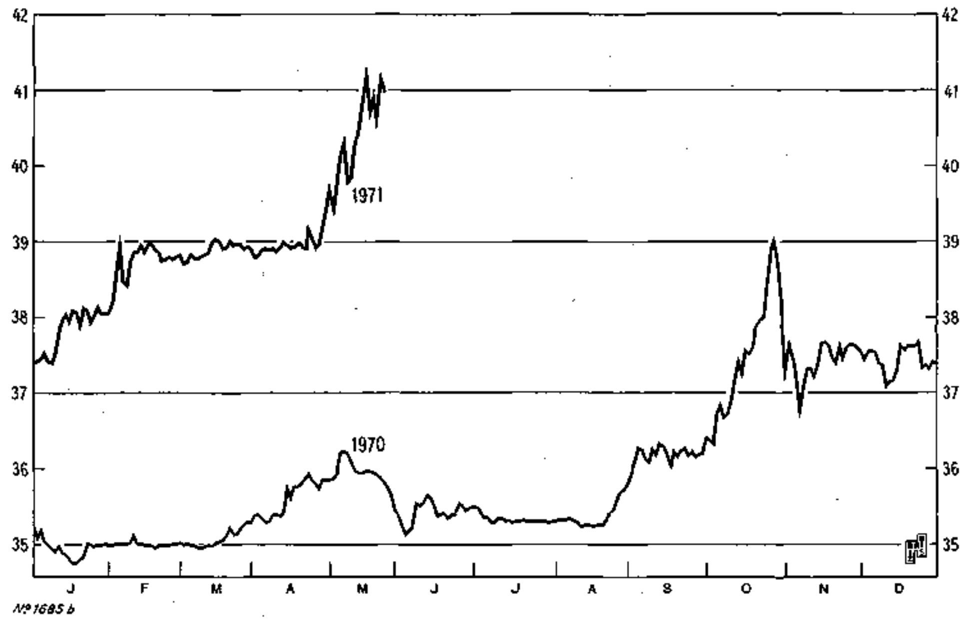
Items	1968 April to December	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 3rd quarter	1970 4th quarter
	In millions of US dollars						
Change in South African reserves	500	− 130	− 450	− 115	− 60	− 20	− 255
Change in western official holdings outside South Africa	170	235	720	310	25	35	350
Amount sold on free market*	390	1,315	1,180	160	400	355	265
Total (=gold production)	1,060	1,420	1,450	355	365	370	360

* Residual figures.

While full details of South Africa's gold transactions with the Fund during 1970 are not available, it seems that there were substantial sales under each of the three headings contained in the 1969 agreement. So far as the first heading is concerned, under which South Africa may sell gold to the Fund in any amounts necessary to meet its current foreign exchange needs whenever the market price of gold falls to \$35 per ounce or below, sales were concentrated in the first quarter of the year and appear to have amounted to about \$200 million. Under the second heading, which provides for sales irrespective of the market price to the extent that over a semi-annual period South Africa's foreign exchange requirements exceed the proceeds from the sale of total current gold production, sales were concentrated mainly in the fourth quarter of the year, following a further deterioration in South Africa's balance of payments, and amounted altogether to some \$280 million. The remaining sales to the Fund, amounting to about \$165 million, were made under the heading which provides for transfers to the Fund of up to \$35 million per quarter out of South Africa's gold stock as at 17th March 1968, less subsequent sales to national monetary authorities. Also included under this heading in 1970 was a \$35 million sale to the Fund against sterling originally proposed in May 1968.

The decline of \$135 million in net market absorption of gold, as compared with 1969, probably reflects in large part the fact that in early 1970, following the conclusion of the agreement between South Africa and the IMF and the introduction of SDRs into the monetary system, a certain proportion of non-monetary demand was satisfied with gold sold out of previously built-up speculative holdings. Net non-monetary demand appears to have been lower than in 1969 both in European markets, notably France, and in South America. On the other hand, Middle and Far Eastern demand, both for jewellery and for hoarding purposes, increased last year, as did also industrial demand in the United States.

Price of gold bars on the London market.
Daily figures, in US dollars per fine ounce.



With regard to the development of prices in the free market, the steep 1969 rise in Euro-dollar interest rates, the deterioration in South Africa's balance of payments, the ratification of the SDR scheme and the return of confidence to the exchange markets following the French and German parity adjustments had pushed the gold price down from almost \$44 per ounce in May 1969 to about \$35 at the end of that year. Quotations then remained at around that level throughout most of the first quarter of 1970. Net market offtake in the first quarter of the year, at \$160 million, was only 37 per cent. of what it had been in the second and third quarters of 1969. Just on 55 per cent. of new production in the first quarter of 1970 went into official reserves and South Africa sold about \$280 million's worth of gold to the IMF. In the second half of March 1970 the market price began to edge up again, reaching \$36¼ in the first week of May. Depletion of stocks, strong demand from the Middle and Far East, the malaise on Wall Street and the sharp deterioration in the US balance of payments on an official settlements basis may all have played a part in this recovery. Its strength was reflected less in the gold price, which fell back to about \$35½ in June, than in the level of net market purchases, which rose to \$400 million during the second quarter.

After a period of slack during the summer, the market began to pick up again towards the end of August. Quotations rose from \$35¼ in the middle of that month to about \$36¼ by early September. At \$355 million, net market offtake of gold in the third quarter remained quite high. At the beginning of October the uncertainties resulting from President Nasser's death, together with strong industrial demand from western Europe and the United States, initiated a renewed upward price movement which seems to have developed its own momentum. A wave of speculative buying carried quotations to a peak of nearly \$39¼ on 27th October, but this level turned out to be unsustainable and for the rest of the year the price fluctuated around \$37½. The fall in quotations would have been more pronounced but for a marked slow-down in new supplies to the market. In November and December South Africa sold some \$250 million's worth of gold to the IMF and Switzerland. Net market offtake for the fourth quarter fell away to \$265 million.

From the second half of January 1971 onwards, however, the market began to firm up again; quotations rose to nearly \$39 in the middle of February and remained close to that level until late April. Net private purchases of gold seem to have been substantial over this period, since there were large market sales by South Africa. In addition, for the first time since 1965, there was some evidence of Russian selling. The strength of demand was probably mainly attributable to the outlook for the commodity price of gold against a background of steadily rising industrial demand for the metal and of world-wide inflation. As a by-product of the currency crisis, the market price of gold went above \$41 per fine ounce on certain days in May and at the end of the month stood a little below that level.

Last year's \$270 million increase in western official gold stocks brought them up to \$41,280 million. At this level, however, they were still some \$2 milliard below the end-1965 figure. There were two large-scale and opposite shifts in official stocks during 1970: a rise in the gold holdings of international institutions by \$2,220 to 4,100 million and a \$1,950 million drop in countries' gold reserves to \$37,180 million. Both these movements principally reflected operations of the IMF, whose gold stock rose by \$2,030 to 4,340 million. The Fund's gross acquisitions of gold totalled \$2,940 million, including \$1,795 million from gold subscription payments, \$640 million from South Africa, and \$400 million out of the \$800 million it had sold to the United States against special US Treasury paper in the period 1956–60. On the other hand, the Fund sold \$550 million's worth of gold to the United States to offset US gold losses caused by other members' gold subscription payments, and a further \$370 million to various member countries in order to replenish its holdings of their currencies. The remainder of the increase in international institutions' gold holdings during 1970 was accounted for by the BIS, whose negative spot gold position declined from \$485 to 285 million.

Nearly two-thirds of the \$1,950 million fall in countries' gold reserves was accounted for by two countries — the United States and South Africa; the former's gold stock declined by \$785 to 11,070 million and the latter's by \$450 to 665 million. The United States sold \$630 million's worth of gold to other countries, mostly for use in making gold subscriptions to the Fund, the largest single sales being \$130

World gold reserves.

Countries or areas	Changes in 1968	Changes in 1969	Changes in 1970	Holdings at end-1970
	in millions of US dollars			
United States	— 1,175	+ 970	— 785	11,070
United Kingdom	+ 185	— 5	— 125	1,350
Other western Europe	— 660	— 740	— 435	19,245
of which				
Belgium	*+ 45*	*— 5*	*— 50*	*1,470*
Denmark	*+ 10*	*— 25*	*— 25*	*65*
France	*—1,355*	*— 330*	*— 15*	*3,530*
Germany	*+ 310*	*— 460*	*— 100*	*3,980*
Ireland	*+ 55*	*— 40*	*— 25*	*15*
Italy	*+ 525*	*+ 35*	*— 70*	*2,890*
Netherlands	*— 15*	*+ 25*	*+ 70*	*1,790*
Portugal	*+ 155*	*+ 20*	*+ 25*	*900*
Spain	*—*	*—*	*— 285*	*500*
Sweden	*+ 20*	*—*	*— 25*	*200*
Switzerland	*— 465*	*+ 20*	*+ 90*	*2,730*
Others	*+ 55*	*+ 20*	*— 25*	*1,175*
Canada	— 155	+ 10	— 80	790
Japan	+ 20	+ 60	+ 120	535
Latin America	+ 35	+ 55	— 5	1,085
Middle East	+ 270	— 35	— 85	970
Other Asia	+ 40	— 20	— 30	705
Africa	+ 740	— 90	— 470	1,065
of which				
South Africa	*+ 660*	*— 130*	*— 450*	*665*
Australia	+ 25	+ 5	— 25	240
Other countries	+ 105	— 15	— 30	125
Total for all countries	— 570	+ 195	— 1,950	37,180
International institutions	— 130	— 90	+ 2,220	4,100
of which				
BIS	*+ 275*	*— 130*	*+ 200*	*— 285*
European Fund	*— 10*	*+ 20*	*— 10*	*45*
IMF	*— 395*	*+ 20*	*+2,030*	*4,340*
Grand total	— 700	+ 105	+ 270	41,280

million to France, \$120 million to Japan, \$60 million to Taiwan and \$50 million each to Switzerland and the Netherlands; in addition, it transferred a net amount of \$155 million to the Fund, the principal transactions being the return of the \$400 million's worth already mentioned, a \$385 million gold subscription payment, the "mitigation" purchases of \$550 million and a purchase of \$100 million in September 1970.

The gold reserves of western European countries declined by \$560 million. Apart from Spain, whose official gold holdings dropped by \$285 million concurrently with a rise of \$905 million in total reserves, the decline was fairly broadly distributed and stemmed primarily from gold subscription payments to the IMF. This was true, in particular, of the \$125 and 100 million decreases in the United Kingdom's and Germany's gold holdings, which contrasted with the quite spectacular strengthening of those two countries' overall official reserve positions. Switzerland and the Netherlands, on the other hand, added \$90 and 70 million respectively to their holdings, including in each case purchases of $50 million from the US Treasury; but even these accruals did not prevent a further marked decline in the share accounted for by gold in those two countries' official reserves.

Outside Europe, the only major increase in official gold stocks was that of $120 million in Japan. Elsewhere, gold reserves declined. The $450 million fall in South Africa's gold stock has already been mentioned. Canadian holdings went down by $80 million and there were also declines (in millions of dollars) in the Middle East (85), "Other Asia" (30), Australia (25) and "Other countries" (30).

It would appear that there was virtually no change in the total of world gold reserves during the first quarter of 1971. The gold holdings of international institutions increased by $275 million, while countries' gold reserves went down by about the same amount. The US gold stock declined by $110 million, mostly as a result of sales to the Netherlands and Switzerland, whose gold reserves went up by $25 and 75 million respectively. The IMF's gold stock rose by $65 million, half of which came from sales by South Africa, while the BIS negative spot gold position declined by a further $210 million.

Monetary movements.

United States. In 1970, for the second successive year, the biggest single influence on the external monetary balance of the United States was the change in the liabilities of US commercial banks to their foreign branches. As a result of the easing of US monetary policy these liabilities declined in the course of the year by $5.1 milliard and were the main factor behind the reduction of $6.2 milliard in liquid liabilities to non-official foreigners. Consequently, although the balance-of-payments deficit as measured on the liquidity basis showed a marked drop from $7 milliard in 1969 to $4.7 milliard excluding the first SDR allocation, or $3.9 milliard including it, the balance on the official settlements account showed a record deficit of $9.8 milliard, or $10.7 milliard excluding the SDR allocation.

Most of last year's official settlements deficit was financed by a $7.3 milliard rise in US liabilities to foreign official agencies. Official liquid liabilities went up by $7.6 milliard, while non-liquid liabilities showed a moderate further decline of $0.3 milliard. Included in this latter figure were falls of $0.8 milliard in US commercial banks' long-term liabilities, mostly certificates of deposit, to foreign official holders and of $0.5 milliard in the Deutsche Bundesbank's holdings of non-liquid US Government paper denominated in Deutsche Mark. On the other hand, the large rise in Canada's monetary reserves last year led to an increase of $1.2 milliard in Canadian holdings of non-liquid and non-marketable US Government securities.

Including the first allocation of SDRs, US reserve assets declined by $2.5 milliard in 1970. While holdings of all types of reserve asset, except SDRs, fell during 1970, the overall decline was mainly attributable to a $2.1 milliard reduction in official holdings of foreign exchange, resulting from British and French repayments of assistance. Holdings of sterling went down by $1.8 milliard during the year and those of French francs by $0.2 milliard. The US gold stock, which had risen by almost

United States: External monetary movements.

Items	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 3rd quarter	1970 4th quarter	1971 1st quarter
	In millions of US dollars (+ = increase in assets, decrease in liabilities)						
Reserves	+1,190	−2,475	+ 385	−1,020	− 800	−1,040	− 145
of which							
Gold	+ 970	− 785	+ 45	− 15	− 395	− 420	− 110
Foreign exchange	− 815*	−2,150	− 830	− 815	− 35	− 470	− 375
SDR allocations	—	+ 865	+ 865	—	—	—	+ 720
SDR transfers	—	− 15	+ 55	+ 35	+ 35	− 140	− 125
IMF gold tranche position	+1,035	− 390	+ 250	− 225	− 405	− 10	− 255
Liabilities to foreign official agencies	+1,510	−7,345	−2,355	−1,050	−1,810	−2,130	−4,540
of which							
Liquid	+ 515	−7,615	−2,765	− 540	−2,050	−2,260	−4,755
Non-liquid	+ 995	+ 270	+ 410	− 510	+ 240	+ 130	+ 215
Balance on official reserve transactions basis	+2,700	−9,820	−1,970	−2,070	−2,610	−3,170	−4,685
less Non-liquid liabilities to official foreigners	+ 995	+ 270	+ 410	− 510	+ 240	+ 130	+ 215
Total change in official liquid position	+1,705	−10,090	−2,380	−1,560	−2,850	−3,300	−4,900
plus Liabilities to non-official foreigners	−8,715	+ 6,240	+1,690	+ 130	+1,210	+3,210	+2,470
Balance on liquidity basis including SDR allocations	−7,010	−3,850	− 690	−1,430	−1,640	− 90	−2,430
Balance on liquidity basis excluding SDR allocations	−7,010	−4,715	−1,555	−1,430	−1,640	− 90	−3,150

* The 1969 decline in US official foreign exchange holdings shown in the above table is $65 million greater than that shown in the table on page 15. This is because it does not include the effect of the DM revaluation on this item.

$1 milliard in 1969, declined by $0.8 milliard last year, as already described on pages 126–127. Practically all of this decline occurred in the latter half of the year. Despite the quota increase, the US gold tranche position in the Fund went down by $0.4 milliard in 1970. The new gold subscription was more than offset by the effects of Fund net gold and SDR sales against dollars totalling $0.4 milliard, net currency repurchases in dollars by other Fund members totalling $0.2 milliard, and a US drawing on the Fund of $0.1 milliard.

The official settlements deficit had been increasing steadily during 1970, and reached the very substantial figure of $3.2 milliard in the final quarter. Then in the first quarter of 1971 there was a further large increase to $4.7 milliard, or $5.4 milliard if the second SDR allocation is excluded. A substantial part of this deficit was accounted for by a further reduction of $2.5 milliard in liquid liabilities to non-official foreigners. US banks' liabilities to their foreign branches fell by $4.6 milliard — almost as much as during the whole of 1970 — but this was partly offset by the branches purchasing $1.5 milliard of special three-month paper offered to them by the Export-Import Bank. The financing of the official settlements deficit continued to be mainly assured through increases in liabilities to foreign official institutions, which went up by $4.5 milliard.

United Kingdom. The outstanding feature of UK monetary movements during the period under review was the very large further improvement in the net reserve position, as measured by the changes in official reserve assets and in official short and medium-term external indebtedness. During the fifteen months to end-March 1971 the United Kingdom recorded an official financing surplus of $6.1 milliard, including the first two SDR allocations. External indebtedness was reduced by $4.7 milliard, including the repayment of the whole of the $3.7 milliard of central-bank assistance outstanding at the end of 1969, together with a $1 milliard reduction in indebtedness to the International Monetary Fund. At the same time official reserve assets rose by $790 million, including the 1970 and 1971 allocations of SDRs totalling $710 million. During the two and a quarter years from the end of 1968, when it reached a peak of $8 milliard, the United Kingdom's short and medium-term official external indebtedness was reduced by $6.4 milliard, $5.3 milliard having been repaid to foreign monetary authorities and $1.1 milliard to the IMF.

For the year 1970 the official financing surplus (including the SDR allocation) was $3.5 milliard, nearly 90 per cent. of which was used to reduce indebtedness. While $1.5 milliard of this surplus resulted from the balance-of-payments surplus, the remaining amount of just on $2 milliard essentially reflected two substantial monetary inflows: additions of $1.1 milliard to sterling balances, excluding balances which represent the counterpart of central-bank assistance; and a net inflow of $0.7 milliard through foreign currency operations of UK banks with non-residents.

As in 1969, the bulk of the rise in the sterling balances was in those of overseas-sterling-area holders, which went up by $835 million. Within this total, official holdings rose by $490 million. Since the introduction of the dollar-value guarantees in September 1968 the sterling balances of overseas-sterling-area countries, under the combined influence of a large balance-of-payments surplus, the guarantees themselves and the level of interest rates in the United Kingdom, have risen by $1.6 milliard. This is more than accounted for by a rise of $1.7 milliard in officially-held balances; private balances continued to fall until the end of the third quarter of 1969, but rose by $0.3 milliard during 1970. In addition, the sterling balances of non-sterling-area countries went up by $0.2 milliard in 1970, almost entirely on private account. At the end of 1970, however, these balances were still well below pre-devaluation levels.

The inflow of $730 million arising out of UK banks' net foreign currency transactions with non-residents reflected short-term foreign currency borrowing from UK banks by UK companies for domestic purposes. Such borrowing was influenced by the credit ceilings on the banks' sterling lending and, especially in the last quarter of the year, by considerations of relative cost.

The balance of official financing items fluctuated very widely during the course of the year, from a $2.2 milliard surplus (excluding the first SDR allocation) in the first quarter to a $0.5 milliard deficit in the third, and then back again to a surplus of $0.8 milliard in the final quarter. While these fluctuations were clearly linked to the variations in the overall balance of payments, their size was increased by the swings that occurred in non-official monetary flows.

Thus, the very large first-quarter official financing surplus included a net monetary inflow of $1.1 milliard. The chief factor in this inflow was a $0.7 milliard rise in sterling

United Kingdom: External monetary movements.

Items	1969	1970 Year	1970 1st quarter	1970 2nd quarter	1970 3rd quarter	1970 4th quarter	1971 1st quarter
	in millions of US dollars (+ = increase in assets, decrease in liabilities)						
Official financing							
Gold and foreign exchange reserves	+ 105	+ 35	− 120	+ 100	− 110	+ 165	+ 275
SDR allocations	—	+ 410	+ 410	—	—	—	+ 300
SDR transfers	—	− 145	− 105	− 20	− 15	− 5	− 85
Counterpart of gold subscription to IMF	—	+ 90	—	—	—	+ 90	—
Net payments (+) to/receipts (—) from foreign monetary authorities	+1,605	+2,785	+2,175	+ 445	− 380	+ 545	+1,455
IMF	+ 75	+ 320	+ 250	+ 20	+ 15	+ 35	+ 690
Total	+1,785	+3,495	+2,610	+ 545	− 490	+ 830	+2,635
Other monetary movements							
Sterling balances (gross)	− 655	−1,090	− 700	− 375	+ 15	− 30	.
of sterling-area holders	*− 605*	*− 835*	*− 465*	*− 420*	*− 65*	*+ 115*	.
of non-sterling-area holders	*+ 120*	*− 235*	*− 240*	*+ 40*	*+ 75*	*− 110*	.
of international institutions[1]	*− 170*	*− 20*	*+ 5*	*+ 5*	*+ 5*	*− 35*	.
Sterling claims of UK banks[2]	+ 120	− 155	− 125	+ 100	− 55	− 75	.
Foreign currency transactions of UK banks (net)[3]	+ 265	− 730	− 260	− 215	+ 195	− 450	.
Total	− 270	−1,975	−1,085	− 490	+ 155	− 555	.
Overall balance	+1,515	+1,520	+1,525	+ 55	− 335	+ 275	.
Overall balance excluding SDR allocations	+1,515	+1,110	+1,115	+ 55	− 335	+ 275	.

[1] Excludes sterling liabilities to the IMF as the counterpart to drawings, repurchases and subscriptions. [2] Excludes export credit. [3] Excludes trade credit and UK residents' Euro-dollar borrowing in London for investment overseas; includes UK banks' net transactions in currencies of the overseas sterling area.

balances; the seasonal strength of the sterling area's balance of payments produced a rise of $0.5 milliard in its balances, while the return of confidence in sterling brought a $0.2 milliard increase in non-sterling countries' balances. In the second quarter, when the overall payments surplus almost vanished, the net official surplus mainly reflected a continued marked increase in the sterling area's sterling balances. In the third quarter, when the emergence of an overall payments deficit was accompanied by a turn-round of non-official monetary movements to a net outflow of $0.2 milliard, the official financing balance showed a deficit of $0.5 milliard. Most of this deficit was covered by a $400 million drawing on the Federal Reserve swap line. The change to a small net outflow on non-official monetary account was accounted for partly by a seasonal decline in the sterling area's accumulation of sterling, and partly by confidence factors — the effects of which showed up in a decline in non-sterling countries' sterling balances as well as in a net foreign exchange outflow through the banks. In the fourth quarter the return to a substantial official financing surplus owed most to a net inflow of $450 million through the banks' foreign exchange position, the reasons for which have already been mentioned.

In the first quarter of 1971 there was an official financing surplus of $2.6 milliard, of which $0.3 milliard came from the second allocation of SDRs. In response to the high level of interest rates and, more generally, to a shortage of liquidity in the company sector there was a large inflow of short-term funds. Although much of this will probably be reflected in a large positive errors and omissions item in the balance of payments, it is likely that the sterling balances showed a further substantial rise and that there was further switching of foreign currencies into sterling through the banks.

France. As in the United Kingdom, the main feature of external monetary movements was the very substantial improvement in the net reserve position. For the fifteen months to end-March 1971 this amounted to $2.5 milliard, including the first two SDR allocations. Reserve assets other than SDRs rose by $1.3 milliard, all of which was added to foreign exchange reserves; and official liabilities declined by $0.8 milliard, including the repayment by April 1970 of the whole of the $1.1 milliard central-bank assistance outstanding at the end of 1969. This repayment was partly financed by a $0.5 milliard drawing on the Fund in February 1970. In September 1970 and May 1971, however, France made repurchases of $0.2 and 0.4 milliard respectively, the latter mainly with gold purchased from the US Treasury.

There were very considerable shifts during the course of 1970 in the sources of the improvement in the net official monetary position. During the first quarter, most of the official monetary surplus was derived from the balance of payments. There was also some net inflow through the banks, mainly a rebuilding of non-residents' franc balances. In the second quarter, when the balance-of-payments surplus proper doubled, the banks' net position turned round rather sharply to a net outflow of $0.4 milliard. Consequently, the net official surplus was less than in the preceding quarter. The second-quarter increase in the banks' foreign position was strongly influenced by

France: External monetary movements.

Items	1970			1971
	1st quarter	2nd quarter	3rd and 4th quarters	1st quarter
	In millions of US dollars (+ = increase in assets, decrease in liabilities)			
Official assets	+ 275	+ 350	+ 475	+ 530
Gold and foreign exchange reserves	*+ 125*	*+ 320*	*+ 505*	*+ 350*
SDR allocations	*+ 165*	—	—	*+ 160*
SDR transfers	—	—	*+ 5*	*+ 20*
Other	*− 15*	*+ 30*	*− 35*	—
Official liabilities	+ 420	+ 165	+ 300	− 45
to foreign monetary authorities	*+ 905*	*+ 165*	*− 75*	*− 45*
to IMF	*− 485*	—	*+ 375*	—
Net official position	+ 695	+ 515	+ 775	+ 485
Banks' net position	− 95	+ 355	− 710	− 295
Overall balance including SDR allocations	+ 600	+ 870	+ 65	+ 190
Overall balance excluding SDR allocations	+ 435	+ 870	+ 65	+ 30

the repayment to them of \$0.5 milliard of foreign currency which they had had on deposit at the Bank of France since early 1969. Apart from this repayment, there was a net inflow to the banks in the second quarter, including a further rise in non-residents' franc balances.

During the second half of 1970 the pattern changed very sharply, and virtually the whole of the net official surplus came from a large net inflow of \$0.7 milliard to the banks. The greater part of this inflow resulted from the banks taking foreign currency on deposit and switching into francs, for interest rate considerations; in addition, however, there was an increase of \$0.3 milliard in non-residents' franc balances in the last quarter. During that quarter, in fact, the total inflow to the banks, at \$0.4 milliard, was greater than the net official surplus, since the balance of payments reverted to a moderate deficit.

In the first quarter of 1971 the overall balance was just in surplus. Thanks, however, to a further net inflow of \$0.3 milliard through the banks, as well as to the second SDR allocation, net official assets rose by \$0.5 milliard.

Germany. As a result of short-term inflows of various kinds, Germany's net reserve position (excluding the first SDR allocation) increased by \$6 milliard during 1970, thus more than reversing the downward movement that had occurred in the months immediately following revaluation. By the end of last year the Bundesbank's total net official monetary assets, including the SDR allocation, had risen to \$13.5 milliard, which was \$1.3 milliard above the end-September 1969 figure. The upward trend continued during the first months of 1971 and by the time the exchange market was temporarily closed on 5th May nearly \$5 milliard had been added to exchange reserves since the end of 1970.

The 1970 increase in net official assets came essentially from a \$4.4 milliard net inflow of short-term funds to the non-bank sector and a \$2.2 milliard inflow through the banking system. The latter inflow consisted mainly of a \$1.8 milliard increase in the banks' net DM liabilities to non-residents, including a rise of \$1.4 milliard in non-residents' DM balances at German banks.

The total increase in net official assets was a little less than the growth in foreign exchange reserves, which amounted to \$6.3 milliard. Germany's IMF gold tranche position also rose quite substantially during 1970, by \$0.6 milliard, of which the gold part of the Fund quota increase accounted for only \$0.1 milliard; the Bundesbank's holdings of non-marketable US Government securities, on the other hand, declined by \$0.5 milliard. There was also during 1970 an increase of \$0.4 milliard in official monetary liabilities, most of which took the form of a rise in foreign monetary authorities' DM balances at the Bundesbank. As, in addition, some \$0.6 milliard of the increase in non-resident DM balances with German commercial banks last year appears to have been for official account, the total of non-residents' officially-held DM balances may have risen by not far short of the equivalent of \$1 milliard in 1970.

Half of last year's total inflow through the banks was in the fourth quarter of the year. And this was followed by a \$1.2 milliard net banking outflow in the first quarter of 1971 as end-year operations were reversed. Consequently, although the overall payments surplus for the quarter (including the second SDR allocation) was $3.5 milliard, the amount added to net official assets was $2.3 milliard. Then in April the net official position improved by a further $0.9 milliard, bringing the total of net official assets up to $16.7 milliard, $3.1 milliard above the end-1970 level. The exchange reserves increased by $2.9 milliard during the first four months of this year to $10.7 milliard. At that point their share in total gross official monetary assets was a little over 60 per cent., as against a low point of 21 per cent. at the end of 1969. Before closing the exchange market on 5th May, the Bundesbank had purchased a further $2 milliard of exchange.

Italy. After running a substantial deficit in the early part of the year, Italy ended 1970 with a payments surplus of $0.4 milliard, excluding its first SDR allocation. As the banks' net foreign position was practically unchanged over the year, virtually the whole of the payments surplus was reflected in an increase in net official assets. More striking than the increase, however, was the change in the composition of Italy's reserves during the course of the year. This came about because the deficits were financed through the use of the Federal Reserve swap line, Italy's accumulated IMF claims and its holdings of non-marketable Canadian and US Government bonds, while the surpluses were added to the exchange reserves.

Broadly speaking, the first seven months of 1970 were a period of deficit for the official monetary sector, interrupted in May by a substantial surplus resulting from public-sector borrowing abroad. Taking these seven months as a whole, the official monetary sector had to finance a cumulative payments deficit (excluding the SDR allocation) of $0.5 milliard, as well as a $0.2 milliard increase in the banks' net spot foreign assets — the latter representing the counterpart to abnormal forward sales of lire by the banks' customers in June and July, when the political outlook was especially uncertain. The net official monetary deficit was particularly heavy in January and February, when it amounted to $0.9 milliard. In the first place, this was financed mainly by drawing $0.8 milliard on the Federal Reserve swap line, which was increased from $1,000 to 1,250 million. By July these drawings had been repaid, mostly through the mobilisation of Italy's various claims on the IMF, totalling $0.7 milliard. In addition, holdings of non-marketable US and Canadian Government securities were reduced by $0.2 and 0.1 milliard respectively during the first seven months of the year. While most of this represented simply the non-renewal of maturing paper, some of the Canadian securities were paid off in advance of maturity.

The balance of payments took a definite favourable turn from mid-August onwards and an overall surplus of $0.9 milliard was recorded for the last five months of the year. Furthermore, with the earlier forward selling of lire being unwound, the banks' net spot foreign assets declined by $0.2 milliard. The net official surplus for these five months therefore came to $1.2 milliard, practically all of which was added to exchange reserves.

The official monetary surplus continued on about the same scale in the first quarter of 1971, amounting to $0.7 milliard, of which $0.2 milliard came from a further reduction in the banks' net foreign position. The exchange reserves went up by another $580 million, and holdings of SDRs by $140 million, of which $105 million came from the second annual allocation.

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

Countries	End of year	Gold, net foreign exchange and SDRs	Net IMF and GAB position	Total official assets (net)	Commercial banks (net)	Total foreign assets (net)	Changes (+ = increase in assets, decrease in liabilities) Official: Including SDR allocation	Official: Excluding SDR allocation	Banks
		in millions of US dollars							
Austria	1969	1,385	165	1,550	60	1,610	+ 35	+ 35	+ 70
	1970	1,605	160	1,765	— 55	1,710	+ 215	+ 185	— 115
Belgium-Luxemburg . .	1969	2,215	155	2,370	— 575	1,795	+ 205	+ 205	+ 85
	1970	2,435	390	2,825	— 850	1,975	+ 455	+ 385	— 275
Denmark	1969	425	—	425	— 10	415	—	—	— 80
	1970	435	25	460	— 15	445	+ 35	+ 10	— 5
Finland	1969	300	40	340	— 50	290	— 10	— 10	+ 65
	1970	395	65	460	— 90	370	+ 120	+ 100	— 40
France	1969	2,670	— 500	2,170	— 625	1,545	— 1,100	— 1,100	— 565
	1970	4,765	— 610	4,155	—1,075	3,080	+ 1,985	+ 1,820	— 450
Germany	1969	7,060	305	7,365	—1,250	6,115	— 3,040[1]	— 3,040[1]	—1,185[1]
	1970	12,615	915	13,530	—3,445	10,085	+ 6,165	+ 5,965	—2,165[1]
Greece	1969	290	25	315	10	325	— 5	— 5	—
	1970	275	35	310	10	320	— 5	— 25	—
Iceland	1969	35	— 10	25	—	25	+ 5	+ 5	+ 10
	1970	40	—	40	— 5	35	+ 15	+ 15	— 5
Ireland.	1969	635	55	690	.	.	+ 145	+ 145	.
	1970	665	30	695	.	.	+ 5	— 10	.
Italy	1969	4,160	865	5,025	75	5,100	— 515	— 515	— 660
	1970	5,245	275	5,520	90	5,610	+ 495	+ 390	+ 15
Netherlands. . .	1969	2,070	440	2,510	—	2,510	+ 60	+ 60	+ 90
	1970	2,675	540	3,215	— 160	3,055	+ 705	+ 615	— 160
Norway	1969	610	90	700	45	745	+ 5	+ 5	— 60
	1970	675	120	795	100	895	+ 95	+ 70	+ 55
Portugal	1969	1,430	20	1,450	175	1,625	+ 65	+ 65	+ 20
	1970	1,485	20	1,505	200	1,705	+ 55	+ 55	+ 25
Spain	1969	885	—	885	— 10	875	— 265	— 265	+ 45
	1970	1,745	45	1,790	— 50	1,740	+ 905	+ 865	— 40
Sweden.	1969	560	100	660	85	745	— 140	— 140	— 190
	1970	575	125	700	160	860	+ 40	+ 5	+ 75
Switzerland . . .	1969	4,495	—	4,495	660	5,155	+ 10	+ 10	+ 150
	1970	5,185	—	5,185	1,050[2]	6,235	+ 690	+ 690	+ 390[2]
Turkey	1969	—	— 35	— 35	.	.	— 60	— 60	.
	1970	85	— 75	10	.	.	+ 45	+ 30	.
Total	1969	29,225	1,715	30,940	—1,410[3]	28,875	— 4,605	— 4,605	—2,205[3]
	1970	40,900	2,060	42,960	—4,135[3]	38,120	+12,020	+11,165	—2,695[3]
Canada	1969	2,420	475	2,895	1,455	4,350	+ 50	+ 50	+ 495
	1970	3,960	670	4,630	1,540	6,170	+ 1,735	+ 1,610	+ 95
Japan.	1969	3,035	625	3,660	695	4,355	+ 800	+ 800	+1,485
	1970	3,820	970	4,790	1,060	5,850	+ 1,130	+ 1,005	+ 365

[1] After elimination of statistical changes. [2] Owing to major changes in coverage, data for end-1970 on Swiss commercial banks are not comparable with the corresponding figures for earlier periods. [3] Excluding Ireland and Turkey.

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

Belgium-Luxemburg Economic Union. Excluding its first allocation of SDRs, the BLEU had an increase last year of $0.4 milliard in its net official monetary assets. Taking the year as a whole, most of this came from an inflow through the banks, whose net foreign liabilities increased by $0.3 milliard. Looking at the pattern of developments during the course of the year, however, there were two different phases. Up to the end of the third quarter net official assets (excluding the SDR allocation) had risen by $0.3 milliard, to which the overall payments surplus had contributed two-thirds and banking inflows only one-third. Then in the fourth quarter a net official monetary surplus of less than $0.1 milliard was more than accounted for by an acceleration of the banking inflow to $0.2 milliard resulting from the decline in Euro-dollar interest rates. Practically the whole of the fourth-quarter banking inflow took the form of switching foreign currency into Belgian francs. For the year as a whole the net increase in the banks' foreign currency liabilities to non-residents was $190 million; in addition, non-residents increased their Belgian franc balances by $75 million during 1970.

Whether looked at with or without the SDR allocation, almost the whole of the 1970 increase in Belgium's official monetary assets was, in one way or another, at the International Monetary Fund. The Fund reserve position went up by $235 million, of which $55 million arose out of the increased gold subscription and had a counterpart in a decline in the gold reserve; the SDR allocation came to $70 million; and in addition Belgium accepted $135 million of SDRs from other countries, mainly the United States. The Belgian franc proceeds of $110 million of these SDR transfers were used by the Federal Reserve to reduce its swap drawings on the National Bank of Belgium, which between end-May and early December 1970 had risen from zero to $320 million. Belgium's exchange reserves went up by $70 million.

There was little further inflow through the banks in the first quarter of 1971, so that the increase of $0.2 milliard that occurred in the net official position, excluding the second SDR allocation, broadly reflected an overall payments surplus. The Fund reserve position increased by another $70 million and Belgium accepted a further $25 million of SDRs from other countries; in addition, $65 million was added to exchange reserves, and Federal Reserve swap drawings on Belgium rose from $210 million at the beginning of the year to $420 million in early March.

Netherlands. As in Germany, though on a much smaller scale, inflows of capital and short-term funds produced a substantial increase in the net official monetary assets of the Netherlands during 1970 and the first part of 1971. When the inflows began to include a large speculative element in early May, the exchange market was closed at the same time as in Germany, in order to avoid any further increase in reserves.

For the year 1970 the increase in net official assets, including the first SDR allocation, was $0.7 milliard. Of this, $0.5 milliard came from the overall balance-of-payments surplus and $0.2 milliard from an increase in the banks' net foreign liabilities. Both the increase in net official assets and, still more, the inflow through the banks were concentrated in the latter part of the year. In fact, during the first six months of 1970 net official assets increased by less than $0.2 milliard, and most of this represented simply the SDR allocation, while in the banking sector there was a $0.1 milliard outflow, almost three-quarters of which was a rise in the banks' net foreign currency assets. In the second half of the year, on the other hand, net official assets went up by \$0.6 milliard, broadly reflected in a rise in the exchange reserves and derived about equally from the overall balance-of-payments surplus and from a net inflow through the banks. The latter movement, which more than offset the outflow of the first half-year, consisted almost entirely of an increase in foreigners' guilder balances, probably for interest rate considerations. During the second half of the year the Federal Reserve drew the whole of its \$0.3 milliard swap facility with the Nederlandsche Bank.

In the first quarter of 1971 half of the \$0.3 milliard increase in net official assets was again derived from a net inflow through the banks, and this again took the form mainly of an increase in the banks' net guilder liabilities. The remainder arose out of an overall surplus of \$80 million and the second SDR allocation of \$75 million. In fact, SDRs formed the bulk of the rise in net official assets during the quarter, since in addition to the allocation \$100 million of SDRs was transferred to the Netherlands by the United States. The proceeds of this transfer and of a \$125 million US drawing of guilders on the Fund, together with a \$75 million sale of Deutsche Mark to the Nederlandsche Bank, enabled the Federal Reserve to liquidate its swap drawings. At the same time, the Netherlands' exchange reserves rose by a further \$110 million during the quarter.

Switzerland. Net official monetary assets increased during 1970 by \$0.7 milliard, of which \$0.6 milliard was added to exchange reserves. In addition, the table on page 135 shows the net foreign assets of the Swiss commercial banks as having gone up by \$0.4 milliard, giving an overall external surplus of \$1.1 milliard, as against only \$0.2 milliard in 1969. Owing, however, to the effects of changes in the statistical coverage of the banks' foreign positions, it seems likely that the increase in their net foreign assets last year was a little smaller than these figures indicate.

Furthermore, the 1970 increase in net official assets was itself boosted by the fact that end-year transfers of dollars from the commercial banks to the National Bank came to \$1.1 milliard, as against \$0.8 milliard at end-1969. If an adjustment is made for the difference between these two figures, the rise in reserves last year is reduced to \$0.4 milliard. This means that, apart from the temporary effects of larger end-year window-dressing operations, more than half of Switzerland's external surplus last year went to increase the net foreign assets of the banking system — despite the decline in Euro-currency interest rates.

In the first quarter of 1971 net official assets fell by \$0.5 milliard. This was almost entirely the outcome of the reversal of end-year operations with the banks, which gave rise to a \$0.9 milliard decline in January, and of end-quarter operations with the banks, which produced a \$0.4 milliard rise in March. Federal Reserve drawings on the swap line with the Swiss National Bank, which had gone up during 1970 from \$145 to 300 million, rose further to \$450 million at the beginning of March. With the aid of a \$75 million gold sale by the US Treasury and the issue of a \$250 million equivalent non-marketable US Government security to the Swiss National Bank, the swaps were liquidated during the course of March. In April, despite the reversal of the banks' end-quarter operations, net official assets scarcely declined, pointing to a substantial inflow of funds during that month. The inflow accelerated in early May, when the exchange crisis blew up, but for May as a whole the reserves showed a rise of only $160 million.

Sweden. The overall surplus of $80 million, excluding the first SDR allocation, which was recorded for 1970 showed up almost entirely in a rise in the commercial banks' net foreign assets. Including the $35 million SDR allocation the overall surplus was $115 million and the increase in net official assets $40 million. The adverse balance-of-payments situation which had characterised the year 1969 continued during the first quarter of 1970, when an overall deficit of $80 million, excluding the SDR allocation, was financed by drawing on the exchange reserves. During the remainder of 1970 the overall balance showed a surplus of $160 million, with the first-quarter reserve losses being recouped and the banks adding $75 million to their net foreign position. The overall balance continued to be favourable in the first quarter of 1971. Including the second SDR allocation the surplus was $85 million and as there was in addition a net inflow of $25 million through the banks, net official assets rose by $110 million. Virtually the whole of this showed up in exchange reserves, while the SDR allocation was almost offset by a $30 million reduction in Sweden's GAB claims.

Denmark. There was a small surplus of $5 million in the overall payments balance last year. Including the first SDR allocation of $25 million, net official assets increased by $35 million. However, these figures mask a quite dramatic improvement in the Danish external position between the two halves of 1970. In the first six months there was an overall deficit, excluding the SDR allocation, of $110 million, and a $20 million outflow through the banks. Net official assets therefore declined by $130 million. In the second half an overall surplus of $115 million together with an inflow of $25 million through the banks produced a $140 million rise in net official assets. The improvement was maintained in the first quarter of 1971, when an overall surplus of $115 million was reflected entirely in a rise in net official assets, of which the second SDR allocation accounted for $30 million.

Finland. Excluding the SDR allocation, the overall balance showed a surplus of $60 million in 1970, about the same as the year before. Unlike 1969, however, when there was an outflow of $65 million through the banks, in 1970 there was an inflow of $40 million. As a consequence, Finland's net official assets went up by $100 million, or by $120 million if the first SDR allocation is included. Most of this increase was in the exchange reserves, which went up by $90 million. In the first quarter of 1971 net official assets rose by $85 million, of which the second SDR allocation accounted for less than a quarter.

Norway. Following a deficit of $55 million in 1969, the overall payments position improved to a surplus, excluding the SDR allocation, of $125 million last year. The 1969 deficit had been covered by a $60 million banking inflow; in 1970, as a result of net banking outflows of $55 million, the rise in net official assets was limited to $70 million, or with SDRs to $95 million. As in 1969, there were substantial offsetting flows of exchange between the official and banking sectors, from the reserves to the banks in the first half-year and back to the reserves in the second. In the first quarter of 1971 there was a further overall surplus, including the $25 million SDR allocation, of $60 million. This was broadly reflected in a rise of net official assets.

Austria. The overall external surplus in 1970 amounted to $70 million, slightly less than the $105 million of the previous year. However, a decline of $115 million in the banks' net foreign position, the first since 1966, produced an increase of $185 million in net official assets. Including the first SDR allocation, the improvement in the net official position came to $215 million.

Spain. The large overall payments surplus of $0.9 milliard gave rise to a corresponding improvement in the net official monetary position. Exchange reserves in fact went up by $1.1 milliard, while the gold stock fell by $0.3 milliard. Most of the 1970 surplus was recorded in the second half of 1970, and in the first quarter of 1971 Spain's reserves went up by a further $0.3 milliard, of which the second SDR allocation accounted for only $40 million.

Portugal. At $80 million, the overall surplus in 1970 was very little different from that of the previous year. It was reflected in increases of $25 million in the banks' net foreign assets and $55 million in the reserves. The latter in fact fell by $70 million in the first half of the year, as a result of capital outflows; but in the second half the capital account swung into surplus and the reserves rose by $125 million. In the first quarter of 1971 net reserves showed a slight further increase.

Turkey. The net official external monetary position recorded a surplus of $30 million in 1970 (excluding the first SDR allocation) after a $60 million deficit the year before. The improvement was clearly related to the August 1970 devaluation, since the trade deficit declined from $260 to 90 million between the first and second halves of the year. For the year as a whole, however, the trade deficit was $85 million higher than in 1969, but invisible receipts rose by $110 million and capital inflows by $65 million. Looking at the composition of Turkey's reserves, the exchange reserves went up by $75 million, two-thirds of which can be accounted for by net drawings on the IMF. These were the main factor behind a $40 million increase in Turkey's indebtedness to the Fund. The improvement in Turkey's position accelerated in the first quarter of 1971, when net reserves rose by $80 million, of which the second SDR allocation accounted for only $15 million.

Greece. With capital inflows offsetting most of the $415 million current-account deficit, the overall balance showed a deficit of $25 million last year. This was entirely reflected in a fall in the reserves, which declined in each quarter except the seasonally favourable third. Including the first SDR allocation, however, the decline in reserves was only $5 million. In the first quarter of 1971, despite a $15 million second allocation of SDRs, reserves fell by a further $10 million.

Ireland. Net official assets showed very little change in 1970, after their rise of $145 million in 1969. The exchange reserves in fact rose by $40 million, which was also the amount that Ireland drew on the IMF in 1970. The Fund reserve position and the gold stock both fell by $25 million. In the first three months of this year there was a substantial rise of $105 million in net official assets, including an SDR allocation of $15 million.

Canada. Unlike the previous year, when practically the whole of the $0.5 milliard overall payments surplus had financed a rise in the Canadian banks' net foreign assets, more or less all of the 1970 surplus showed up in a $1.6 milliard increase in net official assets. The exchange reserves went up by $1.3 milliard, including a rise of $1.2 milliard in holdings of non-liquid US Government securities. In addition, the net IMF and GAB position improved by $0.2 milliard, about half of which resulted from Canada's increased gold subscription to the Fund.

Although the banks' net foreign position showed little change for the year as a whole, there was a sharp contrast between the first seven months and the last five. In the earlier period, partly for interest rate reasons and partly in connection with the speculative movement into the Canadian dollar just before the exchange rate was floated, there was a net inflow through the banks of $0.6 milliard. During the rest of the year, when Canadian interest rates were coming down, there was an outflow of $0.7 milliard. In the official sector, the increase in net assets in the first five months of the year prior to the floating of the Canadian dollar came to $0.9 milliard and a further $0.4 milliard was bought for future delivery. Over the rest of the year, therefore, excluding what had been bought forward earlier, the rise in net official assets was only $0.3 milliard.

In the first quarter of 1971 Canada's overall payments position changed to a deficit of $0.4 milliard, or $0.3 milliard including the second SDR allocation. With Canadian interest rates again relatively attractive, however, there was a banking inflow of $0.5 milliard, most of which occurred in the first two months of the year. Net official assets therefore rose moderately during the quarter.

Japan. As in the case of Canada, the bulk of Japan's overall surplus, which in 1969 had financed an increase in the banks' net foreign assets, showed up in 1970 as a rise in the reserves. In fact, net official assets rose by $1.1 milliard, including the first SDR allocation of $0.1 milliard, to stand at $4.8 milliard at the end of 1970. The exchange reserves went up by $0.6 milliard and claims on the IMF by $0.3 milliard — the latter principally as a result of Japan taking over from Italy a $250 million loan to the Fund. The gold stock also rose, by $0.1 milliard. The banks' net foreign assets increased by $0.4 milliard, as against $1.5 milliard in the previous year.

There were quite sharp fluctuations in the pattern of Japan's external monetary movements during the course of the year. In the first six months a rise of $0.4 milliard in net official assets was derived mainly from a $0.3 milliard banking inflow. From June onwards the Bank of Japan made yen loans to the banks outside their rediscount and loan quotas at the official discount rate for conversion into foreign currency in order to reduce the banks' dependence on foreign borrowing for import financing. As a result, in the third quarter the banks increased their net foreign assets by $0.8 milliard and the net official position declined a little. In the fourth quarter, however, net official assets increased by $0.8 milliard from a renewed inflow of $0.1 milliard through the banks coming on top of an overall surplus of $0.7 milliard.

The pattern of the last quarter continued into the first quarter of this year, when, in addition to an overall surplus of $0.7 milliard, including a $0.1 milliard SDR allocation, there was a further banking inflow of $0.2 milliard. Net official assets therefore rose by $0.9 to 5.7 milliard. By the end of May, following a substantial inflow in the early part of the month, they had reached $7 milliard.

International Monetary Fund.

The most important events for the International Monetary Fund during the period under review were the first and second allocations of special drawing rights and the general increase in members' quotas. Actual operations in SDRs, however, as well as member countries' net use of the Fund's resources, were on quite a modest scale.

Of the $3.4 milliard first allocation of SDRs in January 1970, participating countries used a gross amount of $857 million during the course of the year. $472 million was transferred to other participants and the remainder to the General Account of the IMF. The Fund in its turn transferred $95 million of SDRs to participants during the year. Consequently, participating countries' total gross receipts of SDRs in 1970 (other than from the first allocation) came to $567 million. Three countries — Canada, Finland and the United States — opted to receive SDRs in preference to gold for a total amount of $68 million in September 1970 when the Fund replenished by means of gold sales its holdings of several participants' currencies; and, in addition, seventeen participants opted to receive $27 million of SDRs when the General Account of the Fund paid remuneration on countries' creditor positions and made a distribution out of its net income to member countries.

On a net basis, changes in SDR holdings during the year were somewhat smaller, since certain countries, as well as the Fund, both used and accepted SDRs. The broad pattern of the net flows of SDRs during 1970 was that less-developed countries used $371 million, while the Fund's General Account accepted $290 million and developed countries $81 million. Within the less-developed areas of the world, there were large differences in the degree to which SDRs were used, varying from 88 per cent. of initial allocations in the Middle East to 18 per cent. in Latin America. Apart from the General Account of the Fund, the most important single net acceptor of SDRs in 1970 was Belgium, with $134 million. At the end of the year Belgium's SDR holdings were 289 per cent. of the initial allocation, that is, only 11 per cent. below the maximum amount that it could have been obliged to hold on the basis of that allocation. On the uses side, the United Kingdom and India were the biggest single net users, with $144 and 82 million respectively.

A second allocation of $2,949 million SDRs was made on 1st January 1971. During the first three months of this year the overall movement of SDR flows was from participating countries to the General Account of the Fund. Thus, the Fund's holdings of SDRs went up by a net amount of $231 million, while developed countries made net transfers of $80 million and less-developed countries net transfers of $151 million. The largest single net user of SDRs during these three months was the United States, for an amount of $125 million, followed by the United Kingdom with $84 million. The latter, in fact, transferred $160 million of SDRs to the Fund as part of its March 1971 repayment, and this made up two-thirds of the Fund's total net SDR receipts. Apart from the Fund, easily the principal receiver of SDRs was the Netherlands, with $100 million. In April 1971, when the Fund made a $320 million offer to sell gold in order to replenish its holdings of fourteen member countries' currencies, three countries — in this case Canada, Finland and Italy — opted to receive SDRs instead of gold, for a total of $56 million.

The general increase in quotas authorised by the Fund's Board of Governors in February 1970 had by the end of the year taken effect for 105 member countries. As a result of that, together with a rise in the membership of the Fund from 115 to 117 countries, the total of Fund quotas went up by one-third during 1970, from $21.3 to 28.4 milliard. China (Taiwan), one of the countries that did not accept a quota increase in 1970, subscribed in full (though with only an 11 per cent. gold payment) to the $550 million quota allotted it in December 1945. Previously it had made only a token subscription of $60,000.

Total net use of the Fund's resources in 1970 was only $307 million. Gross drawings, at $1,839 million, were about $1 milliard lower than in 1969, while repurchases, at $1,532 million, were very little less than in the previous year. Contrary to what happened with SDRs, developed countries were the main users of the Fund's resources in 1970. European countries — in particular France, Italy and the United Kingdom — together with the United States and South Africa accounted for 82 per cent. of total gross drawings but only 54 per cent. of repurchases. Altogether, developed countries' combined net use of the Fund's resources, despite a reduction of $321 million in the United Kingdom's indebtedness to the Fund, was more than twice the total of all net drawings. In the rest of the Fund membership taken together, there were net repurchases of $340 million. India repurchased $197 million and Latin American countries a net amount of $182 million.

Nineteen different currencies were used in drawings and repurchases during 1970. As in 1969, the most used currency for both purposes was the US dollar; but contrary to the experience of the previous year, repurchases in dollars, at $742 million, were larger than drawings, which amounted to $589 million. The other currencies principally used for drawings were (in millions of dollars) the Deutsche Mark (394), the Belgian franc (180), the Canadian dollar (156), the Dutch guilder (145) and the Japanese yen (133). For repurchases, apart from the US dollar, the greatest use was made of SDRs (292) and the Japanese yen (106). The $153 million of net repurchases in US dollars, together with a US drawing of $150 million and net Fund gold sales of $416 million for US dollars, raised the Fund's holdings of US dollars during the year from 55 to 71 per cent. of the US quota.

Fund borrowing outstanding under the GAB declined during 1970 by $236 million. The GAB was activated in February 1970 for $94 million in connection with

International Monetary Fund: Drawings and repurchases in 1970.

Countries or areas	Drawings		Repurchases[1]		Net drawings	
	in millions of US dollars					
Europe		1,238		827		411
of which						
France	*485*		*246*		*239*	
Italy	*463*[2]		*—*		*463*	
United Kingdom	*150*		*471*[3]		*—321*	
Other	*140*		*110*		*30*	
United States		150		—		150
South Africa		125		—		125
New Zealand		—		39		— 39
Other Africa		46		76		— 30
Middle East		65		9		56
Asia		91		275		— 184
of which						
India	*—*		*197*		*—197*	
Latin America		124		306[4]		— 182
Total		1,839		1,532		307

[1] Includes repayment of $138 million by other members' drawings. [2] Includes repayment by the Fund of $330 million borrowed from Italy. [3] Includes repayments of $43 million by other members' drawings and $90 million by the Fund's use of sterling for the purchase of gold. [4] Includes repayment of $5 million by another member's drawing.

France's drawing of $485 million; on the other hand, Italy was repaid all of its $330 million GAB claims in July. Outside the GAB, there was no change in the level of Fund borrowing, but its special borrowing of $250 million from Italy was repaid in June and July and replaced by equivalent borrowing from Japan.

During the first quarter of 1971 member countries' net use of the Fund's resources declined by $507 million. Drawings totalled $333 million, including one of $250 million by the United States, and repurchases (including those resulting from other members' drawings) $840 million, of which the United Kingdom accounted for $689 million. In connection with the UK repurchase, the Fund repaid a further $70 million borrowed under the GAB, $40 million to the Netherlands and $30 million to Sweden. Towards the end of April the Fund sold $320 million of gold and SDRs to fourteen member countries to replenish its holdings of their currencies. Also in April, the Fund repaid to Japan $125 million out of the $250 million borrowed from it outside the GAB in mid-1970.

Foreign exchange markets.

In the exchange markets the main characteristic of the period under review was the weakening of the US dollar and the strengthening, or continued strength, of other major currencies, leading to the appreciation of the Canadian dollar in June 1970 and of various European currencies in May 1971.

The situation out of which these changes emerged began to develop early in 1970 as a result of the easing of monetary policy in the United States at a time when a number of other countries were maintaining, or in some cases introducing, more restrictive policies. By the spring of 1970 most major currencies were above par on the US dollar, the only exceptions being the lira, which was adversely affected by both political and economic pressures, the guilder and the Swedish krona. At the end of May 1970 upward pressure on the Canadian dollar, basically reflecting a very strong current-account balance of payments but with speculative elements added to it, had become such that the Canadian authorities decided to abandon the upper intervention limit — since when the Canadian dollar has appreciated by over 6 per cent. against the US dollar.

With the continued easing of US and Euro-dollar interest rates, and a recovery of confidence in the lira, by the last quarter of 1970 all major currencies, with the exception of sterling, which was recovering from a period of temporary weakness in the summer, were above par on the US dollar and a number of them were at or near their upper limits. During 1970 speculative pressures were very much less than they had been in 1969 and, except in the case of the Canadian dollar and the lira, of little significance.

Sterling rejoined the group of strong currencies early in 1971. Outflows from the United States and inflows into European countries, particularly Germany and the United Kingdom, continued on a large scale in the first quarter of 1971. In the case of Germany, currency speculation gradually replaced interest rates as the main force behind the inflow and towards the end of April events suddenly acquired an irresistible momentum. Firstly, it became known that the Economic and Finance Ministers of the European Economic Community were discussing possible ways and means, including greater flexibility of their currencies vis-à-vis the dollar, of insulating their economies against undesired inflows of funds from abroad. Shortly afterwards, a number of German private economic research institutes gave it as their opinion that the Deutsche Mark should be either left to float upwards or revalued. The inflow of money to Germany became a flood and on 5th May the Deutsche Bundesbank withdrew from the market, which was then temporarily closed. On the same day, as a result of similar though lesser pressures, the Austrian, Belgian, Dutch and Swiss authorities also stopped buying dollars. After some days of deliberation, the Swiss franc was revalued by 7.07 and the Austrian schilling by 5.05 per cent. with effect from 10th May. Simultaneously, the Deutsche Mark and the guilder were allowed to float, thus avoiding on the one hand the need for the German and Dutch authorities to buy any more dollars from the market and on the other hand outright revaluations in situations where they were not considered appropriate. In Belgium the action taken by the authorities was to separate completely the official and the financial exchange markets.

The suspension of the intervention limits for the Deutsche Mark and the guilder entailed postponing the execution of the decision, taken by the Council of Ministers of the EEC in February 1971, to begin narrowing the margins within which the currencies of member countries would be permitted to fluctuate against one another in the exchange markets. The first step in this direction was to have been taken by the central banks on an experimental basis in mid-June this year, with a narrowing of these margins from 1.50 to 1.20 per cent. on either side of parity. The narrowing of intra-EEC exchange rate margins forms one element in the first stage of the movement towards economic and monetary union of the EEC countries adopted by the Council of Ministers in February 1971 as an objective to be achieved during the ten years 1971–80.

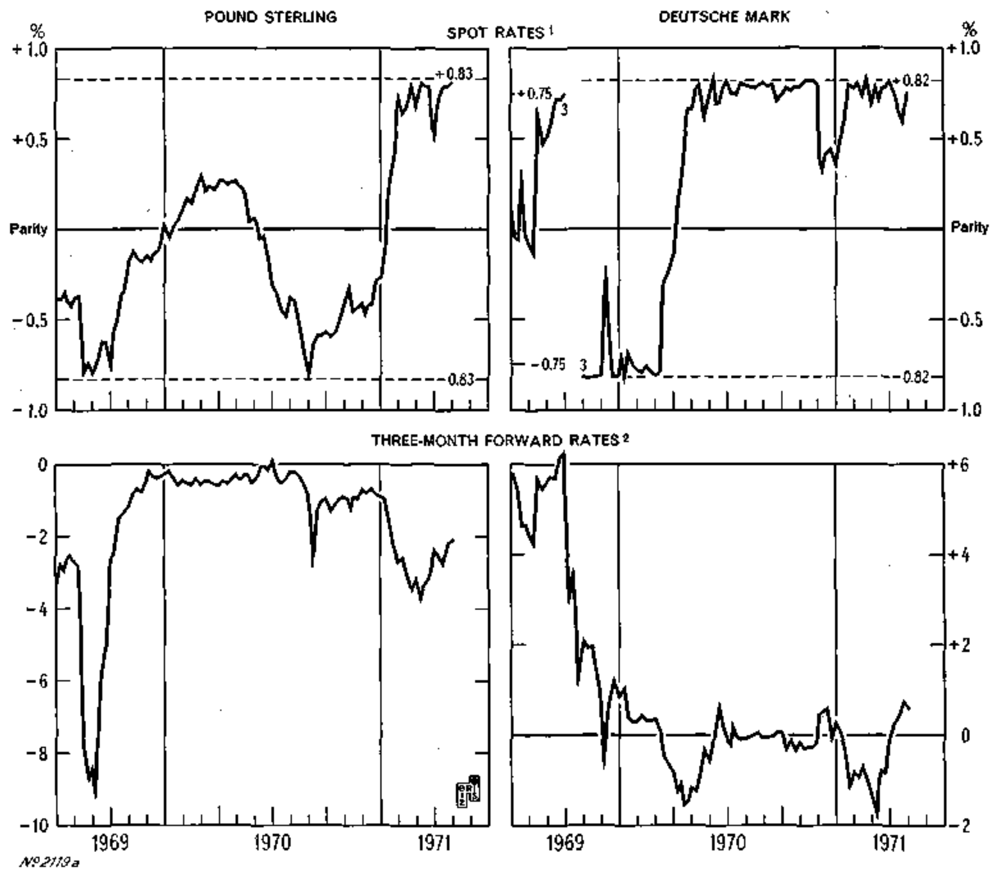
Sterling. Under the combined influence of a favourable basic external balance and tight domestic money-market conditions the spot rate for sterling against the dollar rose from par at the beginning of 1970 to about 0.3 per cent. above in early March. Bank rate was twice reduced by ½ per cent., in March and April, but quotations remained firm at about 0.2 per cent. above par until mid-May.

At that point the trend changed. In May and early June rising Euro-dollar rates reinforced the effect of the reduction in domestic interest rates, while at the same time sterling was adversely affected by the floating of the Canadian dollar. By late July the spot rate had fallen to 0.5 per cent. below par and by end-August, under the influence of adverse seasonal factors and the acceleration of wage and price increases, it had almost reached the lower limit against the dollar. In these circumstances the publicity given to exchange rate flexibility prior to the annual meeting of the IMF led temporarily to very heavy pressure on sterling in early September, with the authorities having to give substantial support in the spot market. At the same time forward quotations weakened sharply, the discount on three-month sterling widening from 0.2 per cent. in early August to nearly 3 per cent. per annum at one point in the second week of September.

The crisis was short-lived, however, as sterling soon became heavily oversold. By end-September the spot rate had recovered to about 0.5 per cent. below par and the three-month forward discount to 1 per cent. per annum. During the last quarter of 1970 the recovery continued, partly as a result of improved foreign trade figures and partly because a further fall in Euro-dollar rates brought a renewed inflow of funds to London. By end-December spot sterling was only 0.3 per cent. below par on the dollar and after the turn of the year quotations began to rise rapidly, almost reaching the upper limit in mid-February. At the same time the three-month forward discount widened to 4 per cent. The demand for sterling was heavily reinforced by a further fall in Euro-dollar rates and expectations of a decline in UK interest rates. The inflow of exchange kept the spot rate consistently near the upper limit until end-March. Then, following a further 1 per cent. reduction of Bank rate, quotations eased briefly to 0.5 per cent. above par. By mid-April, however, they were close to the ceiling again and sterling remained firm during the exchange crisis of early May.

In the investment currency market, where UK residents are able to purchase foreign currency for portfolio and direct investment outside the sterling area and where they may dispose of up to 75 per cent. of the proceeds of their sales of such investments, the premium at which the dollar stood as compared with quotations in the official exchange market fluctuated between about 34 and 38 per cent. between January and mid-March 1970. It began to fall in the latter half of March and for the next six months fluctuated between 21 and 29 per cent. Towards the end of September the premium rose again to a peak of almost 37 per cent. in response to the upward movement of prices on the New York stock market. In December the exchange control regulations governing foreign currency borrowing by UK residents for portfolio investment abroad were eased, as described on page 153, and the premium fell from 33 per cent. just before the change to 22 per cent. early in January. Thereafter it continued to fall, although more slowly, reaching a low point of 15 per cent. in April. By late May, however, it had risen again to about 22 per cent.

Pound sterling and Deutsche Mark quotations for the US dollar.



¹ Friday figures, as percentages above (+) or below (−) par on the US dollar. ² Friday figures, as premium (+) or discount (−) on the spot rate in percentages per annum. ³ Previous intervention limits suspended on 30th September; new parity from 27th October 1969.

Deutsche Mark. During the first two months of 1970 the Deutsche Mark remained at or near the lower limit against the dollar in the spot exchange market, to which it had fallen immediately following the October 1969 revaluation. As the outflow of funds caused directly by the appreciation of the exchange rate tapered off, the main factor behind the continued weakness of the Deutsche Mark became the relatively low level of domestic interest rates — despite both the monetary tightening caused by the post-revaluation outflow of funds and the fall in Euro-dollar rates from the beginning of 1970. Following the 1½ per cent. increase in the Bundesbank's discount rate on 6th March, however, the situation changed completely. German corporations began to borrow funds abroad on a large scale and by mid-May the spot rate against the dollar had reached the upper limit, at or close to which level it then remained for nearly seven months, despite ½ per cent. reductions in the Bundesbank's discount rate in July and November.

On 2nd December a third reduction of ½ per cent. in the official discount rate was announced and the spot rate immediately fell to about 0.3 per cent. above par, around which level it remained until the end of the year. After the turn of the year, however, with Euro-dollar rates falling sharply again, the Deutsche Mark strengthened rapidly and by the end of January the spot rate against the dollar had returned to the upper limit. A further 1 per cent. cut in the Bundesbank's discount rate at the beginning of April, together with a rise in Euro-dollar interest rates, produced a temporary easing of quotations in the middle of that month, but the rate was soon back at the upper limit again and remained there until the closing of the market on 5th May. When dealings started again on 10th May, with the Bundesbank no longer buying dollars at the previous upper intervention point, the Deutsche Mark appreciated at once to nearly 3½ per cent. above its dollar parity.

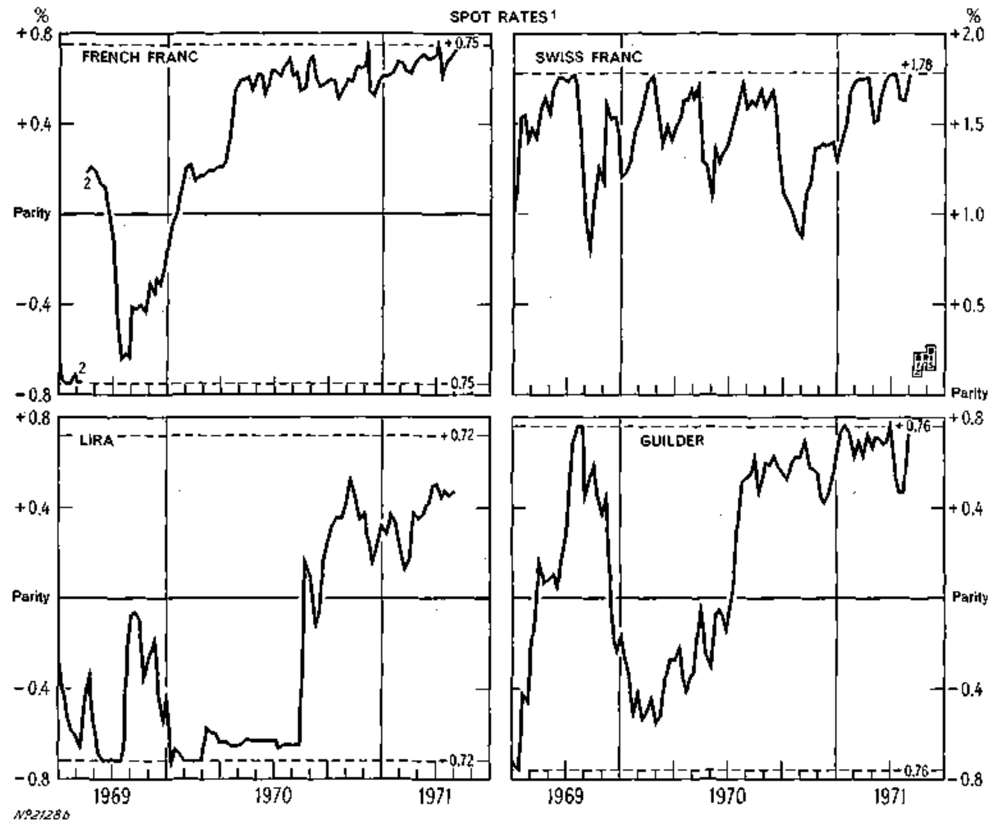
In the forward market the sharp rise in German interest rates in March 1970 had the effect of depressing the rate for three-month Deutsche Mark from a small premium to a discount of 1.6 per cent. per annum in mid-April. Subsequently the discount narrowed and until the end of the year the three-month forward rate moved quite narrowly on either side of the spot quotation for the dollar. By March 1971 a discount of nearly 2 per cent. per annum had reappeared, reflecting a renewed widening of the differential between German and US interest rates. Subsequently, however, the demand for Deutsche Mark sent the three-month forward rate to a premium of 1 per cent. per annum in early May.

French franc. From the beginning of 1970 until early April spot quotations for the French franc against the dollar followed a course rather similar to that of sterling, rising from 0.1 per cent. below to 0.3 per cent. above par. The balance of payments was steadily improving, previously adverse leads and lags were being reversed and the decline in Euro-dollar interest rates contrasted with relatively tight domestic monetary conditions. Contrary to the performance of sterling, however, the French franc continued to strengthen into the second quarter of the year. At the end of April, by which time the foreign trade balance was in surplus and all central-bank indebtedness had been paid off, spot quotations were 0.6 per cent. above par on the dollar. Since then the franc has remained consistently firm, practically reaching the upper limit in early December 1970 and again in April 1971. The French franc was largely unaffected by the May exchange crisis, though the spot rate against the dollar eased from 0.7 to around 0.5 per cent. above par during the first half of the month.

Swiss franc. During the period under review movements in the Swiss franc exchange rate for the dollar principally reflected seasonal changes in domestic liquidity conditions. Thus, during February and again during April and early May 1970, the franc was very firm as a result of tight domestic liquidity conditions, going to its upper limit against the dollar in February and very close to it in May. Both these episodes were followed by a temporary easing of the rate. On the other hand, both at end-March and end-June the spot rate was not affected by the banks' quarterly window-dressing operations, since these were taken care of through swaps between the National Bank and the commercial banks. A further period of domestic liquidity tightness ensued in July and the spot rate again went close to its upper limit against the dollar. It remained very firm until end-September, when easier domestic monetary conditions caused quotations to dip quite sharply, reaching a low point of about 0.9 per cent. above par by late October. A further tightening of the Swiss market took the spot rate up to 1.4 per cent. above the dollar parity just before the end of the year. The Swiss franc continued to strengthen in early 1971, practically reaching the upper limit against the dollar again in February. It subsequently remained very firm up to 5th May, when the Swiss authorities, following the German example, suspended their market intervention in the face of speculative inflows. Following the 7 per cent. revaluation announced on 9th May, the Swiss franc found itself in the novel position of being quoted below par on the dollar in the spot market.

Lira. 1970 opened with the lira under heavy pressure in the exchange market, owing mainly to substantial outflows of capital. The spot rate against the dollar, which had been weakening since the previous November, reached the lower intervention point in mid-January and remained there for about two months. The various measures taken in March to stem the outflow of funds produced some improvement in the market situation, but lack of confidence persisted and the spot rate remained at about 0.6 per cent. below par until mid-August. From May onwards industrial unrest and political uncertainties, including the resignation of the government, added to pressures on the lira and in the three-month forward market the discount widened from 1 per cent. to a maximum of 17 per cent. per annum towards the end of July.

French franc, Swiss franc, lira and guilder quotations for the US dollar.



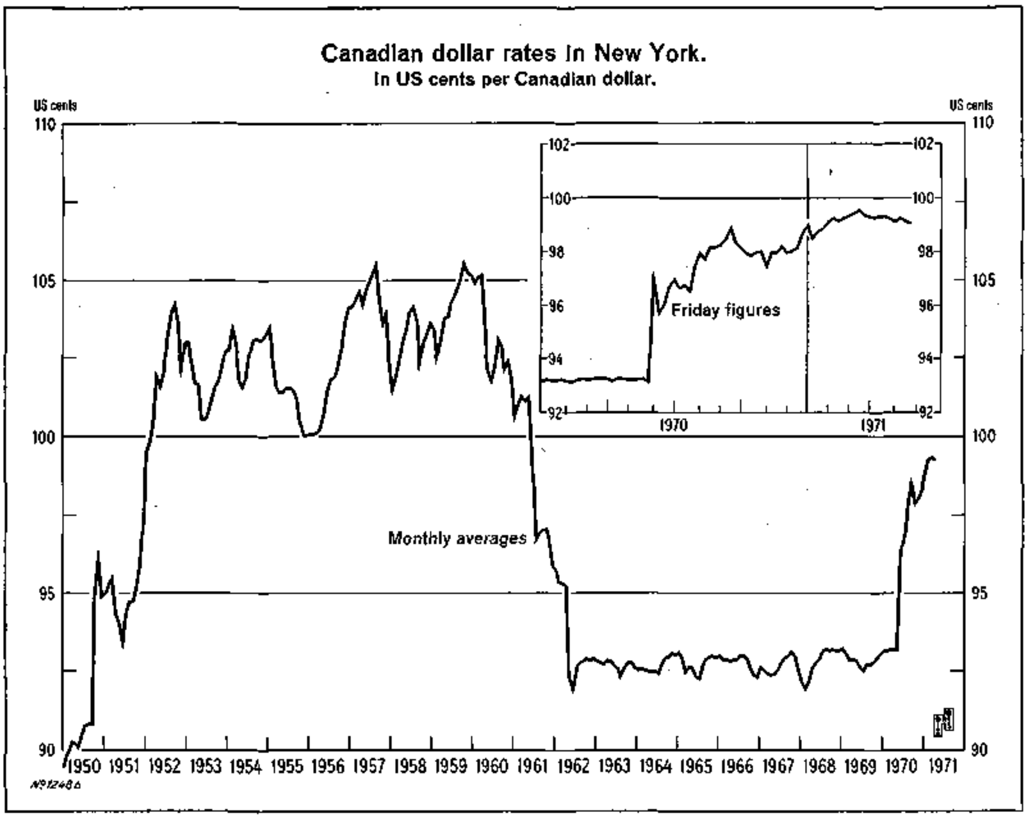
[1] Friday figures, as percentages above (+) or below (—) par on the US dollar. [2] New parity from 11th August 1969.

Early in August a new government was formed. The announcement of tax increases and other fiscal measures brought a rapid change in sentiment. As a consequence, and with seasonal factors also being favourable, by end-August the spot rate was, for the first time since February 1969, above par. After easing briefly to just below par in early September, the spot rate resumed its upward movement and by early November, with the aid of falling Euro-dollar rates, it was 0.5 per cent. above par. At the same time, the three-month forward discount of the lira narrowed to only 1 per cent. per annum again. While spot quotations eased to about 0.2 per cent. above the dollar parity in mid-December, and even a little lower in early February 1971, the lira has on the whole remained quite firm. It was not involved in the May exchange crisis and in mid-May the spot rate stood at 0.4 per cent. above par.

Guilder. At the beginning of 1970 the guilder was well below par on the dollar, having eased very sharply late in 1969 when it became clear that, unlike 1961, the Dutch authorities were not going to follow the German example and revalue. This phase ended in March and the guilder began to strengthen again. It went above par in early July and by mid-August 1970 was 0.6 per cent. above its dollar parity, at or around which level it then remained until near the end of the year. This development, which occurred in the face of a substantial deterioration in the current account of the balance of payments, was essentially due to interest rate differentials, domestic monetary policy (as in Germany) having remained restrictive at a time when dollar interest rates were declining. Except for two short periods — in November 1970 and again in early April 1971, when the official discount rate was reduced by ½ per cent. — the guilder remained very firm right up to the May exchange crisis. When the authorities stopped buying dollars at the previous upper limit on 5th May and allowed the exchange rate to float with effect from 10th May, the guilder immediately appreciated to almost 2½ per cent. above par.

Other European currencies. In the regulated exchange market, spot quotations for the *Belgian franc* have remained at or near to the upper intervention point vis-à-vis the dollar ever since the revaluation of the Deutsche Mark in late October 1969. On the free market a discount of about 2 per cent. on the spot rate in the regulated market at the beginning of 1970 had declined to negligible proportions by the end of the year. Following the May 1971 exchange crisis, the Belgian authorities completely separated the regulated and the free exchange market, with the latter now restricted entirely to financial transactions. Subsequently, the franc went to a premium of nearly 1 per cent. in the free market as compared with the regulated market, where the spot rate against the dollar was at its upper limit. In February last year the *Swedish krona* declined to 0.6 per cent. below par when the authorities abandoned their support at about the parity level. Subsequently the rate gradually recovered and, after falling briefly to the lower support point in September, rose above par during the last quarter of 1970. In mid-May 1971 the krona was quoted in the spot market at 0.2 per cent. above the dollar parity, having been very little affected by the exchange crisis. The *Danish krone* fluctuated rather narrowly on either side of its dollar parity during most of 1970. Reflecting the persistent easing of dollar interest rates, however, quotations rose a little in November to reach 0.2 per cent. above par at the end of the year, around which level they subsequently remained until mid-April 1971. By early May the krone had eased fractionally below parity, but it subsequently went above it again. Quotations for the *Norwegian krone* followed very much the same pattern in 1970. After remaining rather close to par against the dollar for most of the year, the spot rate rose to almost 0.3 per cent above parity in December. It eased to par at end-January 1971, but then appreciated again by about 0.2 per cent. by mid-April. It strengthened a little further during the exchange crisis and in mid-May was nearly 0.5 per cent. above its dollar parity. The *Austrian schilling* was quoted at between 0.4 per cent. above par and its upper limit vis-à-vis the dollar throughout 1970 and the early part of 1971. When the exchange crisis began on 3rd May, the spot rate was 0.7 per cent. above parity. Following the 5 per cent. revaluation it fell close to the new lower limit, nearly 1 per cent. below par. The *Spanish peseta* strengthened steadily during the first half of 1970, from par on the dollar to 0.6 per cent. above. Since then quotations have moved only very narrowly on either side of that level.

Canadian dollar. Perhaps the most significant event in the field of exchange rates during 1970 was the Canadian Government's decision, which took effect on 1st June, that "for the time being the Canadian Exchange Fund will cease purchasing sufficient US dollars to keep the exchange rate of the Canadian dollar in the market from exceeding its par value of 92½ US cents by more than 1 per cent." For practical purposes this meant that Canada returned, after an interval of almost exactly eight years, to a floating exchange rate regime. Formally, however, the present arrangements differ from those



that were in force from September 1950 to May 1962 in that this time the Canadian dollar has retained its par value declared to the IMF of 92½ US cents.

Before the decision to float, the Canadian dollar had during the first five months of 1970 been almost continually at its previous upper limit of 93¼ US cents, which was 0.8 per cent. above the parity. Since June last year the spot rate has gradually appreciated by about 6½ per cent. Immediately following the change in policy, quotations rose to between 97 and 98 US cents and this initial upward movement was followed by a period in which the rate fluctuated quite markedly before settling down in late June at a little above 96½ US cents, an appreciation of about 3½ per cent. In mid-July quotations began to move up again, going above 99 US cents in mid-September. This was followed, however, by some easing of the rate to about 98 US cents by the end of the month, around which level it then moved quite narrowly until near the end of the year. A further upward movement began in late December, quotations going above 99 US cents again at the very end of the year. Since then the spot rate has remained in the range of 99–99½ US cents, except for a brief rise above 99¾ US cents late in February 1971.

Japanese yen. The continuing surplus in Japan's balance of payments ensured that the Japanese yen was rather firm against the US dollar during most of the period under review. In the first four months of 1970 the yen was mostly close to its upper limit against the dollar in the spot market. There followed some easing of the rate from late April onwards, and in mid-July it was hardly above par. In August the yen strengthened again quite rapidly and since then it has fluctuated generally between 0.6 per cent. above its dollar parity and the upper intervention point. There were substantial inflows to the reserves during the May exchange crisis and the yen has again been at its upper limit.

Other exchange developments.

During the period under review there were more changes in European exchange rates than for many years. While the most significant were the various appreciations of major European currencies vis-à-vis the dollar that emerged from the May 1971 exchange crisis, there were also devaluations in Turkey and Yugoslavia.

The revaluation of the Swiss franc which came into effect on 10th May 1971 amounted to 7.07 per cent., the franc's gold content being increased from 0.20322 to 0.21759 grammes. The new dollar parity is Sw.fr. 4.0841 = US $1 and the National Bank's official buying and selling rates for the dollar are now fixed at Sw.fr. 4.01 and 4.16 respectively — the spread between the two rates being 3.67 per cent.

The revaluation of the Austrian schilling, which also took effect on 10th May 1971, amounted to 5.05 per cent. The schilling's gold content was thereby increased from 0.0341796 to 0.0359059 grammes. The new dollar parity is Sch. 24.75 = US $1 and the Austrian National Bank's new official buying and selling rates for the dollar are Sch. 24.51 and 24.99 respectively. Compared with the previous buying and selling rates of Sch. 25.80 and 26.20, this represents a widening of the margins between the schilling and the dollar from 0.77 to 0.97 per cent. on either side of the parity.

In Germany the suspension of the intervention limits against the dollar on 10th May was accompanied by certain measures designed to discourage inflows of funds from abroad. The payment (with minor exceptions) of interest to non-residents on their accounts at German banks, the acquisition of German money-market paper by non-residents and the placing by German banks of domestic fixed-interest securities "en pension" with foreign banks were all made subject to prior authorisation — it being understood that as a general rule permission will be refused. In the Netherlands the floating of the guilder was followed by the prohibition of interest payments on foreign banks' guilder sight deposits.

In Belgium, the other European country significantly involved in the May 1971 exchange crisis, the authorities retained the dual exchange market system in force for many years, though in a modified form. With effect from 11th May 1971 the two exchange markets were completely separated, the official market being reserved exclusively for current-account transactions and the financial market, where the National Bank of Belgium does not intervene to prevent quotations going outside the margins permitted by the IMF, exclusively for other transactions. In addition, BLEU residents are no longer allowed, except for very minor amounts, to receive advanced payments from non-residents through the official exchange market; nor may BLEU banks either open in favour of non-residents deposit accounts the balances on which are convertible on the official exchange market or pay interest on non-residents' convertible sight accounts in domestic currency.

Finally, in connection with the recent exchange crisis, the French authorities have taken powers to impose, should circumstances warrant it, reserve requirements of up to 100 per cent. on French commercial banks' deposit liabilities to non-residents and to limit, or forbid, the payment of interest on such deposits.

The Turkish pound was devalued by 40 per cent. with effect from 10th August 1970. Its gold content was reduced from 0.0987412 to 0.0592447 grammes, while the dollar parity changed from T£9 = US $1 to T£15 = US $1. At the same time there has been some simplification of the exchange rate system. The new parity applies to all transactions, except the conversion of the foreign exchange proceeds from certain traditional agricultural exports, to which a rate of T£12 = US $1 applies. Previously, in addition to the official exchange rate, there had been three other effective rates, ranging from T£11.25 to T£13.5 = US $1, applied to various types of invisible transactions. As well as the devaluation and the reduction in the number of exchange rates, the rates of the guarantee deposits which importers are obliged to constitute in domestic currency, and which had ranged from 1 to 120 per cent., were generally halved — though the effects of this were largely offset by the devaluation — and the stamp tax on imports was reduced from 25 to 10 per cent.

The Yugoslav dinar was devalued by 16.67 per cent. on 23rd January 1971. The new dollar parity is Din. 15 = US $1, as against Din. 12.5 previously, while the new gold content of the dinar is 0.0592447 grammes. The devaluation was accompanied by the abolition of an import deposit scheme introduced the previous October at a rate of 50 per cent., subsequently reduced to 20 per cent., as well as by a reduction from 5 to 2 per cent. in the rate of the general import tax introduced in July 1970.

Other exchange developments in Europe included the dismantling of a number of important restrictions, particularly in France and the United Kingdom. On the other hand, there were also some instances of new restrictions being introduced.

In France the authorities continued with the dismantling, begun soon after devaluation, of exchange controls imposed following the crisis of May–June 1968. Firstly, the compulsory depositing at the Bank of France of any French commercial bank's net asset position in foreign currencies vis-à-vis non-residents, the ratio for which had in April 1970 been reduced from 100 to 50 per cent., was abolished in June 1970. Secondly, in August 1970 all restrictions were lifted on the repurchase by French banks from their foreign correspondents of French bank-notes at the official exchange rate. This effectively did away with the discount at which French bank-notes were quoted on international markets. Thirdly, the foreign currency allowance for non-business travel abroad by residents was raised in two steps, in August 1970 and March 1971, from Fr.fr. 1,000 a year to Fr.fr. 2,000 per trip twice a year. Also in August 1970, the maximum amount in French bank-notes that residents may take abroad was raised from Fr.fr. 200 to 500 and the basic daily allowance for residents' business trips abroad put up from Fr.fr. 200 to 400 per day, with a ceiling of Fr.fr. 4,000 per trip. Fourthly, certain relaxations were made in the regulations governing transfers of funds abroad for investment purposes. In August 1970 the proportion of their foreign investment expenditure which French oil and mining enterprises are allowed to meet out of domestic funds was raised from 50 to 66 per cent.; then, in January 1971, the maximum amount that French industrial and commercial enterprises may automatically transfer abroad each year to finance their foreign subsidiaries was raised from Fr.fr. 2.5 to 5 million or to the amount of investment income repatriated from subsidiaries.

In the United Kingdom, too, there were a number of relaxations of exchange controls. Most important, perhaps, was the phasing-out of the import deposit scheme during the course of 1970. The rate of deposit, which had already been put down from 50 to 40 per cent. in December 1969, was further reduced to 30 and then to 20 per cent. in May and September respectively. The whole scheme was terminated on 4th December 1970, after an existence of just over two years.

In addition, the conditions under which UK residents may make foreign investments not permitted through the official exchange market were eased in a number of ways. Firstly, in August 1970 the so-called "property currency" market was amalgamated with the larger "investment currency" market, where 75 per cent. of the proceeds from UK residents' sales of their other assets owned outside the sterling area are dealt in. Secondly, in September the proportion of their total foreign security portfolios which UK institutional investors are allowed to place in offshore funds — whose switching operations in foreign currency securities are not subject to the provision that generally requires 25 per cent. of the proceeds from the sale of foreign currency securities to be offered on the official exchange market — was raised from 10 to 20 per cent. Thirdly, in December facilities for UK residents to borrow foreign currency abroad for the purpose of investing in foreign securities, which had hitherto been limited to institutional investors, was extended to banks, stockbrokers and other professional managers of securities. At the same time, the limit on the period for which the foreign currency may be borrowed (previously five years) was abolished.

In contrast to these relaxations of restrictions, the rules governing foreign borrowing by UK residents for expenditure within the United Kingdom were, as already mentioned on page 26, tightened up in January 1971.

In Italy the most important exchange measure taken was the normalisation of the maximum time-limit allowed for the repatriation of export proceeds. The limit, which had been reduced from twelve to four months early in 1970, was put back to one year again in January 1971. The maximum period allowed for advance payment on imports, however, remains unchanged at thirty days.

In Sweden the regulations governing purchases by residents of Swedish shares held abroad and the export of capital from Sweden by emigrants were liberalised in April 1971. The amount of foreign exchange allowed to residents for the purchase of holiday houses abroad, however, was reduced from S.kr. 75,000 to S.kr. 40,000.

In Norway new guide-lines for the banks' foreign exchange positions were introduced in July 1970. In general, banks have since then not been permitted to increase their net foreign exchange assets beyond the end-January 1970 level and in certain cases have had to reduce them below that level. Banks which had a net liability position in January 1970 were permitted to build up a moderate net asset position. At the same time, banks were requested not to increase their foreign currency liabilities to foreign banks beyond the end-March 1970 level without the prior permission of the Bank of Norway.

In Finland, in an attempt to slow down the growth of imports, a range of goods which account for about one-quarter of total imports was made subject to cash payment in advance of customs clearance in November 1970.

In Spain the import deposit scheme introduced in December 1969 for a period of one year was extended at the end of last year for a further six months until end-June 1971. The rate of deposit, however, was halved to 10 per cent. in January 1971.

In Portugal certain limits were introduced in February 1971 on the net foreign asset positions of commercial banks. Banks' foreign assets in the form of sight deposits or of investments with a maturity of up to one year, net of foreign liabilities with maturities of up to six months, may not exceed 5 per cent. of their total liabilities.

In Greece measures were taken late in 1970 to try and attract foreign exchange into the Greek banking system, and in particular to encourage Greek nationals living abroad to hold more of their savings in Greece. Authorised Greek banks are now allowed to pay interest on time deposits in foreign currencies received from non-residents and at rates higher than those applying to corresponding deposits in national currency.

In the United States a number of minor relaxations were made in the balance-of-payments restraint programme during the period under review. In January 1971 the Federal Reserve Board excluded from the voluntary guide-lines on foreign loans and investments of US banks purchases of bonds and notes issued by international institutions of which the United States is a member, as well as short-term export credits to residents of developed countries in continental western Europe. At the same time, the mandatory controls on direct investments abroad were relaxed to exclude investments of up to $2 million a year, as against $1 million previously, and the percentage of the previous year's annual earnings which may be retained abroad by foreign affiliates of US corporations was raised from 30 to 40 per cent. With effect from 1st April 1971, the interest equalisation tax on US citizens' purchases of foreign securities was extended for a further two years. On purchases of foreign bonds the tax is equivalent to an annual interest rate of 0.75 per cent. and on purchases of shares to one of 11.25 per cent.

In Canada, apart from the decision to float the dollar in June 1970, the only other exchange measure of any importance was the extension to Canadian dollars of the guide-lines introduced in 1968 for the banks' net foreign currency positions vis-à-vis residents of countries other than Canada and the United States. As from March 1971 the Canadian banks may therefore not increase any further their net claims in Canadian dollars on residents of countries other than Canada and the United States. The object of this regulation is to prevent funds being channelled from the United States through Canada to other countries, particularly in Europe.

In Japan a number of measures were taken to facilitate the foreign operations of domestic enterprises. In August 1970 limitations on the operations of the overseas offices of Japanese banks were eased substantially; in September 1970 the ceiling on automatically approved direct investment abroad was raised from \$200,000 to \$1 million per project; and in May 1971 Japanese traders and other business organisations were allowed (a) to retain export proceeds for six months, instead of only twenty days, for use in payment for imports, and (b) to hold whatever working balances they wish at their overseas branches or subsidiaries. Foreign investment in Japan was also liberalised in two respects during the period under review. In September 1970 the number of Japanese industrial corporations in which foreign direct investment is allowed either without limit or up to 50 per cent. of the total capital was increased by some three hundred; and at the same time the maximum investment that non-residents are automatically permitted to make in non-restricted Japanese corporations through market purchases of securities was raised from 20 to just under 25 per cent. Finally, in May 1971 the foreign travel allowance for Japanese residents was increased from \$1,000 to \$3,000 per journey.

On the other hand, the size of Japan's external surplus has recently led the authorities to take certain steps to limit capital inflows. For the fiscal year beginning April 1971 it was decided that, in principle, permission would not be given for any issues of Japanese bonds on foreign capital markets in cases where the proceeds would be converted into yen. Then in May, when the inflows to Japan assumed a partly speculative character, foreign purchases of unquoted Japanese stocks and bonds were temporarily forbidden; Japanese banks were prohibited from either taking up foreign credits or guaranteeing loans taken up abroad by Japanese corporations; and the latter were asked, so far as possible, to avoid guaranteeing foreign borrowing by their overseas subsidiaries.

In South Vietnam a partial devaluation came into effect in October 1970. Since then a rate of Piastres 275 = US \$1, as compared with Piastres 118 = US \$1 previously, has applied to all export proceeds, certain imports, the conversion of allied troop pay and some other invisibles. The old rate still applies to most imports and to certain invisible transactions.

In December 1970 Indonesia took the final step to a unitary exchange rate by applying to commodity imports and related services paid for with aid provided by foreign governments the rate of Rupiahs 378 = US $1 used for all other transactions, instead of Rupiahs 326 = US $1, as previously.

In Latin America, Brazil continued to make small and frequent downward adjustments in the free exchange rate, which applies to most transactions. During the year to mid-May 1971 the rate was lowered nine times by a total of 12 per cent. from Cruz. 4.56 to Cruz. 5.19 = US $1, about the same rate of depreciation as in the preceding twelve months. In Chile, on the other hand, the rate of depreciation of the escudo was very much less during the period under review. On the official market, which is used for all trade transactions, the rate fell by 7 per cent. during the year to May 1971, as against 24 per cent. in the preceding twelve months. In fact, the depreciation of the escudo came to a halt in July 1970, since when the official and free market rates have been stable at Esc. 12.23 and 14.35 = US $1. This stability has, however, been achieved at the cost of a considerable fall in the exchange reserves. Furthermore, in September 1970 a 50 per cent. tax on purchases of currency for foreign travel was introduced, and in January 1971 restrictions were placed on the retention by residents of income earned in foreign exchange. In Argentina there was a 12½ per cent. devaluation in June 1970, the first for more than three years, from Pesos 3.5 to Pesos 4 = US $1. More recently a crawling peg system, similar to that used in Brazil, appears to have been introduced, as two small further adjustments of the rate were made in April and May 1971, bringing it to Pesos 4.12 = US $1. In Ecuador there was a 28 per cent. devaluation in August 1970, the par value declared to the International Monetary Fund being changed from Sucres 18 to Sucres 25 = US $1. At the same time the previous dual exchange rate system was unified. Very shortly afterwards, Ecuador accepted the obligations of Article VIII of the Fund's Articles of Agreement. In Uruguay, although there has been no change in either the official rate of exchange, which continues to be Pesos 250 = US $1, or in the virtually identical free market rate, the peso has depreciated very considerably on the "marché parallèle" as a result of domestic inflation. In April 1971 the authorities temporarily suspended all sales of exchange to residents, except those required to pay for perishable goods imports and very small amounts for foreign travel. This was followed in May by the introduction of what amounts to a multiple exchange rate system, involving a partial devaluation of the peso, under which residents must pay "commissions" varying from Pesos 50 to Pesos 100 per dollar on their purchases of exchange for a range of invisible transactions.

V. THE EURO-CURRENCY MARKET.

General developments. Despite the large repayment of funds to it by US banks, the Euro-currency market continued to expand quite rapidly in 1970. External assets of the banks of the eight reporting European countries in seven foreign currencies went up by $19.4 milliard and liabilities by $18.2 milliard. Net of duplication due to redeposits between reporting banks but including positions vis-à-vis non-bank residents, the outstanding amount of foreign currency credit channelled through the reporting European banks may be estimated to have increased from about $44 to 57 milliard. This rise of about 30 per cent. came on top of a nearly 50 per cent. expansion in 1969. The dollar component is estimated to have gone up from $37.5 to 46 milliard.

It might have been expected that, given last year's monetary ease in the United States, the Euro-currency market would, at the very least, have stopped expanding significantly or even that it would have actually shrunk in size. Neither of these things happened. Instead, the market not only found other outlets for the money being returned to it from the United States but also substantially increased its total lending. It was able to do this in large part because of the high level of domestic interest rates in countries outside the United States last year, principally in Europe. Thus, interest rate differentials between the United States and Europe continued to be an important factor in the market's growth, only with the demand for funds coming this time from Europe instead of, as in 1969, from the United States.

In 1969 the inflow of funds to the market had been larger than the offtake by banks in the United States; similarly, in 1970 new Euro-currency lending outside the United States was much larger than the amount returned to the market by US banks. This indicates clearly that there is not a fixed supply of funds available to the market, which moves from country to country according to shifts in the geographical demand for credit, but rather that the market is able to expand its own resources by attracting funds from various national financial markets to meet demand from whatever borrowers are prepared to pay the necessary prices.

On both the supply and the demand side, the sources of last year's growth of the market were different from what they had been in 1969. As regards supply, there were two main differences. One was that the share of currencies other than the dollar in the supply of new funds to the market increased quite considerably — on the basis of the gross figures — from 15 to a little over 30 per cent. To a large extent this increase was accounted for by Deutsche Mark, the uncovered yield on Euro-DM deposits having been on the average higher than in 1969. Moreover, in the dollar part of the market, whereas in 1969 the exceptionally high interest rates paid by Euro-banks had drawn an unusually large volume of non-bank money directly into the market, last year the supply of new funds came largely from banks. In particular, it included a substantial increase in the volume of funds held in the market by official monetary authorities in many parts of the world, owing to the combination of a very large rise in dollar reserves and the inability of the US money market to offer competitive rates, as it had done in 1969, for foreign official deposits.

On the demand side of the market, the outstanding feature of 1970 was that non-banks, particularly in Europe, replaced US banks as the most important group of borrowers. With generally tight credit conditions in Europe and the banks in most European countries restricted in their domestic lending activity by credit ceilings or higher marginal reserve requirements on foreign borrowing, there was for the first time in the market's history a very sharp increase in direct lending to non-bank corporations. The recourse of non-bank enterprises to Euro-currency borrowing, particularly in countries without exchange controls, constituted a threat to the effectiveness of domestic credit-restraint policy which could not always be averted through compensatory domestic monetary action. Furthermore, this widening of the Euro-banks' direct contacts with non-bank customers appears to have caused an increase in the extent of maturity transformation engendered by the Euro-currency market. Another aspect of the shift in demand for Euro-dollars away from banks in the United States was that, whereas in 1969 the market had increasingly been becoming an appendage of the US banking system, in 1970 the initiative to some extent passed from the foreign branches of US banks to the other banks in the market. Lastly, on the demand side also, the share of currencies other than the dollar in the market's growth increased considerably between 1969 and 1970, from 15 to almost 35 per cent.

Total positions. Following upon increases of $24.8 and 23 milliard in 1969, the external liabilities and assets in domestic and foreign currencies of the banks of the eight reporting European countries mounted by a further $22.6 and 21.1 milliard respectively in 1970. As in the preceding year, the bulk of this expansion occurred in foreign currencies, whereas domestic currency liabilities and assets went up by only $4.2 to 18.7 milliard and $1.2 to 9.7 milliard. The rise in external domestic currency assets was accounted for chiefly by Switzerland (+ $1.3 milliard) and that in liabilities by Switzerland (+ $1.6 milliard), Germany (+ $1.3 milliard), the United Kingdom (+ $0.6 milliard) and France (+ $0.4 milliard).

The increase in the reporting European banks' external liabilities in dollars slowed down from $19.3 milliard in 1969 to $12.5 milliard last year, and that in dollar assets from $17.2 to 12.7 milliard. The slight rise of $0.2 milliard in net assets is explained by the fact that Euro-currency placements by the Bank for International Settlements (BIS) are included in the assets of Swiss banks; without the BIS, there would have been an increase in net liabilities, reflecting switching out of dollars into other foreign currencies and dollar lending to residents. Not only the size but also the composition of the change in gross dollar assets and liabilities was quite different compared with 1969. Reflecting the shift in the main focus of Euro-dollar borrowing away from banks in the United States to European corporations, the increase in dollar claims on banks slowed down from $16.3 to 7 milliard, while claims on non-banks, which had accounted for only 5 per cent. of the increase in total dollar claims in 1969, rose six times as much as in 1969, viz. by $5.8 milliard. On the sources side the picture was rather the reverse. Dollar liabilities to non-banks, which had gone up by $4.2 milliard in 1969 as a result of the very high interest rates and the weakness of capital markets, edged up by only $0.8 milliard.

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

End of	Dollars vis-à-vis banks	Dollars vis-à-vis non-banks	Dollars Total	Other foreign currencies* vis-à-vis banks	Other foreign currencies* vis-à-vis non-banks	Other foreign currencies* Total*	of which Deutsche Mark	of which Swiss francs	of which Pounds sterling
	in millions of US dollars								
					Liabilities				
1966 December .	10,640	4,130	14,770	3,060	510	3,570	970	1,220	710
1967 June . . .	10,840	4,090	14,930	3,610	510	4,120	1,470	1,300	950
1967 December .	13,440	4,680	18,120	3,680	470	4,150	1,670	1,400	800
1968 June . . .	15,990	6,390	22,380	4,890	700	5,590	2,160	2,030	1,020
1968 December .	20,630	6,240	26,870	5,620	1,040	6,660	3,010	2,290	600
1969 March . . .	22,280	7,600	29,880	6,490	930	7,420	3,060	2,800	900
1969 June . . .	29,270	8,690	37,960	7,790	1,320	9,110	4,260	3,290	910
1969 September.	31,580	9,960	41,540	8,600	1,340	9,940	4,800	3,790	760
1969 December .	35,740	10,460	46,200	8,850	1,320	10,170	4,640	4,030	810
1970 March . . .	34,950	11,100	46,050	9,660	1,370	11,030	4,420	4,970	970
1970 June . . .	38,440	11,000	49,440	11,040	1,660	12,700	5,550	5,350	950
1970 September.	39,460	10,770	50,230	12,410	2,210	14,620	6,830	5,740	940
1970 December .	47,460	11,240	58,700	13,550	2,320	15,870	8,080	5,720	940
					Assets				
1966 December .	13,970	2,100	16,070	3,150	690	3,840	1,420	930	800
1967 June . . .	13,930	2,650	16,580	3,670	810	4,480	1,670	830	1,340
1967 December .	16,460	3,430	19,890	3,720	850	4,570	2,060	1,110	870
1968 June . . .	21,240	4,320	25,560	4,200	1,340	5,540	2,730	1,570	600
1968 December .	25,280	5,150	30,430	5,480	1,500	6,980	3,920	1,820	610
1969 March . . .	28,420	5,230	33,650	5,380	1,670	7,050	4,020	1,850	590
1969 June . . .	36,340	5,940	42,280	6,700	2,030	8,730	5,380	2,010	670
1969 September.	38,710	6,110	44,820	7,850	2,520	10,370	6,980	2,240	630
1969 December .	41,540	6,090	47,630	8,030	2,160	10,190	5,990	2,980	580
1970 March . . .	40,210	6,760	46,970	8,820	2,470	11,290	6,270	3,490	880
1970 June . . .	43,470	8,560	52,030	9,560	2,980	12,540	6,850	3,930	710
1970 September.	43,040	9,890	52,930	10,780	3,760	14,540	8,140	4,540	640
1970 December .	48,520	11,850	60,370	12,410	4,480	16,890	10,110	5,080	610
					Net position				
1966 December .	3,330	−2,030	1,300	90	180	270	450	− 290	90
1967 June . . .	3,090	−1,440	1,650	60	300	360	200	− 470	390
1967 December .	3,020	−1,250	1,770	40	380	420	390	− 290	70
1968 June . . .	5,250	−2,070	3,180	− 690	640	− 50	550	− 460	− 420
1968 December .	4,650	−1,090	3,560	− 140	460	320	910	− 470	− 190
1969 March . . .	6,140	−2,370	3,770	−1,110	740	− 370	960	− 950	− 310
1969 June . . .	7,070	−2,750	4,320	−1,090	710	− 380	1,120	−1,280	− 240
1969 September.	7,130	−3,850	3,280	− 750	1,180	430	2,180	−1,550	− 130
1969 December .	5,800	−4,370	1,430	− 820	840	20	1,350	−1,050	− 230
1970 March . . .	5,260	−4,340	920	− 840	1,100	260	1,850	−1,480	− 90
1970 June . . .	5,030	−2,440	2,590	−1,480	1,320	− 160	1,300	−1,420	− 240
1970 September.	3,580	− 880	2,700	−1,630	1,550	− 80	1,310	−1,200	− 300
1970 December .	1,060	610	1,670	−1,140	2,160	1,020	2,030	− 640	− 330

* Including, in addition to the currencies given separately, French francs, guilders and lire.

In contrast to developments in the dollar part of the market, the expansion in the banks' external positions in the other six reported currencies was much larger than in 1969. After increases of \$3.5 and 3.2 milliard in 1969, liabilities and assets went up by \$5.7 and 6.7 milliard respectively. Liabilities to non-banks rose by \$1 to 2.3 milliard and claims on non-banks more than doubled to \$4.5 milliard. The most important single factor behind this development was lending to Germany. In fact, the Deutsche Mark alone accounted for about 60 per cent. of the expansion in assets and liabilities in foreign currencies other than dollars, and the Swiss franc for a further 30 per cent. Sterling's share in total foreign currency positions continued to decline.

Individual reporting countries. Not surprisingly, banks in the *United Kingdom* were most affected by the market's slower rate of growth last year. Their external foreign currency assets increased by $6.4 milliard, after a rise of $11.8 milliard in 1969. The effects of the repayments by US banks were, of course, most particularly felt by their London offices, whose new lending in foreign currencies declined between the two years from $7.8 to 1.3 milliard. The external foreign currency assets of other banks in the United Kingdom, on the other hand, grew faster than in 1969, by $5.1 milliard as against $4 milliard. The difference in the rôle of US bank offices in London between the two years can be seen from the fact that, whereas in 1969 they had solicited funds from other banks in the United Kingdom for channelling to their head offices, in 1970 they employed a major part of the funds they obtained from abroad for lending to other UK banks. As a result their external net asset position, after increasing by $0.8 milliard to $1.7 milliard in 1969, was eliminated in 1970.

Another striking feature was the sharp rise in direct foreign currency lending by UK banks to non-banks abroad. After showing very little increase in 1969, assets vis-à-vis non-banks doubled from $5.6 to 11.3 milliard. Because of the repayments by banks in the United States, claims on banks edged up by only $0.8 milliard.

The slow-down in the growth of the UK banks' foreign assets was entirely accounted for by assets in dollars, which after a $10.3 milliard increase in 1969 went up by only $4 milliard. The slow-down in the growth of dollar liabilities, however, was much less pronounced. As a result the UK banks' net external debtor position in dollars rose from $0.5 to 2.2 milliard; $1 milliard of this increase was used for net dollar lending to non-bank residents, and $0.6 milliard seems to have been converted into the other main Euro-currencies. Switching into sterling by the UK banks, on the other hand, appears to have been very slight. In order to underpin domestic credit restraint and to avoid building up too large a volume of short-term indebtedness in foreign currencies, Euro-currency borrowing by UK residents for domestic use was limited in January 1971 to periods of five years and upwards.

In *Germany,* despite the introduction as from April 1970 of an additional 30 per cent. reserve requirement on increases in their foreign liabilities, the banks' net external indebtedness in domestic and foreign currency rose from $2 to 3.7 milliard last year. $1.4 milliard of this expansion was in Deutsche Mark and only partly reflected Euro-currency borrowing. In fact, a substantial proportion represented the increased use of the Deutsche Mark for reserve purposes. Thus, the German banks' liabilities to foreign monetary authorities rose by $0.8 milliard in 1970, the bulk of this increase apparently having been in Deutsche Mark. Net external liabilities in foreign currencies went up by only $0.3 to 0.6 milliard. By far the greater part of German Euro-currency borrowing in 1970 was in the non-bank sector and is, of course, not reflected in these figures.

The external position of banks in *Switzerland,* including the Euro-currency position of the BIS, continued to expand quite strongly throughout 1970. Their

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]		
		Liabilities	Assets	Net	Liabilities	Assets	Net
		In millions of US dollars					
Belgium-Luxemburg	1969 December	2,110	2,410	300	1,890	1,180	— 710
	1970 March	2,090	2,390	300	1,950	1,340	— 610
	June	2,600	2,800	200	2,420	1,970	— 450
	September	2,760	2,760	—	2,760	2,400	— 360
	December	3,730	3,330	— 400	3,020	2,900	— 120
France	1969 December	5,310	5,430	120	2,180	1,540	— 640
	1970 March	5,150	5,160	10	2,150	1,530	— 620
	June	5,100	5,240	140	2,160	1,710	— 450
	September	5,410	5,200	— 210	2,350	1,980	— 370
	December	6,650	6,010	— 640	2,410	2,120	— 290
Germany	1969 December	2,000	1,670	— 330	90	120	30
	1970 March	2,030	1,670	— 360	150	160	10
	June	1,660	1,480	— 180	140	160	20
	September	1,980	1,670	— 310	180	190	10
	December	2,690	2,050	— 640	180	190	10
Italy	1969 December	4,650	4,780	130	1,640	1,620	— 20
	1970 March	4,110	4,160	50	1,540	1,770	230
	June	4,410	4,330	— 80	1,550	1,880	330
	September	4,630	4,620	— 10	1,930	2,170	240
	December	6,930	6,650	— 280	2,440	2,670	230
Netherlands	1969 December	1,590	2,140	550	980	700	— 280
	1970 March	1,760	2,240	480	1,260	930	— 330
	June	1,960	2,630	670	1,490	1,060	— 430
	September	1,840	2,820	980	1,910	1,270	— 640
	December	2,090	2,970	880	1,930	1,300	— 630
Sweden	1969 December	300	420	120	150	220	70
	1970 March	300	400	100	230	290	60
	June	340	460	120	240	300	60
	September	440	580	140	160	210	50
	December	320	520	200	150	200	50
Switzerland[2]	1969 December	4,460	5,520	1,060	530	1,580	1,050
	1970 March	4,560	5,640	1,080	550	1,630	1,080
	June	4,820	7,240	2,420	670	1,320	650
	September	4,580	7,600	3,020	880	1,590	710
	December	4,890	9,590	4,700	1,100	1,890	790
United Kingdom	1969 December	25,780	25,260	— 520	2,710	3,230	520
	1970 March	26,050	25,310	— 740	3,200	3,640	440
	June	28,550	27,850	— 700	4,030	4,140	110
	September	28,590	27,680	— 910	4,450	4,730	280
	December	31,400	29,250	—2,150	4,640	5,620	980
Total	1969 December	46,200	47,630	1,430	10,170	10,190	20
	1970 March	46,050	46,970	920	11,030	11,290	260
	June	49,440	52,030	2,590	12,700	12,540	— 160
	September	50,230	52,930	2,700	14,620	14,540	— 80
	December	58,700	60,370	1,670	15,870	16,890	1,020
Canada	1969 December	4,240	6,170	1,930	90[3]	140[3]	50
	1970 March	4,360	6,090	1,730	100[3]	130[3]	30
	June	4,850	6,450	1,600	140[3]	130[3]	— 10
	September	5,040	6,750	1,710	100[3]	160[3]	60
	December	5,370	7,430	2,060	130[3]	170[3]	40
Japan	1969 December	3,810	5,470	1,660	330	360	30
	1970 March	3,880	5,300	1,420	300	340	40
	June	3,940	5,560	1,620	400	330	— 70
	September	3,950	6,250	2,300	310	350	40
	December	4,670	6,870	2,200	310	410	100

[1] Deutsche Mark, French francs, guilders, lire, pounds sterling, Swiss francs. [2] Including Euro-currency assets and liabilities of the BIS. [3] All other currencies, but mainly sterling.

external liabilities in Swiss francs rose by $1.6 milliard and those in foreign currencies by $1.1 milliard, while their assets went up by $1.3 and 4.6 milliard respectively.

In *France* the banks' net external liabilities rose by $0.7 to 1.8 milliard, half of the increase being in domestic currency. In dollars alone their net external position shifted from $0.1 milliard of assets to $0.6 milliard of liabilities, while at the same time they reduced their dollar deposits with the Bank of France by $0.6 milliard. On the other hand, the French banks' net external liabilities in the other reported foreign currencies declined by $0.3 milliard.

Banks in *Belgium-Luxemburg* recorded the largest percentage increase — 70 per cent. — in external foreign currency assets and liabilities. Their overall net position, however, showed relatively little change. Their net external dollar position shifted from $0.3 milliard of assets to $0.4 milliard of liabilities, but their net indebtedness in other foreign currencies declined by $0.6 milliard. Claims on foreign non-banks jumped from $0.6 to 2.4 milliard, mainly in dollars and Deutsche Mark.

In *Italy* nearly the whole of the $3.1 and 2.9 milliard increases in the banks' external foreign currency liabilities and assets occurred during the fourth quarter of 1970; and a substantial part of these fourth-quarter changes seems to have been associated with end-year operations. Foreign currency lending to residents edged up by only $0.2 to 2 milliard.

Sources and uses. The tables on pages 164 and 165 indicate the origins and destinations of Euro-currency flows. The differences in the coverage and conception of the two tables were described in last year's Annual Report (pages 155 and 157). A new feature this year is the inclusion in the table on page 164 of an estimate for the total of all reported currencies combined. Partly because the data for other currencies are less complete than those for the dollar, their inclusion complicates the task of estimating the size of the market and inevitably widens the inherent margin of error. In view of the quantitative importance of Euro-DM and Euro-Swiss franc flows in 1970, however, a break-down for the dollar alone would not have been wholly satisfactory.

Three points are worth stressing about the figures in the table on page 164. Firstly, they are arrived at by defining all liabilities and assets vis-à-vis the outside area as original sources and ultimate uses of Euro-currency funds. Thus, there is no netting-out when funds are lent to outside-area banks and redeposited by them with banks inside the reporting area. Secondly, the figures in the dollar part of the table, under both sources and uses, include all Euro-dollar credit flows, even if they show up in dollars on one side only of the reporting banks' balance sheets. Thus, funds received in the form of dollars but switched by the banks into Deutsche Mark would also be included on the dollar uses side, under "banks".

Thirdly, it is worth emphasising that, contrary to what is sometimes supposed, the size of the dollar component of the Euro-currency market is not limited by the total of US banks' liquid liabilities to non-residents. In fact, at the end of 1970 the former happened to be $46 milliard and the latter $42.7 milliard. Moreover, the figure of $42.7 milliard includes substantial dollar assets held directly in the United States by non-residents other than the Euro-banks, in particular by foreign monetary authorities. The Euro-currency market is essentially a vehicle for international capital flows. The dollar part of the market, as measured in the table on page 164, represents simply the cumulative amount of such flows that have taken place in dollars through the banks of the eight reporting European countries. The fact that these flows are denominated in dollars does not make them any different from other capital flows as regards their relation to the external liquid liabilities reported by banks in the United States. In particular, capital flows in dollars between countries other than the United States — which accounted for the greater part of Euro-dollar credit outstanding at the end of 1970 — do not, by and large, have any effect on the volume of US liquid liabilities, but only on their country distribution.

Net of the double-counting that ensues when credit flows pass through more than one reporting bank on their way from the original suppliers to the ultimate users, the total volume of Euro-currency credit channelled through the banks of the eight reporting European countries is estimated to have expanded from about $44 milliard at the end of 1969 to roughly $57 milliard a year later. This increase of $13 milliard occurred despite a decline of $3.7 milliard in claims on the United States. Repayments by US banks to their foreign branches during the year, at $5.1 milliard, were $1.4 milliard larger than this drop in reporting banks' total claims on US residents; and it is probable that the difference between the two changes partly reflects Euro-dollar borrowing by US non-banks. This appears to be confirmed by the US balance-of-payments statistics, which show a $1.1 milliard increase in US non-bank liabilities towards the United Kingdom.

The reduction in assets vis-à-vis the United States was more than offset by an expansion in claims on the rest of the outside area of $7 milliard — about two and a half times as much as in 1969, when the demand from US banks had been such as to limit what other borrowers could obtain from the market. Over 90 per cent. of this $7 milliard rise was denominated in dollars and about 60 per cent. occurred during the second half of the year. Moreover, it appears that a substantial part of the increase represented lending to non-banks. Claims on "Other western Europe" went up by $1.3 milliard and those on Canada and Latin America by $1.0 milliard in each case. Other important takers were Japan ($0.9 milliard) and eastern Europe ($0.6 milliard). At $1.9 milliard, the largest increase was vis-à-vis "Other", for which a further breakdown is not available but which includes the Bahamas and Bermuda.

Inside-area claims rose by $9.7 milliard, about half of which seems to have been in currencies other than the dollar, notably Deutsche Mark (the $10 milliard advance in intra-area dollar claims shown in the table on page 165 includes substantial double-counting). Moreover, $7 milliard of this increase represented direct lending to non-banks and in large measure reflected Euro-currency borrowing by German and British private firms and by Italian semi-public corporations. The estimated $2.7 milliard growth in "bank" uses of Euro-currency funds was largely due to inward switching of Euro-dollars and to the taking-up by German banks of DM funds from the Euro-currency market.

More details of inside-area flows can be seen from the table on page 165. This shows increases of $1.3 milliard and $3.1 milliard in the reporting banks' assets vis-à-vis Germany in dollars and other currencies respectively. Claims on the United Kingdom

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

Country or area	Sources		Uses		Net position[1]	
	End-1969	End-1970	End-1969	End-1970	End-1969	End-1970
	in milliards of US dollars					
	All Euro-currencies					
Reporting European area	22.3	28.5	15.2	24.9	— 7.1	— 3.6
of which: Banks[2]	*10.3*	*14.5*	*7.1*	*9.8*	— *3.2*	— *4.7*
Non-banks	*12.0*	*14.0*	*8.1*	*15.1*	— *3.9*	+ *1.1*
United States	4.1	4.5	16.8	13.1	+ 12.7	+ 8.6
Rest of the world	17.6	24.0	12.0	19.0	— 5.6	— 5.0
Total	44.0	57.0	44.0	57.0	—	—
	Dollars					
Reporting European area	18.3	21.0	11.6	17.4	— 6.7	— 3.6
of which: Banks[3]	*8.5*	*11.3*	*6.0*	*7.3*	— *2.5*	— *4.0*
Non-banks	*9.8*	*9.7*	*5.6*	*10.1*	— *4.2*	+ *0.4*
United States	3.8	4.2	16.5	12.7	+ 12.7	+ 8.5
Rest of the world	15.4	20.8	9.4	15.9	— 6.0	— 4.9
Total	37.5	46.0	37.5	46.0	—	—

[1] A minus sign indicates that the country or area in question is a net supplier of Euro-currency funds, whereas a plus sign indicates that it is a net user.
[2] Includes: (a) under "Sources", deposits by official monetary institutions of the reporting area, the banks' conversions from domestic into foreign currencies and foreign currency funds obtained by the reporting banks from the banks in the country of issue of the currency in question (such as funds received in Deutsche Mark from German banks);
(b) under "Uses", the banks' conversions from foreign currencies into domestic currencies and foreign currency funds supplied by the reporting banks to the commercial banks of the country of issue of the currency in question (such as DM funds deposited with German banks).
[3] Includes: (a) under "Sources", deposits by monetary institutions of the reporting area and the banks' conversions of domestic or third-currency funds into dollars;
(b) under "Uses", funds converted from dollars into domestic or third currencies.

and Italy went up by $3.6 and 2.8 milliard respectively, but these figures should be viewed in the light of the $1.6 and 1.4 milliard increases in liabilities vis-à-vis the two countries.

On the sources side, about $6.2 milliard out of the estimated $13 milliard growth in Euro-currency credit outstanding seems to have been supplied from within the reporting European area. The greater part of this amount, about $4 milliard, came from bank sources. Liabilities to non-banks within the reporting area, the rapid expansion of which had been a prominent feature of Euro-currency developments in 1969, went up by the relatively modest figure of $2 milliard in 1970 — apparently all in currencies other than the dollar. Outside the reporting area, liabilities to the United States rose by only $0.4 milliard, but funds supplied from the rest of the world increased by $6.4 milliard, which was only $0.8 milliard less than in 1969. Liabilities to "Other western Europe" went up by $1.9 to 5.1 milliard, and those to Latin America, Canada and the Middle East by $1.4, 0.9 and 0.8 milliard respectively.

A substantial part of the increase in bank funds coming from inside the reporting area, as well as of the funds received from the outside area (excluding the United States), reflected increased Euro-dollar holdings, either direct or indirect, of official monetary institutions. In 1969, with deposits of foreign official agencies exempt from the Regulation Q ceilings, banks in the United States had been able to offer such agencies interest rates that were competitive with those quoted for Euro-dollar deposits. Indeed,

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

Positions vis-à-vis	December 1969			June 1970			December 1970		
	Dollars	Other currencies*	Total	Dollars	Other currencies*	Total	Dollars	Other currencies*	Total
	in millions of US dollars								
					Liabilities				
Outside area									
Other western Europe	2,790	410	3,200	2,810	480	3,290	4,470	640	5,110
Eastern Europe	1,030	370	1,400	850	470	1,320	1,020	620	1,640
Canada	2,940	120	3,060	3,410	70	3,480	3,780	140	3,920
Japan	400	30	430	340	30	370	550	30	580
Latin America	2,550	180	2,730	2,940	240	3,180	3,670	440	4,110
Middle East	2,000	270	2,270	2,440	430	2,870	2,680	440	3,120
Other	3,690	880	4,570	4,360	740	5,100	4,670	860	5,530
Total	15,400	2,260	17,660	17,150	2,460	19,610	20,840	3,170	24,010
United States	4,550	260	4,810	5,040	150	5,190	5,000	240	5,240
Total outside area	19,950	2,520	22,470	22,190	2,610	24,800	25,840	3,410	29,250
Inside area									
Belgium	2,320	440	2,760	2,170	630	2,800	2,050	930	2,980
France	3,470	700	4,170	2,990	800	3,790	3,940	1,150	5,090
Germany	860	1,050	1,910	1,110	1,430	2,540	1,470	1,660	3,130
Italy	4,230	940	5,170	3,350	1,140	4,490	5,000	1,560	6,560
Netherlands	1,780	620	2,400	2,190	790	2,980	2,500	860	3,360
Sweden	250	90	340	300	110	410	360	80	440
Switzerland	7,910	3,490	11,400	9,250	4,540	13,790	10,970	5,510	16,480
United Kingdom	4,770	670	5,440	5,160	940	6,100	5,990	1,070	7,060
Total inside area	25,590	8,000	33,590	26,520	10,380	36,900	32,280	12,820	45,100
Unallocated	660	—	660	730	—	730	580	—	580
Grand total	46,200	10,520	56,720	49,440	12,990	62,430	58,700	16,230	74,930
					Assets				
Outside area									
Other western Europe	1,610	580	2,190	1,880	650	2,530	2,600	850	3,450
Eastern Europe	1,000	530	1,530	1,290	560	1,850	1,650	500	2,150
Canada	1,360	110	1,470	1,670	140	1,810	2,320	160	2,480
Japan	1,490	210	1,700	1,890	230	2,120	2,320	230	2,550
Latin America	1,440	660	2,100	1,970	680	2,650	2,470	680	3,150
Middle East	460	80	540	450	70	520	810	80	890
Other	2,120	370	2,490	3,060	420	3,480	3,780	600	4,380
Total	9,480	2,540	12,020	12,210	2,750	14,960	15,950	3,100	19,050
United States	17,750	260	18,010	17,560	280	17,840	13,990	350	14,340
Total outside area	27,230	2,800	30,030	29,770	3,030	32,800	29,940	3,450	33,390
Inside area									
Belgium	1,360	990	2,350	1,660	1,160	2,820	2,260	1,410	3,670
France	3,300	930	4,230	3,120	1,040	4,160	4,680	1,200	5,880
Germany	1,610	2,280	3,890	1,730	3,430	5,160	2,870	5,410	8,280
Italy	3,060	740	3,800	3,160	700	3,860	5,510	1,070	6,580
Netherlands	1,050	540	1,590	1,270	620	1,890	1,610	1,000	2,610
Sweden	270	240	510	350	250	600	480	250	730
Switzerland	1,990	900	2,890	2,350	980	3,330	2,500	1,550	4,050
United Kingdom	7,480	1,120	8,600	8,610	1,690	10,300	10,250	1,970	12,220
Total inside area	20,120	7,740	27,860	22,250	9,870	32,120	30,160	13,860	44,020
Unallocated	280	—	280	10	—	10	270	—	270
Grand total	47,630	10,540	58,170	52,030	12,900	64,930	60,370	17,310	77,680

* Deutsche Mark, French francs, guilders, lire, pounds sterling, Swiss francs. For the UK banks the positions in all foreign currencies are included; this accounts for the fact that the totals in this table are slightly larger than those given in the tables on pages 159 and 161.

following the introduction of a 10 per cent. marginal reserve requirement on their Euro-dollar borrowings in September 1969, banks in the United States could afford to pay higher rates for official deposits (which were subject to a maximum reserve requirement of 6 per cent.) than their branches operating in the Euro-dollar market.

In 1970, however, with the gradual easing of US monetary policy and the partial suspension of the Regulation Q ceilings in June, the US banks regained normal access to domestic funds, while at the same time demand from European sources kept Euro-dollar rates above comparable rates in the United States. As a result, banks in the United States were no longer interested in offering foreign monetary authorities deposit rates competitive with those quoted in the Euro-dollar market.

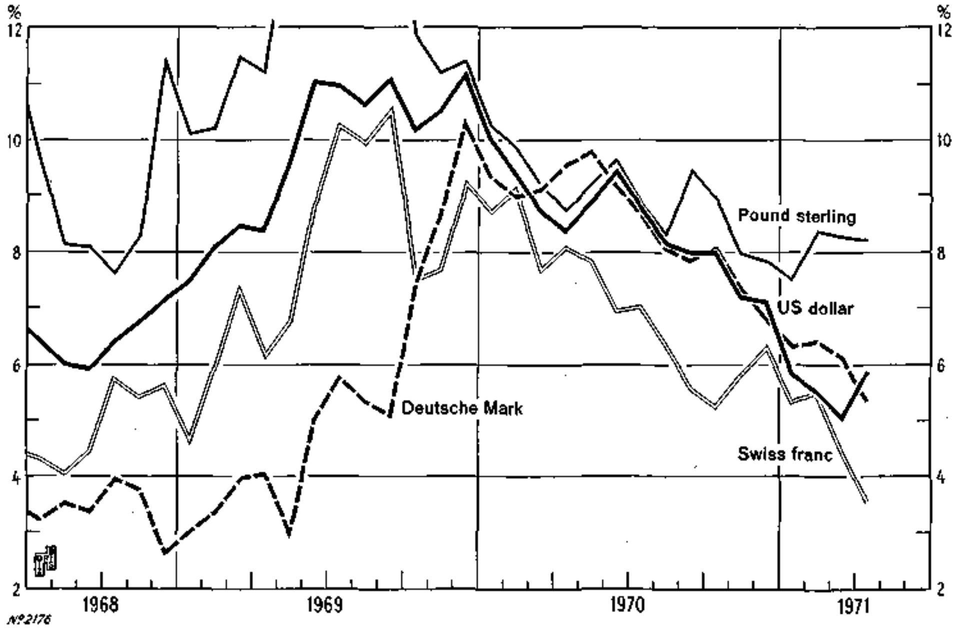
It may be added in this connection that it is not surprising that monetary authorities turned towards the Euro-dollar market last year. For many of them, especially those in less-developed countries, it is permanently a matter of some interest to obtain a favourable yield on their exchange reserves. Central banks are responsible for conserving the value of their countries' official external monetary assets and many smaller central banks are dependent on the income from their exchange reserves. In times of mounting inflation, the preservation of this value means securing a reasonable return on them. Altogether, the increase in official placements in the Euro-currency market during 1970 may have been not much under $7 milliard.

On a net basis, the main feature of Euro-currency flows last year was a $4.1 milliard reflux of funds from the United States, about $3.5 milliard of which may be estimated to have gone to the reporting European area and $0.6 milliard to the rest of the world. This latter amount includes, among other flows, $0.7 and 0.4 milliard of net new borrowing by Japan and eastern Europe respectively, and $0.6 and 0.5 milliard of net new lending by "Other western Europe" and the Middle East.

Interest rate developments. The period under review saw the reversal of the steep rise in interest rates that had carried the Euro-currency rates to unprecedented peaks in 1969. In the first quarter of 1970 the initial signs of monetary relaxation in the United States and the reversal of end-year operations led to a considerable easing in market conditions. As a result of the upward adjustment of Regulation Q ceilings in the second half of January and a decline in US money-market rates, it gradually became easier for US banks to raise funds on the domestic market. Thus, between 14th January and 22nd April they reduced their Euro-dollar indebtedness from $14 to 11.5 milliard and the three-month Euro-dollar rate dropped from 11⅝ per cent. around the middle of December 1969 to 8 per cent. in the middle of April 1970.

In the second half of April, however, an unexpected deterioration in the climate of the US money and capital markets led to a renewed tightening of conditions on the Euro-currency market. The US banks' takings from their foreign branches began to edge up again, while at the same time there was a strong European demand for Euro-currency funds, which was partly due to large-scale borrowing by Italian semi-public enterprises. The three-month Euro-dollar rate went up again to over 9½ per cent. in June and the growth of the market accelerated sharply, the external foreign currency assets and liabilities of the reporting European banks rising by $6.3 and 5.1 milliard respectively during the second quarter.

Interbank rates on three-month Euro-currency deposits.
Monthly averages, in percentages per annum.



On 24th June the US authorities suspended the Regulation Q ceilings on time deposits of \$100,000 or more with maturities of 30–89 days. This meant that US banks regained freer access to domestic funds and therefore that their recourse to outside funds again became subject primarily to cost rather than availability considerations. With comparable Euro-dollar rates showing in the second half of June a premium of about 1½ per cent. over rates on certificates of deposit and with borrowing above the reserve-free ceilings being subject to much higher reserve requirements, the US banks reduced their indebtedness to their foreign branches by \$1.8 to 10.3 milliard between 24th June and 5th August while at the same time obtaining \$5.5 milliard on the domestic market by means of issues of new CDs. The three-month Euro-dollar rate eased to about 8 per cent. around the middle of August, and would have fallen further but for the very strong demand for funds by European (notably German) non-bank borrowers.

By August most banks had reached their reserve-free borrowing ceiling, and in view of the still somewhat uncertain US credit-market outlook were hesitant to go below it. Moreover, the drop in Euro-dollar rates had considerably reduced the cost advantage of CD funds. Towards the end of September, however, the downward trend of US interest rates became more pronounced and the US banks began to whittle away quite rapidly their reserve-free quotas. In late November the US authorities attempted to slow down these repayments by doubling from 10 to 20 per cent. the reserve requirement on any borrowing beyond the reserve-free ceiling (this ceiling being automatically adjusted downwards if a bank reduces its Euro-dollar indebtedness below its reserve-free base as determined by the level at which this indebtedness stood in the November 1970 reserve-computation period). Notwithstanding this measure, banks continued to reduce their liabilities to foreign branches, which fell from $10.5 to 7.9 milliard between mid-September 1970 and mid-January 1971, while at the same time their domestic CD liabilities rose from $21.1 to 27 milliard.

Despite the large reflux of funds from the United States, Euro-dollar rates declined much less than US money-market rates in the fourth quarter. This was due partly to year-end influences and partly to continued strong non-bank borrowing (notably in Germany and the United Kingdom). The growth of the Euro-currency market accelerated again during the quarter. In fact, at $8.5 and 7.4 milliard respectively, the increases in the reporting European banks' external dollar liabilities and assets were the second largest yet recorded in any quarterly period, although these figures are of course inflated by year-end factors.

One salient feature of the Euro-currency market in 1970 was the absence of the wide spreads between rates for the various currencies which had characterised most of 1969. In the first nine months of that year, for example, three-month DM deposits had yielded 5 percentage points less than dollar deposits and three-month sterling deposits at times nearly 10 percentage points more. These differentials had narrowed very sharply with the return of confidence to the exchange markets following the revaluation of the Deutsche Mark, and in 1970 the different rates stayed much closer to each other. With the shift in the focus of demand for Euro-currency funds away from the United States to Germany, rates on three-month DM deposits were on average 3 percentage points higher than in 1969 and at times they were above the corresponding dollar rates. This helps to explain the extremely rapid growth of Euro-DM deposits in 1970.

The downward movement of US money-market rates accelerated again in early 1971, thus further strengthening the incentive for US banks to repay Euro-dollars. In fact, between the middle of January and the middle of May they reduced their indebtedness to their foreign branches from $7.9 to 1.6 milliard. In order to mitigate the international impact of these repayments, the US authorities began to pull back some of the funds in question to the United States by offering the banks' foreign branches special paper which could be counted by the US head offices towards the maintenance of their reserve-free ceilings. Thus $1.0 and 0.5 milliard of special paper issued by the US Export-Import Bank were taken up by the foreign branches in January and March respectively, and another $1.5 and 0.5 milliard of paper issued by the US Treasury were taken up in April and May respectively. This rechannelling of funds of course moderated the downward pressure exerted both on the volume of the market and on Euro-dollar rates by the US banks' repayments, and the premium of three-month Euro-dollar rates over corresponding CD rates in the United States widened from 0.8 per cent. in the middle of January to well over 1.5 per cent. in the first half of April. The size of this premium must itself have been an important factor influencing the volume of the US banks' repayments.

The three-month dollar rate declined from somewhat over 6 per cent. in early January to 5 per cent. in the first three weeks of March. In April the efforts made by the US monetary authorities to put the emphasis of monetary ease on long-term interest rates, and to push up short-term rates in the interest of the international position of the dollar, began to be reflected in Euro-dollar rates, which went up again to 6¼ per cent. at the end of the month. And in early May the turmoil in the exchange markets did not leave the Euro-currency field untouched. The prospect of parity changes led both to some withdrawals of funds from the market and to a strong demand for conversion into the currencies regarded as candidates for revaluation. As could be expected, the tensions were particularly strong in the short-term field and the call-money rate was pushed up from about 5 per cent. in April to a peak of over 10 per cent. on 6th May. The three-month rate, while continuing on an upward path, was also subject to pronounced fluctuations. It jumped to 7¾ per cent. at the height of the currency crisis in early May, receded to a low of 6¾ per cent. in the second half of that month, and, partly under the influence of further uncertainty about the Deutsche Mark, touched a peak of 8¼ per cent. on 2nd June.

Despite the reversal of end-year operations, US repayments and the imposition of restraints by the UK authorities on foreign currency borrowing by non-bank residents, the volume of Euro-currency credit seems to have been well maintained in the first quarter of 1971. There was apparently continued strong demand for Euro-currency funds from non-bank borrowers, particularly in Germany. And, in view of their large premium over comparable money-market rates in the United States, the decline in Euro-dollar rates apparently did not lead to major withdrawals of funds from the market. To the extent that some withdrawals may nevertheless have occurred, they seem to have been more than offset by the expansionary effect of the very large first-quarter deficit in the US balance of payments.

VI. THE EUROPEAN MONETARY AGREEMENT.

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

Review of the Agreement.

Following a comprehensive review in 1968, the Agreement was renewed unchanged for a further three-year period until 31st December 1971, although some minor technical amendments were made to the Directives for its application. While the Agreement has been kept under review, no subsequent changes have been made to it or to the Directives. In July 1970, however, the Board of Management, under its power to take decisions relating to the execution of multilateral settlements, provided for certain procedural measures connected with the working of the exchange rate guarantee. A further general assessment of the Agreement is currently being carried out to decide on its future after 31st December 1971.

Operations under the Agreement.

European Fund. At the end of March 1970 the total of credits outstanding was \$115 million.* Of this amount, \$100 million represented credits to Turkey and \$15 million a credit to Greece.

On 5th February 1971, the due date and value date for multilateral settlements for January, Greece repaid \$15 million, being the final instalment on a credit of \$30 million granted in February 1966.

In February 1970 the Turkish authorities requested the postponement of repayments of the ninth and tenth credits amounting to \$40 million due on 30th April 1970 and of the first instalment, of \$5 million, under the seventh credit due on 31st May 1970. In view of the exceptional circumstances — the Turkish Government had resigned after its budget proposals had failed to gain acceptance in Parliament — the Council decided, on the recommendation of the Board of Management, to postpone

* 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.

the repayments until 31st July 1970. Subsequently, in order to give the new government time to devise and apply appropriate measures to remedy the balance-of-payments situation, the repayments were further postponed until 30th October 1970.

On 29th May and 29th July 1970, the due dates, Turkey repaid the eighth and ninth instalments, each of $5 million, under the sixth credit.

On 10th August 1970 the Turkish lira was devalued by 40 per cent. and an economic stabilisation programme was brought into force. This provided for the abolition of the existing multiple exchange rate system, more effective central-bank

EMA: Utilisation of credits granted from the European Fund.

At value date for settlements for month	Greece		Iceland		Spain		Turkey		Totals		
	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Available and undrawn	Drawings outstanding	Total credit granted
	in millions of units of account										
1959											
February	15.0	—	—	—	—	—	21.5	—	36.5	—	36.5
December. . . .	—	—	—	—	51.0	24.0	0.5	21.0	51.5	45.0	96.5
1960											
December. . . .	—	—	5.0	7.0	76.0	24.0	15.0	21.5	96.0	52.5	148.5
1961											
December. . . .	—	—	7.0	5.0	—	—	—	50.0	7.0	55.0	62.0
1962											
December. . . .	—	—	5.0	—	—	—	—	80.0	5.0	80.0	85.0
1963											
December. . . .	—	—	—	—	—	—	—	95.0	—	95.0	95.0
1964											
December. . . .	—	—	—	—	—	—	—	105.0	—	105.0	105.0
1965											
December. . . .	—	—	—	—	—	—	—	90.0	—	90.0	90.0
1966											
December. . . .	—	30.0	—	—	—	—	—	80.0	—	110.0	110.0
1967											
December. . . .	—	30.0	—	—	—	—	—	95.0	—	125.0	125.0
1968											
December. . . .	—	30.0	—	5.0	—	—	—	110.0	—	145.0	145.0
1969											
January.	—	25.0	—	5.0	—	—	—	110.0	—	140.0	140.0
March	—	25.0	—	5.0	—	—	—	105.0	—	135.0	135.0
April	—	25.0	—	—	—	—	—	105.0	—	130.0	130.0
1970											
January.	—	15.0	—	—	—	—	—	105.0	—	120.0	120.0
March	—	15.0	—	—	—	—	—	100.0	—	115.0	115.0
May.	—	15.0	—	—	—	—	—	95.0	—	110.0	110.0
July	—	15.0	—	—	—	—	—	90.0	—	105.0	105.0
October	—	15.0	—	—	—	—	—	115.0	—	130.0	130.0
1971											
January.	—	—	—	—	—	—	—	115.0	—	115.0	115.0
February	—	—	—	—	—	—	—	130.0	—	130.0	130.0
March	—	—	—	—	—	—	—	130.0	—	130.0	130.0

control over the money supply and a tightening of fiscal policy. In support of the programme Turkey requested financial assistance from both the International Monetary Fund and the European Fund.

In response to the Turkish request the Board of Management recommended that Turkey be granted credits totalling \$115 million, partly to strengthen its foreign exchange reserves over the period during which the stabilisation measures were to take effect, and partly for refinancing purposes. In October 1970 the Council, in accordance with recommendations of the Board of Management, decided to grant to Turkey the following credit facilities from the European Fund:

(a) A credit of \$40 million — the eleventh — consisting of two tranches, the first amounting to \$25 million, available from 30th October 1970, and the second of \$15 million, available from 15th February 1971, the release of the latter being dependent upon a further examination by the Board of Management of Turkey's economic and financial situation. This credit bears interest at the rate of 3½ per cent. per annum and is repayable in seven instalments, the first, of \$10 million, being due on 30th October 1971 and the remaining six, each of \$5 million, on 31st March 1972, 30th June 1972, 30th September 1972, 31st March 1973, 30th June 1973 and 30th September 1973.

(b) A credit of \$65 million — the twelfth — consisting of three tranches of \$5, 45 and 15 million and available, from the dates shown, for the refinancing of the following repayments:

\$5 million due on 28th October 1970, being the tenth repayment instalment of the sixth credit;

\$45 million due on 30th October 1970 (after the postponement of maturities mentioned above), being the first instalment (\$5 million) of the seventh credit and the whole of the ninth and tenth credits (\$25 and 15 million respectively);

\$15 million due on 14th March 1971, being the eleventh repayment instalment of the sixth credit.

This credit bears interest at the rate of 4 per cent. per annum and is repayable in three instalments of \$5 million due on 31st December 1971, 1972 and 1973 and eight instalments of \$6.25 million due at the end of each quarter from 31st March 1974 to 31st December 1975.

(c) A credit of \$10 million — the thirteenth — granted in two tranches of \$5 million to finance the repayment of the second instalment of the seventh credit due on 31st May 1971 and the twelfth instalment of the sixth credit due on 30th October 1971. The two tranches of this credit will be available, at Turkey's request, on the respective dates. The credit bears interest at the rate of 3½ per cent. per annum and is repayable on 31st May 1972, when the remaining amount of \$15 million representing the third instalment of the seventh credit will also fall due for repayment.

In October 1970 the first two tranches, totalling \$50 million, of the abovementioned twelfth credit were drawn by Turkey to finance repayments due in that month.

On 5th November 1970, the value date for multilateral settlements for October, Turkey drew the first tranche, \$25 million, of the eleventh credit and on 16th February 1971, following the approval by the Board of Management, Turkey drew the second and last tranche, \$15 million, of the eleventh credit.

Finally, on 14th March 1971 Turkey drew the third and last tranche, \$15 million, of the twelfth credit to finance the repayment due in that month.

All these transactions are included in the table on page 171, 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 1968 and for each month from end-1968 to March 1971 in which transactions took place.

On the various credits granted between June 1959, when the first drawing was made, and March 1971 there were thirty-nine drawings totalling \$519.5 million. Repayments have amounted to \$389.5 million. The amount outstanding at the end of March 1971, therefore, was \$130 million, all of which was owed by Turkey.

Multilateral System of Settlements. The history of the operations under the Multilateral System of Settlements was described in the last Annual Report (pages 166–168). There have been no settlements under this System during the year ending 31st March 1971. Following the devaluation of the Turkish lira new buying and selling rates applicable from 10th August 1970 were declared by the Turkish authorities. Special settlements for balances held in that currency were therefore arranged by the Agent for 19th August 1970, but no amounts were notified for settlement.

The cumulative total of settlements, therefore, still stands at \$82.6 million.

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

Statement of Account.

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

Credits and claims outstanding, which amounted at the beginning of operations to \$35 million, representing long-term claims on Norway and Turkey taken over from the EPU, stood at \$127.2 million at end-March 1970. Of this sum, \$115 million represented credits outstanding and \$12.2 million the balance of the long-term claims on Norway and Turkey. The amount outstanding declined in May 1970 and again in July 1970 as a result of the above-mentioned repayments by Turkey, which reduced the total to \$117.2 million. In October 1970 the amount outstanding increased to \$142.2 million following the first drawing by Turkey on the eleventh credit. The tenth amortisation payment in respect of the long-term claims on Norway and Turkey, amounting to \$2.9 million, brought the total down in December 1970, and it fell again in January 1971 as a result of the repayment by Greece already described. Finally, the total increased in February 1971 following the second drawing by Turkey on the eleventh credit. The amount outstanding at the end of March 1971, therefore, was $139.3 million.

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 December	71.8	123.5	297.9	160.1	653.3	607.5	45.8
1969 December	96.6	123.5	297.9	142.2	660.3	607.5	52.8
1970 January	106.2	123.5	297.9	132.2	659.9	607.5	52.4
February	106.5	123.5	297.9	132.2	660.2	607.5	52.7
March	111.7	123.5	297.9	127.2	660.4	607.5	52.9
April	112.0	123.5	297.9	127.2	660.7	607.5	53.2
May	117.3	123.5	297.9	122.2	661.0	607.5	53.5
June	119.8	123.5	297.9	122.2	663.5	607.5	56.0
July	124.6	123.5	297.9	117.2	663.3	607.5	55.8
August	124.9	123.5	297.9	117.2	663.6	607.5	56.1
September	125.3	123.5	297.9	117.2	664.0	607.5	56.5
October	101.1	123.5	297.9	142.2	664.8	607.5	57.3
November	101.5	123.5	297.9	142.2	665.2	607.5	57.7
December	106.8	123.5	297.9	139.3	667.6	607.5	60.1
1971 January	121.5	123.5	297.9	124.3	667.3	607.5	59.8
February	106.8	123.5	297.9	139.3	667.6	607.5	60.1
March	106.9	123.5	297.9	139.3	667.7	607.5	60.2

The Fund's non-liquid assets thus rose by $12.1 million during the year. With undistributed net income during the period amounting to $7.3 million, the Fund's liquid resources fell from $111.7 million at the end of March 1970 to $106.9 million at the end of March 1971.

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 also includes the uncalled amounts mentioned above.

Net income received during the calendar year 1970 amounted to \$8.6 million, the highest annual total yet recorded. A drop, compared with 1969, in income received from interest on claims and credits drawn, owing to the considerably lower level of amounts outstanding, was more than offset by the higher income obtained on the Fund's liquid dollar investments. It brought the cumulative total of net income received since the start of operations to \$70.5 million. The payment of interest on member countries' contributions was again based on the principle that the cumulative amount of interest paid to each member country should be equal to 90 per cent. of the share in the Fund's net income which the country would have received if the Fund had been liquidated at the end of the period in respect of which interest is paid. The amount paid out in respect of 1970 came to \$1.3 million and brought the cumulative amount of interest paid in gold to member countries to \$11.1 million. This corresponds to an average annual rate of interest of 2.6 per cent. on the \$38 million of called-up contributions. After the payment of interest in January 1971 on contributions in respect of the second half of 1970, undistributed net income amounted to \$59.4 million. Of this amount, \$52.4 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 1970 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 on the international gold and foreign exchange markets and on the external monetary positions of OECD countries, which the Representative of the Bank comments upon regularly at the Board's meetings.

Since 1963 the Bank for International Settlements has also been entrusted with the transmission of confidential information to participating member central banks relating to the conclusion and utilisation of concerted bilateral arrangements through which special support is given to the currency of a member country. This activity continued in 1970.

VII. ACTIVITIES OF THE BANK.

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

During the past year the Bank has continued to work closely with the principal central banks, participating in technical committees and, where appropriate, co-operating in actions aimed at eliminating undesirable strains in individual markets. If only little use has been made during the same period of certain medium-term arrangements set up by groups of major central banks and the BIS for the purpose of relieving pressures within the international system, this is in part a measure of their success. Nevertheless, the fact that these arrangements remain in being is an aid towards the continued maintenance of stability in the monetary field. In other areas there has been a further substantial expansion in the Bank's business relations with a growing number of central banks.

In addition to the regular meetings of the Governors of the central banks of the Group of Ten countries and Switzerland and to those of the Board of Directors, the Bank has continued to organise meetings of central-bank officials to examine matters such as the development of the gold and foreign exchange markets and the Euro-currency market, as well as to study and exchange information on other economic and monetary problems of mutual interest. The Bank also provides the Secretariat for the Committee of Governors of the central banks of the member countries of the European Economic Community and for its working parties and sub-committees, which hold regular meetings, usually in Basle. Furthermore, meetings of other groups of central-bank experts have been arranged by the Bank for the purpose of studying various technical and legal questions.

During the year the Bank continued to perform the functions entrusted to it in August 1964 by the Ministers of the Group of Ten of collecting and distributing to all participants of the Group and to Working Party No. 3 of the OECD statistical data concerning the financing of external surpluses and deficits of the Group of Ten countries. On the occasion of their meetings at the Bank the central-bank Governors of the Group of Ten countries and Switzerland also have the opportunity of exchanging the latest information on credit facilities arranged between members of the Group, and on the use of such facilities. The Bank has also again been associated with the work of the Deputies of the Group of Ten.

2. Operations of the Banking Department.

The Balance Sheet of the Bank and the Profit and Loss Account as at 31st March 1971, certified by the auditors, are reproduced at the end of this Report.

* * *

The balance-sheet total, which had stood at 20,699,016,057 francs* on 31st March 1970, amounted to 23,856,469,498 francs on 31st March 1971. It thus registered a rise of 3,157,453,441 francs, or 15 per cent.

The total of the monthly statement of account fluctuated fairly widely in the course of the financial year; the maximum, of 24,750 million francs, was reached at the end of December 1970. Throughout the year the total was never less than 20 milliard.

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
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
1970	20,699	+ 6,056	+ 41
1971	23,856	+ 3,157	+ 15

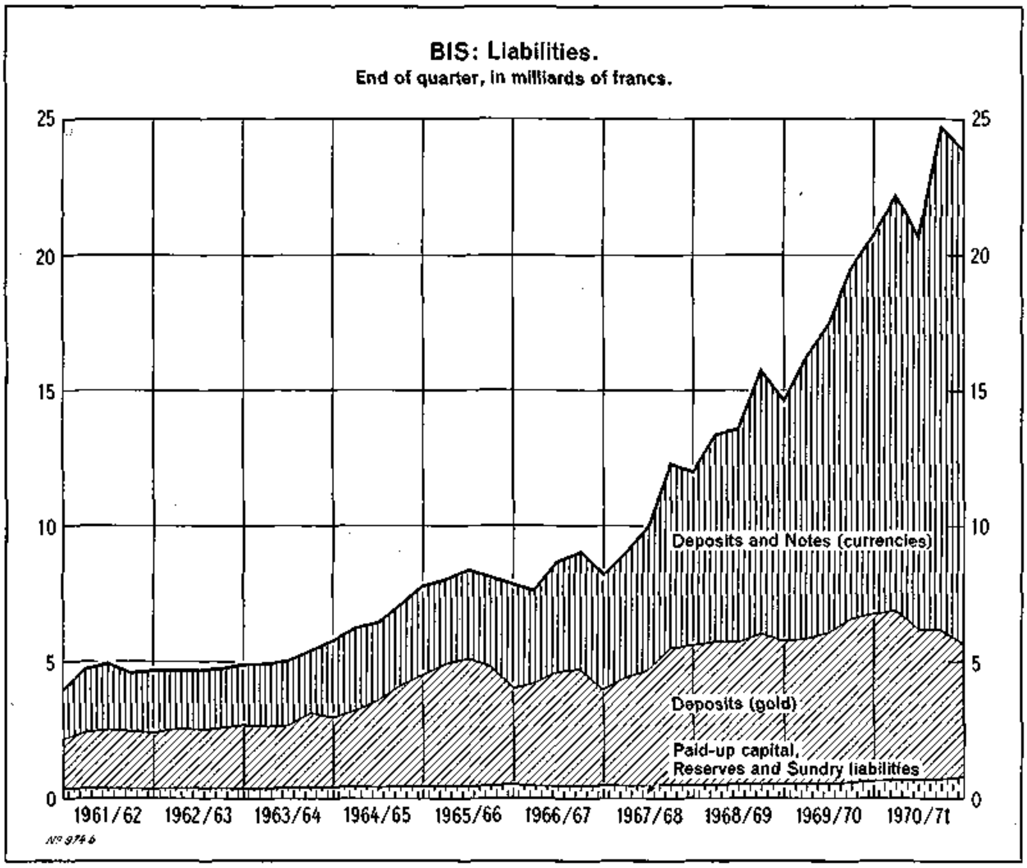
The following items are not included in the balance sheet: gold under earmark, bills and other securities held in custody for the account of central banks and other depositors; the assets (gold under earmark, bank balances, bills and other securities) held by the Bank as Agent for the Organisation for 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 for international government loans. As was done in the case of the balance sheet as at 31st March 1970, the amounts in question are shown at the foot of the assets column under the heading "Memorandum accounts (b)". The figures are given in the table below.

BIS: Memorandum accounts (b).

Items	Financial years ended 31st March	
	1970	1971
	in millions of francs	
Earmarked gold	1,068	958
Bank balances	17	15
Bills and other securities	543	499
Total of items not included in the balance sheet	1,628	1,472

* 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 4 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.

Composition of resources (liabilities).



A. Capital, reserves and sundry liabilities.

In accordance with Article 6 of the Statutes, the Bank made at the beginning of January 1971 a second issue of shares of the third tranche of its capital, all of which are reserved for subscription by central banks. As a result of this issue the Reserve Bank of Australia became a member of the BIS. Furthermore, in accordance with the provisions of Article 9 of the Statutes, the founder central banks which exercised their rights under Article 8(2) to subscribe for a proportion of any new issue placed some of the shares so subscribed at the disposal of the Bank for cancellation. Consequently the Board of Directors was able to issue an equivalent number of new shares to other member central banks.

On the occasion of this second issue of shares of the third tranche of the Bank's capital, a total of 16,400 shares was subscribed. The subscription price was fixed by the Board of Directors at 1,000 francs per share. As the Bank's shares are paid up to the extent of 25 per cent., or 625 francs per share, the subscription price included a premium of 375 francs per share, viz. 60 per cent. of the amount paid up. The aggregate premium received on this issue of shares of the third tranche therefore amounted to 6,150,000 francs, and was allocated as to 1,025,000 francs to the Legal Reserve Fund and as to 5,125,000 francs to the General Reserve Fund.

As a consequence of the operations mentioned above, at the end of the financial year the Bank's paid-up capital had been increased from 280.2 million francs to 290.5 million and the number of issued shares, paid up to the extent of 25 per cent., had risen from 448,325 to 464,725. The Bank's issued capital thus went up from 1,120.8 million to 1,161.8 million.

Following the above-mentioned allocation of the premiums received by the Bank, and taking into account various transfers decided upon by the Annual General Meeting of 8th June 1970 with regard to the distribution of the net profit for the financial year 1969–70 (see Chapter VII, Section 7, of last year's Annual Report), the various sub-items under the heading "Reserves" increased as follows:

(i) the Legal Reserve Fund from 28 to 29 million francs;

(ii) the General Reserve Fund from 64.9 to 100 million;

(iii) the Special Dividend Reserve Fund from 10 to 22 million;

(iv) the Free Reserve Fund from 80 to 98 million.

The item "Miscellaneous" rose from 44.5 to 50.7 million francs.

In accordance with a decision of the Board of Directors, 32 million francs has been transferred to the "Provision for Building Purposes" from the net operating surplus for the financial year 1970–71. The amount of this provision has thus increased from 48.7 to 80.7 million.

The net profit for the financial year under review, which corresponds to the figure for the item "Profit and Loss Account", amounted to 99.4 million francs, against 83.2 million in the previous financial year. Details of the proposed distribution of this profit are given in Section 6 below.

The total of the two items "Capital paid up" and "Reserves" thus increased over the financial year by 76 million, going up from 463 to 539 million francs. The uncalled capital rose by 30 million, from 841 to 871 million francs.

BIS: Development of the composition of resources over the past ten financial years.

Financial years ended 31st March	Paid-up capital and reserves	Borrowed funds	Sundry liabilities	Balance-sheet total
	in millions of francs			
1962	149	4,353	230	4,732
1963	150	4,561	239	4,950
1964	150	5,370	258	5,778
1965	151	7,417	282	7,850
1966	151	7,449	282	7,882
1967	151	7,764	317	8,232
1968	170	11,548	323	12,041
1969	200	14,133	310	14,643
1970	463	20,060	176	20,699
1971	539	23,086	231	23,856

B. Borrowed funds.

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

BIS: Borrowed funds, by origin.

Origin	Financial years ended 31st March 1970	1971	Movement
	In millions of francs		
Central banks	18,001	22,104	+ 4,103
Other depositors	1,225	515	— 710
Notes	834	467	— 367
Total	20,060	23,086	+ 3,026

The fairly sharp increase in the deposits of "Central banks" (+23 per cent.) was responsible for the rise in the balance-sheet total.

In contrast, there were very appreciable declines — although the amounts were small in comparison — in the deposits of "Other depositors" (−58 per cent.) and in "Notes" (−44 per cent.). Both these items were at their lowest point at the end of the financial year.

The decrease in the last-mentioned item concerned notes denominated in currencies that had been sold to commercial banks. The proceeds of these sales had served to finance operations with a number of central banks, which also matured.

The share of deposits of central banks in the Bank's borrowed resources thus grew further, so that they now account for virtually all its liabilities.

BIS: Borrowed funds, by nature and term.

Term	Deposits in gold			Deposits in currencies			Notes in currencies		
	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement	Financial years ended 31st March		Movement
	1970	1971		1970	1971		1970	1971	
	in millions of francs								
Sight	2,320	2,846	+ 526	97	96	— 1	—	—	—
Not exceeding 3 months	2,841	1,691	−1,150	11,660	16,748	+5,088	277	—	— 277
Over 3 months	1,013	402	— 611	1,295	836	— 459	557	467	— 90
Total	6,174	4,939	−1,235	13,052	17,680	+4,628	834	467	— 367

"Deposits in gold" underwent a fairly marked decline (−20 per cent.), the fall in time deposits having appreciably exceeded the increase in the amount of gold received on sight accounts. The decrease in time deposits is attributable to two factors:

(i) large withdrawals by central banks, which used the funds to wind up operations carried out with the Bank;

(ii) conversions of time deposits into sight deposits (hence the increase in the latter). These time deposits had been financing operations which had been carried out within the framework of international co-operation and which were unwound.

It will be seen from the balance sheet that at 31st March 1971, as had been the case a year earlier, the gold deposits of "Other depositors" were all at sight and that they represented only about 3 per cent. of the total amount of gold received on deposit.

In contrast to gold deposits, "Deposits in currencies" registered a very sharp rise both in absolute figures and in relative terms (+35 per cent.). The increase in funds at not exceeding three months was greater than the overall rise, as deposits at over three months underwent a decline — which in percentage terms was fairly marked — following the receipt of the last four amortisation payments made under the Group Arrangement concluded in June 1966 and consolidated in September 1968 (see the Report for the financial year 1968–69). The payments in question were made in advance; the final payment was, in fact, not due until June 1971. The deposits that had been received from central banks for the partial financing of that Arrangement were repaid by the Bank at the same time, i.e. also in advance.

The balance sheet shows that the percentage share of currency deposits of "Other depositors" in the total of deposits received in currencies fell from 8 per cent. at the end of the previous financial year to 2 per cent. at the end of the financial year under review.

The item "Notes in currencies" continued to decrease, largely as a result of the liquidation of the remaining notes at not exceeding three months and to a lesser extent because of a decline in those at over three months, the only category now left.

At the beginning of the financial year "Deposits in gold" represented 31 per cent. of total borrowed resources, "Deposits in currencies" 65 per cent. and "Notes" 4 per cent. On 31st March 1971 the percentage ratios were 21, 77 and 2 respectively. Thus, as in previous financial years, the share of currency resources in the total continued to grow, increasing from 69 to 79 per cent. and thus accounting for just on four-fifths of the Bank's liabilities.

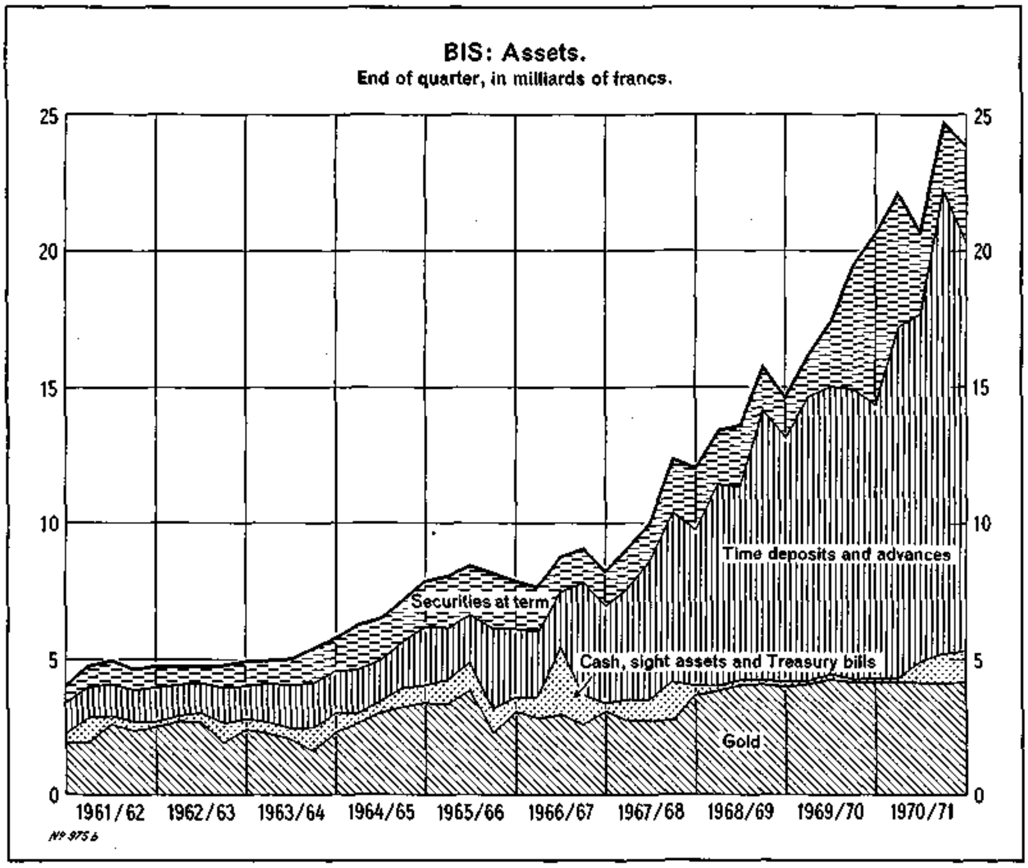
This development illustrates the preponderance which currencies have gradually acquired in relation to gold in the Bank's total operations.

EMPLOYMENT OF RESOURCES (assets).

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

BIS: Gold position.

End of month	Spot position				Net balance of forward operations	Net assets in gold
	Gold holdings	Invest-ments in gold	Deposits received in gold	Net balance		
	In millions of francs					
1970						
March . . .	4,161	462	−6,174	−1,551	+2,110	559
May.	4,128 (min.)	462	−6,212	−1,622 (min.)	+2,184 (max.)	562
June	4,204 (max.)	449 (min.)	−6,233 (max.)	−1,580	+2,126	546 (min.)
1971						
February . .	4,202	520 (max.)	−5,252	− 530	+1,183	653
March . . .	4,202	514	−4,939 (min.)	− 223 (max.)	+ 877 (min.)	654 (max.)
Movement: 31st March 1970 to 31st March 1971	+ 41	+ 52	+1,235	+1,328	−1,233	+ 95



Both "Gold holdings" and "Investments in gold" showed small increases, which together corresponded to the growth in "Net assets in gold". The latter rise was partly the result of the second issue of shares of the third tranche of the Bank's capital, which was subscribed in gold; details have been given above under "Capital, reserves and sundry liabilities".

The development of "Deposits received in gold" has already been commented upon under "Borrowed funds".

The "Net balance of forward operations" fell fairly steadily, though with a few fluctuations, in the course of the financial year. The decline — of over one-half — in this item was mainly due to the maturing or the advance termination of various operations involving forward purchases of gold against currencies; these operations had been covered by time deposits received by the Bank.

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

A. Assets at sight or cashable on demand.

As mentioned above, there was a small increase in the item "Gold", which went up by 41 million francs.

BIS: Distribution, by nature, of sight assets and other investments.

Nature	Financial years ended 31st March 1970		1971		Movement	
	in millions of francs					
Sight assets						
Gold	4,161		4,202		+ 41	
Currencies	61	4,222	53	4,255	— 8	+ 33
Other investments						
Gold	462		514		+ 52	
Currencies	16,002	16,464	19,086	19,600	+ 3,084	+ 3,136
Total						
Gold	4,623		4,716		+ 93	
Currencies	16,063	20,686	19,139	23,855	+ 3,076	+ 3,169

The figure for the item "Cash on hand and on sight account with banks" fell back from 61 million francs to 53 million.

The total of sight assets (gold and currencies) thus showed practically no change, but its percentage ratio to the balance-sheet total declined further, viz. from 20 to 18.

The item "Treasury bills", which had stood at a low level at the beginning of the financial year, rose sharply, mainly because of a series of purchases which began in July 1970, and by January 1971 it had almost reached the figure at which it stood at the end of the financial year — 1,058 million francs. It should be noted, on the other hand, that the item "Other securities cashable on demand" was liquidated by incorporating the small balance shown on it for several years into the item "Treasury bills".

On 31st March 1970 the total of the Bank's assets at sight or cashable on demand, comprising the various asset items so far analysed, was 4,291 million francs and accounted for 20.7 per cent. of the balance-sheet total; on 31st March 1971 the corresponding figures were 5,313 million and 22.3 per cent. Over the same period sight deposits on the liabilities side rose from 2,417 million francs to 2,942 million, but their share of the balance-sheet total went up only from 11.7 to 12.3 per cent. The Bank's liquidity coefficient thus improved slightly.

B. Time funds.

The figure for the item "Time deposits and advances" increased by half — 5,042 million — rising from 10,017 million francs to 15,059 million. This substantial growth represents the difference between:

(i) investments carried out on a number of markets, often running into very large amounts;

(ii) amortisation payments received, as already mentioned, in respect of the Group Arrangement consolidated in September 1968, and the maturing or advance repayment of credits that had been granted to several central banks.

The total of "Securities at term", which had amounted to 6,378 million francs on 31st March 1970, decreased fairly steadily from month to month until the end of

February. In March it rose, to reach 3,483 million at the end of the financial year, thus registering a decline of 2,895 million, or 45 per cent., over a twelve-month period. This was due to a decrease in investments in certificates of deposit of US banks and, to a much lesser extent, to the maturing of government paper.

BIS: Time deposits and advances and securities at term, by maturity.

Periods	Financial years ended 31st March 1970	1971	Movement
	in millions of francs		
Not exceeding 3 months	13,589	14,107	+ 518
Over 3 months	2,806	4,435	+ 1,629
Total	16,395	18,542	+ 2,147

One-quarter of the overall increase in the assets shown in the above table was attributable to a rise in investments at not exceeding three months and three-quarters to the expansion of those at over three months.

* * *

The financial year 1970–71 was, on the whole, a satisfactory one; the Bank in general increased the size and the volume of its operations, and this was reflected in a fairly sharp rise in the balance-sheet total.

The volume of operations increased by an amount comparable to that in the previous year to a new record level of 250 milliard, as against 213 milliard in 1969–70 and 184 milliard in 1968–69.

3. The Bank as Trustee for international government loans.

In conformity with the agreements in force, the Bank continued in the year under review to perform the functions of Trustee for the new bonds of the German External Loan 1924 (Dawes Loan) and 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 1970–71 ended for the Dawes Loan on 15th April 1971 and for the Young Loan on 1st June 1971. The interest in respect of the financial year 1970–71 amounted to the equivalent of about 1 million francs for the Dawes Loan and of about 33.3 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 in respect of the financial year 1970–71 was effected by purchases of bonds on the market.

As regards the Dawes Loan, only bonds of the funding issues are still outstanding and these will mature on 15th October 1972; all the outstanding bonds of the conversion issues were redeemed at maturity on 15th October 1969.

The question whether the exchange guarantee attached to the Young Loan under the terms of the London Agreement is applicable in the case of the revaluations of the Deutsche Mark has still not been settled. The 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 following tables.

German External Loan 1924 (Dawes Loan).
Funding bonds.

Issue	Currency	Nominal value			
		Bonds issued	Bonds purchased for redemption in respect of the financial years		Balance after redemption
			1958–59 to 1969–70	1970–71	
American . . .	$	8,211,000	2,912,000	279,000	5,020,000
Belgian	£	157,800	58,900	5,900	93,000
British	£	2,232,600	826,600	83,100	1,322,900
Dutch	£	291,700	99,500	10,500	181,700
French	£	499,000	186,200	18,600	294,200
Swiss	£	115,000	41,900	4,300	68,800
Swiss	Sw.fr.	415,000	136,000	14,000	265,000

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		Balance after redemption
			1958–59 to 1969–70	1970–71	
		Conversion bonds			
American . . .	$	55,516,000	8,873,000	1,022,000	45,621,000
Belgian	B.fr.	202,852,000	31,832,000	3,706,000	167,314,000
British	£	20,663,700	3,221,900	370,900	17,070,900
Dutch	Fl.	52,574,000	8,084,000	923,000	43,567,000
French	Fr.fr.	501,641,000	78,711,000	9,057,000	413,873,000
German	DM	14,505,000	2,250,000	249,000	12,006,000
Swedish . . .	S.kr.	92,780,000	14,515,000	1,668,000	76,597,000
Swiss	Sw.fr.	58,385,000	9,153,000	1,011,000	48,221,000
		Funding bonds			
American . . .	$	9,013,000	1,368,000	144,000	7,501,000
Belgian	B.fr.	45,683,000	7,030,000	735,000	37,918,000
British	£	4,930,400	749,600	78,900	4,101,900
Dutch	Fl.	8,499,000	1,292,000	136,000	7,071,000
French	Fr.fr.	110,490,000	16,697,000	1,753,000	92,040,000
German	DM	416,000	62,000	6,000	348,000
Swedish . . .	S.kr.	6,014,000	923,000	91,000	5,000,000
Swiss	Sw.fr.	1,405,000	213,000	22,000	1,170,000

* Nominal value on 1st May 1971 established in accordance with the provisions of the London Agreement on German External Debts of 27th February 1953 but without taking account of the revaluations of the Deutsche Mark in March 1961 and October 1969.

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 1969	1970	
American . . .	$	1,667,000	807,000	96,000	764,000
Anglo-Dutch .	£	856,600	410,400	44,400	401,800
Swiss	Sw.fr.	7,102,000	2,858,000	359,000	3,885,000

4. 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.

5. 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.

Such secured loans were issued during the period up to and including 1961 for a total amount equivalent to about 821 million francs. Since September 1961 the Community has raised loans which are not secured in accordance with the Act of Pledge, and the Bank has no function in connection with such loans.

Repayments by the Community up to 1st April 1971 in respect of secured loans amounted to the equivalent of about 450 million francs, so that the total amount outstanding was reduced to the equivalent of about 371 million francs. Further particulars of these loans are given in the table below. The Community has used the proceeds of these loans to grant credits in the member countries.

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 1971	Rates of interest %	Year of final maturity
1st	1954	United States	US Government	$	100,000,000	51,200,000	3⅞	1979
2nd	1955	Belgium	Caisse Générale d'Epargne et de Retraite, Brussels	B.fr.	200,000,000	118,600,000	3½	1982
3rd	1955	Germany	Westdeutsche Landesbank Girozentrale, Düsseldorf and Münster[1]	DM	50,000,000	24,888,900	3¾	1981
4th	1955	Luxemburg	Caisse d'Epargne de l'Etat, Luxemburg	B.fr.	20,000,000	11,860,000	3½	1982
				L.fr.	5,000,000	—	—	—
5th	1956	Saar	Landesbank und Girozentrale Saar, Saarbrücken	DM	2,977,450[2]	1,313,055	4¼	1977
6th	1956	Switzerland	Public issue	Sw.fr.	50,000,000	16,250,000	4¼	1974
7th[3]	1957	United States	Public issue	$	25,000,000	7,900,000	5½	1975
10th	1957	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	69,942,698	5⅝	1982
11th[3]	1958	United States	Public issue	$	35,000,000	18,900,000	5	1978
13th[3]	1960	United States	Public issue	$	25,000,000	16,750,000	5⅜	1980
15th	1961	Luxemburg	Etablissement d'Assurance contre la Vieillesse et l'Invalidité, Luxemburg	L.fr.	100,000,000	81,367,373	5¼	1986
16th	1961	Netherlands	Public issue	Fl.	50,000,000	36,600,000	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.

During the financial year 1970–71 the Bank received from the borrowers and distributed among the Paying Agents for the service of the secured loans the equivalent of about 20 million francs in respect of interest and the equivalent of about 41 million francs in respect of redemption.

6. Net profits and their distribution.

The accounts for the forty-first financial year ended 31st March 1971 show a surplus of 133,049,026 francs. The surplus for the financial year 1969–70 was 101,368,556 francs. The very large increase in earnings is again mainly attributable to the substantial expansion in the Bank's resources in currencies and to the considerable growth in the volume of its operations, both of which have already been mentioned in Section 2 of this Chapter.

The Board of Directors has transferred 1,600,120 francs to the Provision for Exceptional Costs of Administration and 32,000,000 francs to the Provision for Building Purposes. After deduction of these two transfers, the net profit amounts to 99,448,906 francs, compared with 83,179,570 francs for the previous financial year.

The appropriation of this amount is fixed by clauses (2), (3), (4) and (5) of Article 51 of the Statutes.

On the basis of these provisions of the Statutes, the Board of Directors recommends that the net profit of 99,448,906 francs be applied by the General Meeting in the following manner:

(i) a sum of 25,448,906 francs in payment of a total dividend of 56.25 francs per share, consisting of 37.50 francs in respect of the preferential dividend of 6 per cent. per annum and 18.75 francs representing the maximum further dividend of 3 per cent. per annum, such total dividend being payable in respect of a whole financial year in the case of 448,325 shares and in respect of three months in the case of the 16,400 shares issued during the financial year 1970–71;

(ii) an amount of 37,000,000 francs to be transferred to the General Reserve Fund;

(iii) an amount of 14,800,000 francs to be transferred to the Special Dividend Reserve Fund; and

(iv) an amount of 22,200,000 francs, comprising the remainder of the available net profit, to be transferred to the Free Reserve Fund. This Fund can be used by the Board of Directors for any purpose which is in conformity with the Statutes.

The proposed transfer to the Special Dividend Reserve Fund of the sum of 14,800,000 francs, which for this year is the statutory maximum, would result in this Fund being raised to 36,807,964 francs; this amount corresponds approximately to the sum required to pay the preferential dividend of 6 per cent. per annum for two years on the currently paid-up capital.

As regards the dividend for the financial year 1970–71, the proposals of the Board provide for a total dividend amounting to 56.25 francs per share when the distribution relates to a whole financial year and to 14.0625 francs when it relates to a period of three months. These amounts will be payable on 1st July 1971 in the amounts of 75.05 Swiss francs and 18.76 Swiss francs per share, respectively, to shareholders whose names are entered in the Bank's share register on 20th June 1971. Although the dividend in francs is the same as that paid last year, the revaluation of the Swiss franc with effect from 10th May 1971 has resulted in the amount payable in Swiss francs proposed for this year being less than that paid last year. However, in the case of unpaid dividends for earlier years that are payable in Swiss francs, the necessary measures have been taken to ensure that they will be paid in the Swiss franc amounts fixed at the time of their declaration by the General Meeting.

The Balance Sheet, the Profit and Loss Account, the proposed Appropriation of the Net Profit and the movements during the financial year on the paid-up Capital, Reserve Funds and Provisions will be found at the end of this Report.

The Bank's accounts have been audited by Messrs. Price Waterhouse & Co., Zurich, who have confirmed that the Balance Sheet and the Profit and Loss Account give a true and fair view of the state of the Bank's affairs at 31st March 1971 and of its profit for the year ended on that date. Messrs. Price Waterhouse & Co.'s report is appended at the foot of the Balance Sheet.

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

During the past year the Bank suffered two grievous losses, firstly, through the death on 11th August 1970 of the Vice-Chairman of the Board, M. Maurice Frère, following an accident while on a visit to Turkey and, secondly, through the death on 23rd December 1970 of its General Manager, M. Gabriel Ferras, as the result of a motoring accident in France.

A tribute to M. Frère's outstanding qualities and great talents was paid by the Chairman at the meeting of the Board held on 14th September 1970. During his twenty-six years' membership of the Board, M. Frère held the office of Chairman from 1946 to 1958 and of Vice-Chairman from 1965 until his death. He was also President of the Bank from 1948 to 1958.

At the meeting of the Board held on 11th January 1971 the Chairman recalled M. Ferras's great professional and human qualities and his outstanding contribution to the development of the Bank's activities during his all too brief period of eight years as General Manager. His training, his previous experience and his personal qualities had fitted him ideally for the position of General Manager of the BIS and he had carried out his duties with a dignity and a degree of success that had won the esteem of everyone both inside and outside the Bank. All members of the Board and of the staff of the Bank had lost in Gabriel Ferras not only a General Manager of exceptional distinction but also a true friend.

* * *

The mandate of Dr. Jelle Zijlstra as Chairman of the Board and President of the Bank being due to expire on 30th June 1970, he was re-elected to these offices under Article 38 of the Statutes at the meeting of the Board held on 8th June 1970 for a period of three years ending on 30th June 1973.

Dr. Rudolf Brinckmann relinquished his office as a Director on 31st July 1970, an appointment which he had held since June 1950. At the Board meeting held on 6th July 1970 a warm tribute was paid to him for the very valuable services he had rendered to the Bank over so many years.

At the meeting of the Board held on 14th September 1970 the Chairman announced that Dr. Karl Klasen, President of the Deutsche Bundesbank, had appointed Dr. Leonhard Gleske as a member of the Board to fill the vacancy caused by the resignation of Dr. Brinckmann. This appointment was made under Articles 27(2) and 28 of the Statutes for the unexpired period of Dr. Brinckmann's term of office ending on 31st December 1972. Dr. Gleske was welcomed by the Chairman on the occasion of his first attendance at a meeting of the Board.

At the meeting of the Board held on 9th November 1970 M. Henri Deroy, who had been a Director since 1948, was elected Vice-Chairman of the Board for a period of three years from 1st November 1970 to 31st October 1973.

The Chairman announced at the Board meeting held on 11th January 1971 that Baron Ansiaux, Governor of the National Bank of Belgium, had appointed, under Articles 27(2) and 28 of the Statutes, M. Robert Vandeputte as a member of the Board to fill the vacancy caused by the death of M. Frère. His mandate was to run for the unexpired period of the latter's term of office ending on 7th August 1972.

At the end of February 1971 Baron Ansiaux resigned as Governor of the National Bank of Belgium and was succeeded by M. Vandeputte, who thereby became an ex officio member of the Board as from 1st March 1971. At the Board meeting held on 8th March 1971 the Chairman announced that M. Vandeputte had, in accordance with Articles 27(2) and 28 of the Statutes, appointed Baron Ansiaux as a member of the Board for the period ending on 7th August 1972. The Chairman also expressed the Board's pleasure that Baron Ansiaux, who had been an ex officio Director since August 1957, would remain on the Board.

The mandate of Dr. Edwin Stopper being due to expire on 31st March 1971, he was re-elected, under Article 27(3) of the Statutes, at the meeting of the Board held on 8th March 1971 for a further period of three years ending on 31st March 1974.

The Chairman informed the Board at its meeting on 19th April 1971 that M. Vandeputte had appointed M. Georges Janson to act as his Alternate in place of M. Cecil de Strycker. He expressed the Bank's gratitude to M. de Strycker for his valuable services during a period of more than fifteen years.

At its meeting held on 19th April 1971 the Board decided to appoint M. René Larre as the General Manager of the Bank. M. Larre took up the functions of General Manager on 1st May 1971.

M. Georges Janson, who had been a Manager of the Bank since April 1962, resigned from his post on 4th April 1971 upon being appointed a Director of the National Bank of Belgium. At the meeting held on 19th April 1971 the Chairman expressed the Board's gratitude for the valuable work done by M. Janson at the Bank during his nine years' service.

The Chairman announced at the Board meeting held on 8th March 1971 that the Bank had decided to promote Mr. Warren D. McClam, Mr. Michael G. Dealtry and M. Robert Chaptinel to the rank of Sub-Manager as from 1st April 1971. All three had been senior members of the staff for many years.

* * *

The Bank learned with deep regret of the death of Sir Otto Niemeyer on 6th February 1971 and of Herr Karl Blessing on 25th April 1971. Sir Otto had been a Director from June 1932 until March 1965 and during his exceptionally long term of office had served as Chairman for three years and as Vice-Chairman for eighteen years. Herr Blessing had only retired from the Board at the end of 1969 when he gave up his appointment as President of the Deutsche Bundesbank. He had been a member of the Board of Directors since January 1958.

CONCLUSION.

The main conclusion to be drawn from the economic and monetary developments of the past year is that nothing was very conclusive; attainment of key policy goals has to be filed under "work in progress". Both the United States and the United Kingdom remained in a condition of under-utilisation of resources, while in most other industrial countries the rate of growth of the national product declined or flattened; efforts to dampen the rise of prices showed little results in almost all countries, while the increases in wage rates generally exceeded the high figures of 1969; the imbalance in international payments was much greater than the year before, though because of flows of funds rather than basic transactions; and in May 1971 a new exchange crisis broke out which left the Deutsche Mark and the guilder joining the Canadian dollar in floating, the Swiss franc and the schilling revalued, and longer-term confidence in the dollar less firm.

As such, the least worrisome of these problem areas has been the trend of production. In most continental countries the tapering-off of the trend was in response to policy measures aimed at curbing inflation and the difficulty has been that the flattening has been so slow in coming. In the United Kingdom output did advance slightly more than the year before, but unemployment has been growing. However, this was to be expected in view of the priority that had to be given to the balance of payments; a shift in policy measures towards renewed expansion came only with the budget of March 1971. In the United States the turnround in activity has not come as quickly as may have been desired, but there seems little reason to be very concerned about the future on this score. Monetary policy was progressively eased from the beginning of 1970, but the circumstances were such that this alone could not initiate recovery quickly. The inflation itself, which in the past year had a life of its own, was in part absorbing the increase in the money supply and, in addition, business was concerned with rebuilding its liquidity position through an exceptionally heavy volume of new issues on the long-term market. With profits squeezed and with capacity utilisation low, companies had no incentive to take the lead in re-expansion by stepping up plant and equipment outlays. Much has been made of consumers' lack of interest in buying and the high rate of personal savings, but these factors have not been significantly different from those in earlier recessions. In any case, the authorities are prepared to take additional measures to secure recovery if they are required.

More ominous for the future has been the strength of price inflation and the ineffectiveness of policy in dealing with it. In many countries consumer prices showed larger increases than the year before, with Canada being the main exception. In most countries the consumer-price index went up by about 5 per cent., while in Japan, Sweden and the United Kingdom the rise was about 8 per cent. Besides the size of the price increases, it was striking that industrial-goods prices advanced strongly, so that the inflation was not centred on services and rents as in previous years.

The main source of inflation in the past year was rising wage costs, as demand pressures in all the countries were either absent or waning. Increases in average wage rates among the countries began with a rise of 8 per cent. for Switzerland and soared to 21 per cent. in the case of Italy. Comparable data on wage rates are not available for the United States, but the strength of wage pressure is indicated by the rise in average earnings of 6.3 per cent., as against 6.1 per cent. the year before. This is a very high figure for a year of recession, when the working week was shrinking, unemployment rising and business in an enforced cost-saving mood.

The aggressive character of wage demands by organised labour in the past few years is indicated by the heavy losses of working time through strikes. There were relatively large-scale strikes in Sweden in the earlier months of this year for the first time since the war. The man-days lost in strikes in the United Kingdom, which had averaged 3.2 million over the years 1960–68, were 6.9 million in 1969 and 11 million in 1970. In the first quarter of this year, with the strikes in the postal services and the Ford Motor Company, 9.5 million man-days were lost. In the United States the average number of man-days lost in strikes for the years 1960–66 was a bit over 20 million; this soared to a 49 million average in the period 1967–70, with the figure for 1970 having been 62 million. In France last year again the situation was rather quiet on the labour front after the upheaval of May–June 1968, though wage rates continued their steep rise. The worst period in Italy was the fourth quarter of 1969, but none the less about 12 million man-days were lost in the first half of 1970, as compared with 9 million in the whole of 1968. Even so, the strike loss figures do not reflect the larger impact of labour unrest on efficiency and output; social and political issues have been involved perhaps more than wages. Germany is the exception among the large countries; strikes have been quite rare, and fewer man-days have been lost on average in the past two or three years than in the years 1960–67. Of course, German wage earnings per employed person in industry increased over the twelve months to December 1970 by 21.5 per cent.

Past experience has amply demonstrated the troubles caused by inflation; for example, its impact in intensifying the business cycle, its relation to balance-of-payments difficulties, its erosion of the market for fixed-interest securities, and its social and political effects in the longer run. A particular adverse effect recently has been the squeeze on profits, with the related curtailment of plant and equipment outlays. It is apparent that if this problem persists, as it threatens to do, continuation of the productivity gains and the huge expansion of output of the last twenty years will be put in jeopardy. It is ironical that hard-fought-over excessive increases in money wages can be the cause of smaller increases in real wages.

Yet, whatever else was proved by the excesses of the past year or two, it was that demand management alone — particularly with monetary policy the primary instrument — was neither a quick nor an effective cure for wage-push inflation. Events have demonstrated more strikingly than ever that wage policy is an instrument which should be more fully exploited in the efforts for satisfactory management of the economy. It was seen that the private sector could not afford long-lasting industrial disputes and that market forces, even with a recession level of demand for labour, were an inadequate check on the monopolistic power of labour.

One can readily admit that continuously successful wage management has yet to be achieved, that it is beset with political difficulties and that there are circumstances in which new initiatives are all but impossible. None the less, it is a challenge to political leadership which cannot be brushed aside. Labour legislation may have to be strengthened, the influence of government may need to be used more effectively, and public opinion must be brought to see the realities of the problem. In addition, the public sector itself, by far the largest single employer of labour, can hardly do without an articulated and equitable policy towards its own employees which may stand as an example to the private sector of the economy.

The view that the international monetary system has, for some years, been in a state which leaves it vulnerable to crises received further support with the eruption on the exchange markets at the beginning of May of this year, coming so soon after the crisis of October 1969. Yet each crisis has its own special circumstances which underlie it and set it off. The US basic deficit is certainly a continuing weakness of the international monetary situation, but over the past year the general tendency was for basic deficits and surpluses to narrow, including that of the United States. Hence, it was rather the massive movements of short-term funds, described in this Report, which constituted the background of the crisis. One may say, in fact, that this was the first crisis of recent years in which the basic imbalances in international payments — that is, those involving goods, services and long-term capital — were not the direct cause of the flare-up. Its origins go back, of course, to 1969 when severe domestic monetary restraint induced a large inflow of short-term funds to the United States of over $8 milliard. Most of this represented borrowings of US banks from their foreign branches and was a consequence of maintaining Regulation Q interest ceilings on the banks at uncompetitively low levels. Thus, not only was the effort to calm the boom overly concentrated on monetary policy, but the instruments used did not give due attention to their international impact. At the time that funds were flowing so copiously from the Euro-currency market to the US banks, it was generally anticipated that the subsequent outflow — which was bound to happen when the US boom was curbed — would cause difficulties in European exchange and money markets. Therefore, that troubles did arise in 1970–71 is not so surprising. The inflow of funds to the United States in 1969 not only covered the basic payments deficit but actually gave a surplus of $2.7 milliard on official settlements account. Hence, the subsequent official settlements deficit had to cover this artificial surplus as well as the basic deficits of both 1969 and 1970. In fact, the deficit up to the end of the first quarter of this year was even larger.

To explain these movements one must look at developments on both sides of the Atlantic. The process was initiated by the shift in US monetary policy from restraint to ease at the start of 1970. The other side of the coin, however, was severe monetary restraint in several European countries, which acted as a magnet for funds from the United States and the Euro-market — where interest rates were declining. The amounts involved were particularly large for Germany, where there was no control over foreign borrowing by industry, and even very sizable for the United Kingdom.

These inflows quickened in the first quarter of 1971, finally leading to uncertainty in the exchange market. From the beginning of April a strong element of speculation in favour of the Deutsche Mark was evident and this became a flood in the first days of May. Having failed to stop the boom or the inflow of funds from abroad for so many months, there was little the German authorities could do on 5th May but close the exchange market and let the Deutsche Mark float. While there had been suggestions in the press concerning a floating rate for the Deutsche Mark, they cannot be considered the real cause of the crisis; it was rather the wide interest differentials that had resulted from divergent monetary policies and the huge flows of funds which were thereby induced.

The Japanese yen was only marginally involved in the exchange crisis, even though the external surplus has been of very large proportions. The authorities have forcefully stated that the existing parity of the yen will be maintained, which has discouraged speculation. The surplus, no doubt, is unusually big at present owing to the stagnation of demand in Japan; even when re-expansion is in full swing, however, a large trade surplus seems likely to persist. The Japanese authorities have made some moves towards adjustment by reducing barriers against imports and by promoting capital exports. Recently, to counteract pressure to revalue, a broad set of measures in these directions has been initiated. This is a promising development.

The developments of the past year, and of 1969 also, have served to emphasise several realities for the authorities. The first is that there is no point in their proclaiming a complicated set of objectives — full employment, economic growth, price stability and external equilibrium — unless they are prepared to make forceful use of the broad powers they can mobilise to manage the economy. In particular, governments cannot expect success if they keep their hands off distasteful policy actions and leave the whole job to central-bank measures. Managing the money supply is a vital instrument of policy, but it is not a panacea — particularly when the root of inflation is leaping wages.

Secondly, the instruments of monetary policy themselves must be adapted to the actual difficulties in the situation — whether they arise internally or externally. It is clear that the traditional instruments of monetary policy may have to be supplemented by specific measures to avoid an undesired expansion of credit, either domestically from outside the banks or through borrowing from abroad. To shun such measures is to ignore the fact that the raison d'être of central banks is to control the flow of money and credit.

Finally, it is necessary to face the fact of the persistently large US balance-of-payments deficit, which has for some years been adversely affecting the international monetary system and has led more and more to demands for controls over the free flow of international trade and payments. The recent crisis, which left the Deutsche Mark and the guilder floating, was an admitted setback to continued progress in the Common Market. Other difficulties of this kind seem likely to arise. The continuous piling-up of official short-term debt by the United States and the contention that other currencies rather than the dollar have the main responsibility for the adjustment process can hardly be the last words on the subject.

René Larre

General Manager

BALANCE SHEET AND PROFIT AND LOSS ACCOUNT

AT 31st MARCH 1971

BALANCE SHEET

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

			%
Gold		4,202,105,282	17.6
Cash on hand and on sight account with banks		53,286,450	0.2
Treasury bills		1,058,222,479	4.4
Time deposits and advances			
Gold			
Not exceeding 3 months	75,122,049		0.3
Over 3 months	15,162,389		0.1
Currencies			
Not exceeding 3 months	11,094,548,972		46.5
Over 3 months	3,874,215,124		16.3
		15,059,048,534	
Securities at term			
Gold			
Not exceeding 3 months	264,536,957		1.1
Over 3 months	159,440,632		0.7
Currencies			
Not exceeding 3 months	2,673,223,893		11.2
Over 3 months	385,783,133		1.6
		3,482,984,615	
Miscellaneous		822,137	0.0
Land, buildings and equipment		1	0.0
		23,856,469,498	100

MEMORANDUM ACCOUNTS

a. Forward gold operations:

Net balance: gold receivable (currencies payable)	876,777,582

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

Earmarked gold	957,556,782
Bank balances	15,215,376
Bills and other securities	499,312,792

AT 31st MARCH 1971

GRAMMES FINE GOLD — ART. 4 OF THE STATUTES) LIABILITIES

			%
Capital			
Authorised: 600,000 shares, each of 2,500 gold francs ...	1,500,000,000		
Issued: 464,725 shares ...	1,161,812,500		
of which 25% paid up ...		290,453,125	1.2
Reserves			
Legal Reserve Fund ...	29,045,313		
General Reserve Fund ...	99,958,210		
Special Dividend Reserve Fund ...	22,007,964		
Free Reserve Fund ...	98,000,000		
		249,011,487	1.0
Deposits (gold)			
Central banks			
Sight ...	2,687,647,142		11.3
Not exceeding 3 months ...	1,691,193,098		7.1
Over 3 months ...	401,555,940		1.7
Other depositors			
Sight ...	158,940,023		0.7
		4,939,336,203	
Deposits (currencies)			
Central banks			
Sight ...	77,435,804		0.3
Not exceeding 3 months ...	16,438,156,306		68.9
Over 3 months ...	808,999,237		3.4
Other depositors			
Sight ...	19,247,017		0.1
Not exceeding 3 months ...	309,297,765		1.3
Over 3 months ...	27,270,948		0.1
		17,680,407,077	
Notes			
Over 3 months ...		466,450,851	1.9
Miscellaneous ...		50,690,849	0.2
Provision for Building Purposes ...		80,671,000	0.4
Profit and Loss Account ...		99,448,906	0.4
		23,856,469,498	100

REPORT OF THE AUDITORS TO THE BOARD OF DIRECTORS AND TO THE GENERAL MEETING OF THE BANK FOR INTERNATIONAL SETTLEMENTS, BASLE

In our opinion the Balance Sheet and the Profit and Loss Account give a true and fair view of the state of the Bank's affairs at 31st March 1971 and of its profit for the year ended on that date. We have obtained all the information and explanations which we have required. The Bank has kept proper books, and the Balance Sheet and the Profit and Loss Account are in agreement with them and with the information and explanations given us.

Zurich, 4th May 1971. PRICE WATERHOUSE & CO.

PROFIT AND LOSS ACCOUNT
for the financial year ended 31st March 1971

		Gold francs
Net interest and other income		146,766,911
Less: Costs of administration:		
Board of Directors	171,708	
Management and Staff	10,361,121	
Office and other expenses	3,185,056	13,717,885
Net operating surplus		133,049,026
Less: Amounts transferred to:		
Provision for Exceptional Costs of Administration	1,600,120	
Provision for Building Purposes	32,000,000	33,600,120
NET PROFIT for the financial year ended 31st March 1971		99,448,906

APPROPRIATION OF NET PROFIT
(Article 51 of the Statutes)

		Gold francs
Net profit		99,448,906
Dividend of 6% p.a. on paid-up capital		
37.50 gold francs per share on 448,325 shares for twelve months	16,812,187	
9.375 gold francs per share on 16,400 shares for three months	153,750	16,965,937
		82,482,969
Additional dividend (statutory maximum) of 3% p.a. on paid-up capital		
18.75 gold francs per share on 448,325 shares for twelve months	8,406,094	
4.6875 gold francs per share on 16,400 shares for three months	76,875	8,482,969
		74,000,000
Transfer to General Reserve Fund		37,000,000
		37,000,000
Transfer to Special Dividend Reserve Fund (statutory maximum)		14,800,000
		22,200,000
Transfer to Free Reserve Fund		22,200,000
		—

Movement on the paid-up Capital, Reserve Funds and Provisions during the financial year ended 31st March 1971

(Not including allocations to Reserves to be decided at the Annual General Meeting)

In gold francs

Paid-up Capital

Balance at 1st April 1970:	
448,325 shares, each of 2,500 gold francs, of which 25% is paid up ...	280,203,125
Add: 16,400 further shares, each of 2,500 gold francs, of which 25% is paid up, issued during the financial year 1970–71	10,250,000
Balance at 31st March 1971 per Balance Sheet	290,453,125

Reserve Funds

	Legal Reserve Fund	General Reserve Fund	Special Dividend Reserve Fund	Free Reserve Fund
Balances at 1st April 1970	28,020,313	64,833,210	10,007,984	80,000,000
Add: Transfers from Profit and Loss Account 1969–70		30,000,000	12,000,000	18,000,000
Allocation of the premium received on the issue of 16,400 new shares ...	1,025,000	5,125,000		
Balances at 31st March 1971 per Balance Sheet	29,045,313	99,958,210	22,007,984	98,000,000

Provision for Building Purposes

Balance at 1st April 1970	48,671,000
Add: Transfer from Profit and Loss Account 1970–71	32,000,000
Balance at 31st March 1971 per Balance Sheet	80,671,000

BOARD OF DIRECTORS

Dr. J. Zijlstra, Amsterdam	Chairman of the Board of Directors, President of the Bank
Henri Deroy, Paris	Vice-Chairman

Baron Ansiaux, Brussels
M. J. Babington Smith, London
Dr. Guido Carli, Rome
Dr. Leonhard Gleske, Bremen
Dr. Karl Klasen, Frankfurt a/M.
Dr. Donato Menichella, Rome
The Rt. Hon. Sir Leslie O'Brien, London
Dr. Edwin Stopper, Zurich
Robert Vandeputte, Brussels
Olivier Wormser, Paris
Per Åsbrink, Stockholm

Alternates

Dr. Paolo Baffi, Rome, or
Prof. Francesco Masera, Rome
Bernard Clappier, Paris, or
Marcel Théron, Paris
Dr. Otmar Emminger, Frankfurt a/M., or
Johannes Tüngeler, Frankfurt a/M.
Georges Janson, Brussels
C. J. Morse, London, or
R. G. Raw, London

MANAGEMENT

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

D. H. Stapleton	Assistant Manager
Prof. Dr. F. E. Klein	Assistant Manager
A. N. Barltrop	Sub-Manager
Dr. Warren D. McClam	Sub-Manager
M. G. Dealtry	Sub-Manager
Robert Chaptinel	Sub-Manager